



## A Comparative Analysis of the Western and Islamic Fundamentals of Economics

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### Abstract

Since the rise of the western system of economics there have occurred tens of economic crisis throughout the world. Despite repeated reviews of the system by the World Bank and the other relevant international institutions the condition remains the same and vulnerability of the western model continues rising. The latest but not the last among all such collapses was the one occurred in 2008 and caused loss of trillions of dollars. Therefore, it may safely be said that the western economic system has not been able to provide sustainable solution to the human's economic problems so far, despite its centuries long trials and tribulations. This fact is increasingly and universally realized and recognized by the leading economists and academicians of our time. On the other side, Islamic fundamentals of economic, tested and tried for over a millennium by several Muslim dynasties and great empires including Abbasid and Ottomans, never posed such economic challenges to the world. Although the decline of these Muslim Empires can certainly be ascribed to the political fragmentation yet not to the economic principles, in vogue, in those vast Muslim regions. Thus, the economic principles and precepts stand today as a beacon as ever before since revealed and recorded in the last holy scripture. Therefore, this article is an attempt to review these golden principles and precedents in comparison with the Western model in order to provide an insight into the unique economic foundation laid by the Prophet of Islam on the soil of Arabia which is arguably needed today to relieve the mankind from the 'moral-free Economic Order' comprising over centuries.

**Keywords:** Economy; Crisis; West; Islam; Finance

### I. Introduction

Along with the renaissance in the Europe, several disciplines took an academic shape and one among them was Economics, which was previously part of the social sciences. Several authors came forward to expound theories for creation of money. Others discussed labor, capital, land and entrepreneurship as factors of production yet another lot went to deliberate on various ways of distribution of wealth such as profit, wages, rent and interest. One thing common among all of them was that they all believed in 'capital' as of prime value in the whole sphere of the western economy. Moreover, they were sick of the old system run by the kings in collaboration with the churches across Europe and wanted a new system free from the control of these institutions, thus they felt a need to redefine and introduce new means and methods for creation of wealth. This new journey now comprises over around three centuries beginning from Adam Smith<sup>1</sup>, David Ricardo<sup>2</sup> and Thomas Malthus<sup>3</sup>, all from the United Kingdom, to the latest

<sup>1</sup> Smith, Adam. 1776. *An Inquiry into the Nature and Causes of the Wealth of Nations*. London: W. Strahan and T. Cadell.

<sup>2</sup> Ricardo, D. (1817). *On the principles of political economy and taxation*. John Murray



leading economists such as Aghion<sup>4</sup>, Maskin<sup>5</sup>, and Kanbur<sup>6</sup> who represent diverse leading thoughts in different branches of Economics today.

However, all these theoretical endeavors and their practical applications could not solve the basic economic problems of the human being as the economic issues remained the same rather became more complex and complicated leading up to two world wars, a human catastrophe ever witnessed by the world.

Among various reasons for such a state of affairs was that the notion of Economics had no predefined ideological framework for its development and direction. All that happened was the result of the given circumstances. For example, creation of paper money in London<sup>7</sup> was the result of the deposits of gold, silver and other metals to the goldsmiths in London as they used to give receipts to the depositors to claim back their trusts anytime they pleased. These receipts became later paper money and banknotes which further led to modern 'Fractional Reserve Banking', as the gold smiths began to give receipts to the borrowers as an advance, meaning thereby, that these receipts were issued against no deposit of gold. This was in fact "fabrication" and "fraud" in legal jargon as these receipts had no backing of gold yet were exchanged in the market. Thus, the unlawful became lawful when it gained a wide spread practice and acceptance.

Hence, the goldsmiths made it a new profession by issuing receipts to borrowers against no gold while charging interest on such receipts for the reason that these receipts had become medium of exchange as people preferred to buy goods and services by giving these receipts instead of the gold coins deposited to the goldsmith for their ease. This new profession of the goldsmiths is called banking in the modern language.<sup>8</sup>

Another example of 'no predefined ideological framework of the modern economics' is the Bank of England<sup>9</sup> which was established to raise funds from the public to finance the long wars between England and France specifically the Nine years' War.<sup>10</sup> Similarly, its nationalization in 1946 was the result of the collapse of the British economy due to the World War II.

Thus, a past practice or event caused occurrence of another practice or event with no predefined ideological framework which remains the root cause of all the ills in the economic spheres of the nation-states, suffering for centuries. The 'new profession' of the goldsmiths, i.e. the fractional reserve banking, created the main mischief in the whole economic affairs.<sup>11</sup> As, whenever public

<sup>3</sup> Malthus, T. R. (1970). *An essay on the principle of population* (A. Flew, Ed.). Penguin Books. (Original work published 1798).

<sup>4</sup> Aghion, P., C. Antonin, and S. Bunel, *The Power of Creative Destruction: Economic Upheaval and the Wealth of Nations* (Harvard University Press, Cambridge, MA, 2021).

<sup>5</sup> Maskin, E. (1985). "The Theory of Implementation in Nash Equilibrium: A Survey," in *Social Goals and Social Organization: Volume in Memory of Elisha Pazner* (L. Hurwicz, D. Schmeidler, and H. Sonnenschein, eds.), Cambridge University Press, pp. 173–204.

<sup>6</sup> Kanbur R and Svejnar J. *Labour Markets and Economic Development*. New York: Routledge, 2009.

<sup>7</sup> Paper money was first introduced in China during the Tang dynasty between seventh to tenth century AD.

<sup>8</sup> The History of Money Creation, Abridged from the Problem with Interest, 4<sup>th</sup> edition, 2025.

<sup>9</sup> Nichols, G. O. (1971). English government borrowing, 1660–1688. *Journal of British Studies*, 10(2), 83–104.

<sup>10</sup> Nine Years' war lasted from 1688 to 1697.

<sup>11</sup> L. von Mises, *The Theory of Money and Credit*, translated by H. E. Batson (Liberty Fund, Indianapolis, 1981), pp. 139–145.



feels insecure for their deposits in the banks<sup>12</sup> they rush to withdraw their money which result into the banks going bankrupt due to the fact that they give more advances to the borrowers than the deposits they receive, a fabrication in itself.<sup>13</sup> Although all banking laws and regulatory frameworks have been striving to ensure that this fabrication keeps working well but it does not, despite all efforts of the past centuries by the finance experts and financial institutions, because it has an inherent flaw which cannot be eliminated until the whole system is revamped and set on a new foundation free from such a fundamental drawback and the like socioeconomic ills.

The alternative foundation can be considered the one with predefined framework, successfully established for over a millennium by the ever-largest Muslim Empires succeeding the Persian and the Roman regions. Thus, the economic model may be made available again to the world, i.e. Islamic economics.

The unique fundamental features of this system are analyzed below.

## II. The Unique Features of Islamic Economics

### A. Lawful Earning & Source of Income

One of the most distinguished features of Islamic economics is its differentiation between 'ethics-based' lawful and unlawful means of earning, which also include all anti-social means.<sup>14</sup> For example, all kinds of intoxicants are not only unlawful in themselves but also prohibited production, sale, purchase, storage and consumption. Similarly, Islamic economics does not allow sex trade and the like means of moral turpitude. Likewise, in commercial framework, Islamic economics does not approve hoarding, speculation, betting, gambling, monopoly, cartel and money-making at the expense of others. Since these commercial practices are ethically wrong so are forbidden legally for the reason that Law and morality in Islamic economics go hand in hand.

It may also be worth mentioning here that many billionaires today make billions by adopting such means as ethically unwarranted though legally allowed. Whereas in Islamic perspective ethics stand on equal footing with law, thus it becomes less frequent for people to become billionaires while following Islamic code of ethics and commerce. Similarly, Islamic code does not encourage the trend of accumulation of wealth though earned lawfully. Thus, it opens up various ways to facilitate vast circulation of wealth such as by levy of one-fortieth,<sup>15</sup> one tenth,<sup>16</sup> one fifth<sup>17</sup> as well as by the law of succession of Islam, 'the most advance law' in the words of Quaid-e-Azam Muhammad Ali Jinnah.<sup>18</sup>

### B. Lawful Expense

Islam promotes spending on needs and necessities extending to comforts,

<sup>12</sup> It was due to the banks' own manipulations, most of the times, such as excessive lending.

<sup>13</sup> G. Selgin, *Financial History Review* 19, 269 (2012).

<sup>14</sup> <https://umrahinternational.com/2024/12/15/what-is-halal-money-a-comprehensive-guide-to-earning-lawful-income/>

<sup>15</sup> Rate of Zakat on goods etc.

<sup>16</sup> Rate of Ushr on agricultural produce

<sup>17</sup> Rate of Khumus on minerals extracted from the earth and the oceans and spoils of war

<sup>18</sup> Jinnah, 1938.



convenience and embellishment.<sup>19</sup> However, extravaganza such as use of gold, silver ornaments, utensils and silk wear for male etc are all prohibited. Likewise, living a pompous life to impress people and the society at large is not ethically permissible thus denounced by Islam. Instead, giving away in charity and welfare of the underprivileged is highly recommended and counted as great virtues for which Islam promotes and motivates high spirit of caring and sharing and socioeconomic participation. These golden societal traits and values were witnessed by the human history in vogue across the three decades of the Arabian Islamic caliphate.<sup>20</sup>

### **C. Lawful Transactions**

All forms of interest are prohibited in all kinds of transactions in Islam. Thus, making money out of money is prohibited, as money cannot be traded due to its non-intrinsic value. It can only be used as a medium of exchange. Likewise, loan can only be given for socioeconomic support and not for socioeconomic gains. However, commercial gains are well allowed rather strongly encouraged but by dealings in lawful goods and services and not in money. Thus, commercial gains can be made through sole proprietorship and partnership of different kinds. However, corporation limited by liability is subject to the difference of opinions of the jurists for the reason that the limited liability allows a safe exit to the owners of a company to escape their liabilities in the event of the bankruptcy of corporation.

### **D. Circulation of Wealth**

As preceded earlier that Islam does not encourage the trends of accumulation of wealth in the society. Instead, it opens up various ways for social mobilization of capital. Most effective among such openings is Zakat, which may rightly be called 'social insurance'. It is a social security of the people whereby they would need not bother for tomorrow nor would they be forced to keep high savings for rainy days if a robust system of Zakat is installed as was in vogue during the golden period of Islam.

Zakat is deposited in the State exchequer and utilized in public welfare whenever and wherever they need. Thus, this unique feature of Islamic economics relieves all worries of the citizens as regards future security. The concept of high savings drives a society to accumulate wealth whereas the concept of Zakat promotes circulation of wealth in the society as blood in the body and also serves as a social security and insurance for the needful people as each and every eligible individual whether male or female young or old become obligated to give away a certain small fraction (2.5%) of the wealth in the pool.

Moreover, the philosophy of Islamic faith does not aim at setting up a society where people do not share a spirit of contributing to the well-being of others, and make the state-institutions only responsible for all public welfare. Rather Islam promotes a society where individuals also play a volunteer role in the uplift of the society in spirit of sympathy, generosity and magnanimity. Thus, the State as well as its citizens are both encouraged to serve the humanity to the

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<sup>19</sup> Al-Quran.7:32.

<sup>20</sup> M. Masudur Rahman, J. Isl. Thought Civ. 5, 15 (2015).



best of their potentials as a public duty and as a moral duty respectively. <sup>21</sup>

### III. The Islamic Concept of the Factors of Production

As preceded earlier that economic and ethics are not apart from Islamic perspective, rather both are integrated into a single code which is in itself a unique feature of Islamic economics. Thus, the economic problems cannot be addressed from the economic perspective alone rather they need be resolved from the lens of the socioeconomic value system of Islam. Under the Islamic scheme, all the earth resources are considered as the gift and the blessings of Almighty for the human beings at large and no monopoly of a person or group is recognized under this scheme. Therefore, every person has right to utilize these resources provided that no one else has already invested his labor or capital in that natural resource. Unlike socialism, Islam permits private ownership of human being, be a man, woman or a child under guardianship. Thus, a man is allowed to own factors of production including land and capital as economic freedom of a human is duly recognized in Islam. However, Islam circumscribes limits on this freedom by defining the fair and fairs means of production and consumption which distinguishes Islam's unique emphasis on moral behavior unlike the morality of capitalism. In a nutshell, land, labor, capital and entrepreneurship are all allowed but 'jointly' to share in the profit unlike the rules of capitalism. For example, in capitalism all the four factors have fixed ratio of return as capital has fixed interest rate being an advance, landowner has fixed rent on his land, labor has his fixed wages whereas entrepreneur is left vulnerable to bear all the risk of the venture. Whereas Islam encourages a joint venture where capitalist, land owner, labor and entrepreneur come in partnership and share profit if earned and bear loss if occurred, a profit and loss sharing principle, a cardinal principle of Islamic economics based on 'risk and reward sharing'. If labor is invested from one partner and capital from another it is called Modaraba, a kind of partnership, practiced by the Prophet of Islam with the most honorable lady of Mecca Syedah Khadijah (May Allah be pleased with her) who proposed him later for marriage after her wonderful experience in the joint venture. Similarly, if both parties bring capital, services or goodwill it comes under Sharika of various types yet all the stakeholders in all the types of joint venture share risk and reward.

### IV. Equitable Distribution of Wealth (Balancing Economic Freedom with Social Responsibility)

It is interesting to note that Islam mandates 'equitable distribution' of wealth, not necessarily 'equal distribution' unlike the socialism. Islam recognizes natural inequalities in human abilities, capabilities as well as financial means thus Islam does not strive against this natural phenomenon.<sup>22</sup> However, Islam does recommend reduction in financial inequality by shift of the financial burden on the sound people and obligate them to spend on the financially unsound people. Beyond this prescribed financial obligation, Islam further recommends voluntary spending on such people in return of Almighty's promise for paradise, an unseen faith in the divine promise urged by Him from the mankind. In other words,

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<sup>21</sup> Maudoodi SAA. 2013. *First Principles of Islamic Economics*. Islamabad: Institute of Policy Studies.

<sup>22</sup> Ibid



Almighty has created natural inequality among people and demanded the rich to accommodate the poor in his wealth in certain limits. This social obligation is the baseline where lies the divine test of the humans for which they have been raised to attempt and qualify the rounds to come hereafter, though all unseen yet all very logical and corroborated by human experience and observation throughout the life and further complimented by an additional 'chain of the successive scriptures' to confirm the human faith in the unseen. In short, there is no provision in Islamic economic framework for artificial enforcement of economic equality unlike socialism.<sup>23</sup>

Those among whom wealth is distributed on account of social responsibility are as follows<sup>24</sup>:

- A. The Poor
- B. The Needy
- C. Those who are in charge of collecting Zakat
- D. Those whose hearts are to be reconciled
- E. Those in bondage to obtain freedom from it
- F. Those burdened with debts
- G. In the way of Almighty
- H. Wayfarer

## V. Asset-Based Economy Instead of Debt-Backed Financing

This is a modern concept that an economic activity should be backed by an asset instead of a loan unlike the capitalistic framework. For example, in capitalism, capital is obtained from banks and interest is paid on it by the entrepreneur. Whereas, in an Islamic economy, neither capital is borrowed from a bank nor interest is paid on it thus there is no borrowed backed trade or industry. Instead, capital is invested by a bank as a partner with entrepreneur in a joint venture and if profit is earned it is shared with the bank and if loss occurs the same is suffered by the bank jointly. Thus, the economic activity is generated and owned by both the bank and the entrepreneur jointly with all its positive and negative repercussions. This develops a common responsibility among all the stakeholders in a commercial activity instead of exclusive responsibility of the businesspersons. The net result is that the bank does not put itself at risk by providing capital to the investors who potentially lack credibility for the reason that the bank is held liable to jointly bear the loss of the business in adverse situation. Thus, this careful approach of the banks in turn ensures protection of the deposits made by the depositors and keep their trust in the banks intact and keep the economy stable though this is another issue that the 'fractional reserve banking' remains subject to criticism by Islamic Economics experts. Thus, the asset-backed economy can be developed by different modes of financing. A few modes and methods are as follows:

### A. Murabaha (Cost Plus Financing)

This is a transaction of sale of goods where cost of the commodity is disclosed plus the profit. However, it is used as a mode of finance currently by Islamic banks as the client requests/applies to the bank to purchase certain commodity

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<sup>23</sup> Ibid

<sup>24</sup> Al-Quran, 9:60.



on his behalf and sell him against deferred payment.<sup>25</sup>

## **B. Musharakah (Partnership)**

In this mode bank becomes a partner with the client and invests capital jointly while shares profit and loss as per agreed ratio. Thus, debt is eliminated from the economic activity and replaced with an asset which helps prevent the economy from bubble up.<sup>26</sup>

## **C. Modaraba (Labor & Capital)**

Here one partner<sup>27</sup> invests capital and another<sup>28</sup> invests his labor while share profit jointly. In case of loss, the impact goes on both the parties, one party losing his capital and the other his labor.<sup>29</sup>

## **D. Salam**

It is also a sale transaction where the seller obtains price in advance from the buyer against deferred delivery of the goods. This method is mostly used in crop cultivation where farmers obtain advance price against the delivery of the crops after its harvest in order to finance the farming expenditures.<sup>30</sup>

## **E. Istisna**

This mode is also a sale transaction where seller/manufacturer obtains price of the goods in advance from the buyer to finance manufacturing of the goods while deferred delivery.<sup>31</sup>

## **VI. Conclusion**

The above discourse reveals that there is no role for debt to play in an Islamic economy. Since no debt is allowed so no interest is to be charged in any condition. Thus, all empires of 'interest-based businesses are replaced with asset-based business while sharing risk and reward in an Islamic economy.

In addition, all the need for capital is fulfilled either by advance payment by the buyer to the seller to finance goods-manufacturing/constructions/crop cultivation etc. or by joint pool of capital or capital and labor in a joint venture. Moreover, the obligatory fixed social responsibility of the rich, being the social security of the poor is the key feature of Islamic economy. Thus, all these methods and modes ensure fair and fast distribution and redistribution of wealth among all the citizens of a society with exception to none.

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<sup>25</sup> Usmani, M. I. A. (2020). *Islamic finance*. Maktaba Maariful Quran.

<sup>26</sup> Ibid

<sup>27</sup> Rabbul Mal

<sup>28</sup> Mudarib

<sup>29</sup> Usmani, M. I. A. (2020). *Islamic finance*. Maktaba Maariful Quran.

<sup>30</sup> Ibid

<sup>31</sup> Ibid



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