“Economic System of Islam and Its Effect on Growth and Development of Entrepreneurship”

AUTHORS	Alina Zapalska Dallas Brozik Steve Shuklian
ARTICLE INFO	Alina Zapalska, Dallas Brozik and Steve Shuklian (2005). Economic System of Islam and Its Effect on Growth and Development of Entrepreneurship. *Problems and Perspectives in Management*, *3*(1)
RELEASED ON	Thursday, 03 March 2005
JOURNAL	"Problems and Perspectives in Management"
FOUNDER	LLC “Consulting Publishing Company “Business Perspectives”

CHAPTER 1
MACROECONOMIC PROCESSES AND REGIONAL ECONOMIES MANAGEMENT

Economic System of Islam and Its Effect on Growth and Development of Entrepreneurship[1]

Alina Zapalska, Dallas Brozik, Steve Shuklian

I. Introduction

Entrepreneurship has been regarded as a significant casual factor in the process of economic growth and development. Differences in entrepreneurial behavior between and among societies may account for differential rates of growth and development. Those societies that include individuals willing and eager to perform the entrepreneurial function can accelerate the growth and development process while those societies lacking such individuals lag behind.

The decision to behave entrepreneurially is the result of the interaction of many factors. One such set of factors includes the personal characteristics of the individual, the individual's personal environment, the relevant business environment, the individual's personal goal set, and the existence of a viable business idea. A substantial body of research relates elements of culture and religion to entrepreneurial activities (Hofstede, 1980).

The relationship between culture and entrepreneurship could create problems in societies with a strong religious orientation. An example of such a potential conflict exists in the Islamic nations. According to some entrepreneurs who run their businesses in Islamic countries, true believers in these countries can follow the ethics laid down in Islam's holiest book and make a profit. Some believe that this profit should be given back to the people, and such activists blend the profit motive with a mission to aid the poorer members of the Muslim community.

This paper presents a model of the Islamic economic system to examine the theoretical economic implications for a development of entrepreneurship in the countries of Islam. It presents the belief system that defines Islam's conception of the Ideal Man, life, and society in the context of the Islamic norms. The paper specifically focuses on examining the property rights, incentive mechanisms, decision-making structures, and mechanisms for information and coordination to assess barriers to entrepreneurial growth and development. The purpose of the paper is to stimulate interest in the Islamic economic system and to encourage the recognition of the role of entrepreneurship in the process of growth and development of economies that allocate resources according to the principles stated by the Islamic beliefs.

II. An Economic System

An economic system is the organizational arrangement that is used to make decisions about resource allocation. It is a statement of how a society organizes itself to address the basic economic problems of what is to be produced, how much is produced, and who is involved in the production process. In the process of satisfying their wants, economic agents interact individually and through the organizations and institutions that they create. An organization, in turn, develops its own structure, shape, and mode of operation.

Governments are created and laws are enacted to further codify the nature of the economic system. The economic system, reflecting the interaction and participation of individuals, organizations, and institutions in the process of production, consumption, exchange, and distribu-

[1] This paper was written in memory of Steve Shuklian.

tion, is governed by a set of rules and laws specific to that system, and different viable economic systems can exist simultaneously, each with its specific laws and rules.

In order to distinguish one economic system from another, it is necessary to compare the fundamental elements of each system. Gregory and Stuart provide a systematic method of addressing the key characteristics that go to make up a particular economic system (Gregory et al., 1998). In Table 1 we present characteristics of the Islamic system in contrast to Capitalism and Planned Socialism.

The first characteristic of an economic system focuses on the issue of the organization of decision-making arrangements or the method of and process of decision making employed by economic agents, including the government. Economic systems can be classified according to the different degrees of centralization used in the process of decision making, both within organizations and between organizations and their clients.

Table 1

The Classification of Economic Systems by Gregory and Stuart

	Capitalism	**Planned Socialism**	**Islamic System**
Decision- making Structure	Primarily Decentralized	Primarily Centralized	Primarily Decentralized and Some Centralized
Mechanisms for Information and Coordination	Primarily Market	Primarily Planned	Market and Government Coordination
Property Rights	Primarily Private Ownership	Primarily State Ownership	Private and State Ownership
Incentives	Primarily Material	Primarily Moral	Primarily Moral

The second characteristic of an economic system is the mechanism for the provision of information and coordination of decisions. This characteristic is concerned with the process through which decisions made by consumers, producers, and government as to consumption, production, and the use of inputs. These decisions are communicated and coordinated in order to guarantee the production and consumption of the proper basket of goods and services. There are three coordinating mechanisms which have been identified, *the market* which operates through its price-signaling device, *the plan* which operates through its physical quota and target system of inputs and outputs, and *tradition* which operates through its reliance on custom and the status quo. Each mechanism makes its own assumption about human behavior and establishes its own distinct economic objectives.

The third characteristic used by Gregory and Stuart to distinguish economic systems from one another is that of property rights; who is entitled to own what. Ownership in society can take one or a combination of the following forms, *private, public* or *cooperative.* The type of property ownership in society is of great significance since it affects the pattern of income distribution.

The fourth characteristic of an economic system focuses on how society can employ material or moral incentives to regulate its economic activities. Material incentives can be divided into private and collective ones. Collective material incentives are meant to reward individuals materially while promoting a sense of social consciousness and solidarity, rather than competition and individualism. Private material incentives reward proper economic behavior with a greater share of national output. Moral incentives promote man's sense of altruism and his concern for responsibility towards the general or social good. The use of moral incentives assumes that social recognition and approbation are just as important as the provision of material goods in motivating proper economic performance.

Economic systems, however, are significantly affected and shaped by a set of factors such as the level of economic development, social, religious and cultural factors, and the environment. The differences between the various systems are more than cosmetic, and it is crucial to recognize and understand how these differences can shape economic behavior.

III. The Islamic Economic System

The four characteristics shown in Table 1 can be used to illustrate the Islamic economic system which can range from a free market to a planned economy.

a. The Organization of Decision-making Arrangements

Numerous references can be found concerning the management of society, that is, who should make decisions, who constitutes the best manager, and how decisions should be coordinated (Birley and Westlead, 1990; Timmons, 1982; Hisrich and Peter, 1989; Boyd and Vozikis, 1994). At the national level it can be argued that the organization of decision-making arrangements by basic economic units is subject to two types of centralized command.

Within the constraints of the first type of centralized command, individuals have the freedom to make decisions only within the fixed and eternal set of orders coming from God. In contrast to the centrally planned system in which directives, targets, and even economic laws are subject to change according to political decisions of the state leadership, in the Islamic economic system certain commands in the real of production, consumption, exchange, and distribution are fixed and eternal. In this sense, the economic system of Islam can be considered a permanent command economy in those aspects stipulated by primary sources.

The second type of centralized command is moral in nature. It can be argued that the Islamic economic system allows the basic economic units to make the final decisions. However, the freedom of choice of the consumer and the producer is restricted and conditioned by not only the obligations but also the recommendations of Islam’s elaborate value system. Within the constraints of those values and commands that are imposed, Islamic governments seek to attain the economic objectives of the system.

Government intervention in the market is encouraged under specific circumstances. It can be argued that perfect competition, operating through its own self-adjusting automatic mechanisms, constitutes the primary coordinating mechanism of the Islamic economic system, providing it fulfils the Islamic system’s first-order priorities. Numerous general guidelines can be found in the primary sources, which guarantee a free market under normal conditions (Carland et al., 1984; Krueger and Brazeal, 1994; Wilson, 1980; Broakhouse, 1982). Islam prohibits price fixing by buyers or sellers and encourages exchange in a market characterized by numerous buyers and sellers in which none possesses a controlling share. A general consensus exists that profit making does constitute a feature of the Islamic economic system since there are no restrictions on profits.

The market of Islam is characterized by free information and free of discrimination. Producers are expected to inform consumers of the quality and quantity of the goods they claim to be selling, in return for the consumers’ payment of the market price. In the Islamic market, therefore, cheating or short-changing consumers, committing any type of fraud, or the exercise of any type of sellers’ preference, as well as the payment of bribes, is prohibited.

b. The Mechanisms for Information and Coordination: Market Mechanism

Subject to restrictions on the exchange of certain goods, such as wine, pork, gambling instruments, icons, gold or silverware, and musical instruments, Islam accepts the market as the basic coordinating mechanism of its economic system. The institution of the market, under perfect competition, allows consumers to obtain their desired basket of goods and producers to sell what they have produced through the establishment of a mutually acceptable price. In the absence of coercion, the market is said to gratify the profit motive of seller and the satisfaction drive of the buyer.

Islam recognizes a limited but important role of government in an Economy. An Islamic government steps into an economy only when the market fails to operate on its own. According to Islam, there is no role of government under capitalism as the invisible hand takes of the market. On the contrary, in Islamic economy government steers entire economy with a perfectly visible hand and owns all means of production in a socialist framework.

c. Property Rights

Islam's concept of property ownership is based on God's absolute, natural, and divine right of possession in relation to all that is on earth. Real ownership belongs to Allah, and man holds property in trust for which he is accountable, in accordance with established rules. Acquisition of property as well as its use and disposal are subject to limits, and ownership should be guided by the established norms. In a philosophical sense, man cannot become an absolute owner, since ownership of all things, including man himself, belongs to God. As long as man remains worthy of God's trust, then man has the right to enjoy the use and advantages of God's property.

Besides private property, public ownership is also a concept in Islam. Public property in Islam refers to those natural resources created by God to which all men have an equal right. Individuals may use such resources according to their needs. Each individual's right of use is legitimate as long as it does not undermine the equally valid right of others. The role of the Islamic state is supposed to be one of supervision and guardianship. Some writers stand for social ownership of land and other natural resources, confining private property to articles of consumption (Broakhouse, 1976; Carland et al., 1984; Chen et al., 1998; Daily and Dollinger, 1992).

d. Incentive System

Theoretically, it is an absence of immediate private material gain as the reward for desirable acts that distinguishes the Islamic incentive system from other incentive mechanisms. The principal force that motivates man to undertake any economic activity is presented as that of securing the pleasure of God. Private satisfaction can only be attained through pleasing God. Acts pleasing in the eyes of God can include self-satisfying activities. If all activities are conducted with the intention of gaining proximity to God through serving Him according to His laws, man will be rewarded both in this world and the hereafter.

The acquisitive and greedy man has to be reborn as the compassionate, charitable, and generous one if he is to be rewarded in the hereafter. The emphasis on the divine incentive system is on benefiting and enriching others at the cost of forgoing gain and even reducing one's own private riches. Contrary to worldly material incentives, the divine incentive system penalizes a "good" Islamic man in the short-run by decreasing his material possessions. In the long run, he might be compensated with an increase in his worldly wealth, and he certainly attains salvation and eternal bliss in the hereafter. Islam disapproves of worldly preoccupations and the pursuit of material prosperity as an end, while it attaches great importance to spiritual pursuits in this world as a means of attaining salvation in the hereafter.

IV. Economic Enterprise

Philosophy provides the proper perspective to man's economic activities. No inhibitions are attached to economic enterprise. Men are encouraged to take advantage of the vast opportunities of productive enterprise of agriculture, trade, commerce and industry. The various forms of productive enterprise known in the early days of Islam have been explicitly mentioned in this context. What is crucial, however, is the motivation, the ends of economic activity.

Many writers discuss the proper ends of economic enterprise in detail (Zapalska, 1997a and b, Jarillo, 1989; Wilson, 1980; Lansberg et al., 1988; Taylor, 1997). These ends may be individual or social. Legitimate individual ends include the fulfillment of personal needs and those of the family. It is in fact a duty to earn the minimum necessary for survival. Saving to provide for the future and the desire to leave an inheritance are also recognized as proper ends of productive effort (Hannan and Freeman, 1977; Brown, 1991; Gnyawali and Fogle, 1994). While no maxima are fixed in quantitative terms, moderation in fulfillment of these needs is emphasized. Moderation is generally defined with reference to the negative concepts of extravagance and expenditure on goods and services prohibited by Islam. Indulgence in luxurious living and the desire to show off is condemned. Islam does not tolerate conspicuous consumption of the leisure class.

Writings on economic enterprise attach great importance to the social ends, which are summed up by the phrase "striving in the cause of Allah." Eradication of hunger, poverty, disease, and illiteracy and the mobilization of resources for strengthening the Islamic State and spreading the message of Allah are stated to be the primary aims of individual economic activities. One who engages in productive activities for these purposes is doing God's will and is promised adequate rewards here and hereafter. It must be pointed out that in view of the limitless nature of the social ends of enterprise, as against the limited nature of the individual ends, economic enterprise as such is afforded limitless scope and utmost encouragement.

V. The Entrepreneur

No serious attention has been paid to the behavior of the entrepreneur in Islamic society. The code of conduct for a Muslim entrepreneur prohibits dishonesty, fraud and deception, coercive practices, and gambling. Entrepreneurs should not do anything injurious to others. This rules out hoarding, speculation, and collusion among producers and traders against the interests of consumers. Monopoly is also regarded as injurious to the interests of society. The entrepreneur is charged with justice and truthfulness in all his dealings. He should consider the interests of the society. Social good should guide him in his decisions, besides his own profit.

There is an overall positive attitude to economic enterprise and socially oriented rights of ownership in Islamic society. Entrepreneurs can cooperate with one another, especially in production and the exchange of wealth. This view of cooperation does not rule out free and fair competition in the market, provided all economic agents adhere to Islamic morality. Competition is emphasized in contrast to monopoly whose elimination is regarded as a prerequisite to ensuring justice and growth.

VI. Development and Growth

Islam's economic philosophy does not stop at teaching men to cooperate after having encouraged them in productive enterprise; it creates a powerful drive for development. The Muslim society orients its policies in order to ensure efficiency and peace for all. Economic development therefore becomes a necessary condition to be fulfilled to assure the well being of all. The distinguishing feature of the Islamic strategy for economic development is that social justice and growth go together. This is ensured by the motivation that Islam provides for economic development. The individual *profit motive* is not the chief driving force. Developmental efforts are mainly social, and entrepreneurs are willing to cooperate in these ventures. These developmental efforts cannot become an end in themselves. Their aim is a good life in its many dimensions of which the economic aspect is only one.

VII. Conclusions

Islam is founded upon the notion of *Tawhid*, a total commitment to the will of God. Total compliance with God's vision of how man should regulate his relation to Himself, other men, and nature guides the Islamic man in every aspect of life, including the economic life. His vision is focused on both the material world and the hereafter. This double perspective obliges him to develop a very different outlook on life compared to his secular counterpart.

The distinguishing element of an Islamic economy is that entrepreneurs act under the guidance of norms drawn from the traditional sources of Islam. They promote the avoidance of waste, extravagance and ostentation. They discourage activities that create harmful externalities. They stimulate generosity and work hard, charge fair prices, and pay others their dues.

References

1. Birley, S. & P. Westhead. (1990). "The Growth and Performance Contrasts Between Types of Small Firms." *Strategic Management Journal.* 11, 535-557.
2. Boyd, N. G., & Vozikis, G. S. (1994). The influence of self-efficacy on the development of entrepreneurial intentions and actions. Entrepreneurship Theory and Practice, 18: 63-90.

3. Brockhouse, R.H. (1976). Risk Taking Taking Propensity of Entrepreneurs. *Proceedings of Academy of Management*, 457-460.
4. Brockhouse, R.H (1982). The Psychology of the Entrepreneur. In C. Kent, D. Sexton, & K. Vesper. (Eds). *Encyclopedia of Entrepreneurship*, 39-57. Englewood Cliffs: Prentice-Hall.
5. Brown, F.H. (1991). The Family Part of the Business Equation: New Challenges for the Future. *Family Business Review,* 4(4), 363-366.
6. Carland, J.W. Hoy, F. Boulton W.R. and J.A. Carland. (1984). Differentiating Entrepreneurs From Small Business Owners. *Academy of Management Review,* 9, 354-359.
7. Chen, C. C., Greene, P. G., & Crick, A. (1998). Does entrepreneurial self-efficacy distinguish entrepreneurs from managers. Journal of Business Venturing, 13: 295-316.
8. Connor, W. D. (1991). The rocky road: Entrepreneurship in the Soviet economy. In B. Berger (Ed.), The culture of entrepreneurship. San Francisco, CA: ICS Press.
9. Covin, J. G., & Slevin, D. P. (1989). The strategic management of small firms in hostile and benign environments. Strategic Management Journal, 10: 75-87.
10. Daily, C.M. and M.J. Dollinger. (1992). An Empirical Examination of Ownership Structure in Family and Professionally Managed Firms. *Family Business Review,* 5(2), 117-136.
11. Day. D.L. (1992). Research Linkages Between Entrepreneurship and Strategic Management or General Management. In D.L. Sexton and J.D. Kasadra. (EDS). *The State of the Art of Entrepreneurship*, pp117-163. Boston: PWT-Kent.
12. Dubini, P. (1989), "The Influence of Motivation and Environment on Business Start-ups: Some Hints for Public Policies," Journal of Business Venturing 4(1), 11-26.
13. Gnyawali D.R. & D.S Fogel. (1994). “Environments for Entrepreneurship Development: Key Dimensions and Research Implications.” *Entrepreneurship Theory and Practice.* Summer, 43-62.
14. Hannan, M., and J. Freeman (1977), "The Population Ecology of Organizations," American Journal of Sociology 82,929-964.
15. Hisrich, D. and P. Peters. (1989). Entrepreneurship – Starting, Developing, and Managing a New Enterprise. Irwin.
16. Hofstede, G. (1980). Culture’s Consequences: International Differences in Work Related Values, Beverly Hills, CA., Sage Publications.
17. Jarillo, J. C. (1989). Entrepreneurship and growth: The strategic use of external resources. Journal of Business Venturing, 4: 133-147.
18. Krueger, Jr, N. F., & Brazeal, D. V. (1994). Entrepreneurial potential and potential entrepreneurs. Entrepreneurship Theory and Practice, 19: 91-104.
19. Lansberg, I., Perrow, E.L., and S. Rogowsky. (1988). Family Business as an Emerging Field. *Family Business Review*. 1(1). 1-8.
20. Taylor, M. (1997). The business culture in Kazakhstan. In M. Bateman.(Ed.), Business Cultures in Central and Eastern Europe. Oxford, UK: Butterworth-Heinemann.
21. Timmons, J. (1982), "New Venture Creation: Methods and Models," Encyclopedia of Entrepreneurship, ed. C. Kent, D. Sexton, and K. Vesper. Englewood Cliffs, N.J.: Prentice Hall.
22. Wilson, E. (1980). Social Responsibility of Business: What Are the Small Business Perspectives? *Journal of Small Business Managament,* July, 17-24.
23. Zapalska, A. and W. Edwards. (2001). *Chinese Entrepreneurship in a Cultural and Economic Perspective.* Journal of Small Business Management. 2001, 139 (3).
24. Zapalska, A., Perry G. and H. Dabb. (2002) *Culture, Structure, and Regional Levels of Maori Entrepreneurs.* Business Journal for Entrepreneurs. Forthcoming.
25. Zapalska, A. (1997a). *Profiles of Polish Entrepreneurship*. Journal of Small Business Management. April.
26. Zapalska, A. (1997b). *A Profile of Woman Entrepreneur and Enterprise in Poland.* Journal of Small Business Management. October.
27. Zapalska, A. (1998). The Role of New Entrepreneurship in the New Emerging Market Economies. Journal of Private Enterprise. April.