

Constituting Islamic Social Welfare Function: An Exploration in Islamic Moral Economy

Professor Mehmet ASUTAY

Director, Durham Centre for Islamic Economics and Finance
Durham University Business School

Isa YILMAZ

Ph.D. Candidate in Islamic Economics and Finance at the Durham Centre for Islamic Economics and Finance
Durham University Business School

**World Bank and Islamic Development Bank Inaugural Annual Symposium on Islamic
Finance 2015: *Islamic Finance: A Catalyst for Shared Prosperity***
September 8-9, 2015 Istanbul, Turkey

Contents



- ❧ Introduction
- ❧ Background and Overview
- ❧ Research Aims and Questions
- ❧ Reviewing the Literature
 - Arrowian Social Welfare Function (SWF): Exploring his Impossibility Theorem
- ❧ Islamic Moral Economy (IME) Conceptualization of Social Welfare Function
 - Social Welfare in Islam
 - Axiomatic Approach in Articulating IME
 - *Fiqhi* Construction of Islamic Social Welfare Function (ISWF)
 - Moral Construction of ISWF
- ❧ Discussion and Conclusion

Introduction



- ❧ Shared prosperity as a discourse has become an important part of the post-crisis debate;
- ❧ IME essentialises shared prosperity; however, the practice in the Muslim World and in the experience of Islamic finance has been in contrast to the imagination;
- ❧ An important aspect of shared prosperity relates to social welfare; and therefore the nature of this shared prosperity has to be defined in order for it to be articulated;
- ❧ Therefore, at least a theoretical attempt should be made to constitute the potential nature of ISWF so that its articulation in real life can be possible; as without defining its nature and hence the underlying assumptions of ‘shared prosperity’ or ‘social well-being’, we will not be able to act upon it;
- ❧ This paper hence, represents such a humble attempt which is part of ongoing research.

SWF: Definition



- ❧ Conventional definition of social welfare follows liberal value judgments; hence individualism, pluralism of values, importance of rights, and equality constitute the cornerstone for its conceptualization.
- ❧ Social welfare function is traditionally defined as a function of hierarchical needs fulfillment, which also incorporates some issues such as justice, liberty, poverty and inequality.
- ❧ It embodies utility, wellbeing, esteem and self-actualization.
- ❧ It is established through the satisfaction of various levels of individual needs.

Theoretical Articulation of SWF

☞ Three different approaches that propose peculiar methodology for the establishment of its SWF:

A green speech bubble with a white outline and a drop shadow, containing the text "Neoclassical Approach".

Neoclassical
Approach

A green speech bubble with a white outline and a drop shadow, containing the text "Public Choice Approach".

Public Choice
Approach

A green speech bubble with a white outline and a drop shadow, containing the text "IME Approach".

IME Approach

Neoclassical Approach



- ❧ The objective in the methodological framework of economics is to internalize ‘egoism, rationality, self-interest and utility maximization’ (Mueller, 1989)
- ❧ All institutions in society are operated with the explicit approval of market system, which lets price mechanism to rule and decide about how, when and to whom for to produce.
- ❧ Efficiency of market is itself taken as granted because prices are assumed to precisely reflect individuals’ desires and constrain their choices; and hence establish efficiency.
- ❧ As such, since all movements across institutions are left to the mercy of price mechanism to be just, equal and efficient; moral considerations are left aside without its articulation in the economic framework, but only legal environment and market conditions provide instrumental morality.

Public Choice Approach



- ❧ Public choice economists, on the other hand, try to answer the question: “how political institutions and rules can be designed in a manner which will direct the self-interest of political players to the furtherance of the general welfare” (Wagner and Gwartney, 2004: 14)
- ❧ Unlike the neoclassical creed favouring ‘market process’ to study behaviours of the so-called *homoeconomicus*, public choice economists prefer ‘political process’ within which these behaviours are studied.
- ❧ Here, the main distinction is that neoclassical economists mostly stress on the importance of physical constraints of nature, which individuals and states are always subjected to; but public choice approach focuses on such institutions which shape and occasionally constrain choices and behaviours of individuals (Brennan and Buchanan, 2000: 3).

Islamic Moral Economy (IME) Approach



- ☞ IME, with its distinct values and norms, considers and evaluates economic activities of human beings by primary reference to the tenets of *Qur'an* and *Sunnah* (the tradition of Prophet) so that by conforming to these tenets it is believed that people reach *falah* (salvation) in this world and in the *akhirah* (hereafter).
- ☞ *Falah* Process leading to *ihsani* social capital
- ☞ To construct its SWF, IME suggests an axiomatic approach, beyond *fiqhi* or Islamic legal and form based approach, which constitutes the operating tools of this *falah* process.
- ☞ The value loaded nature of it, then, deduces some axioms from these norms and ethics: *Tawhid* (unity; complementarity and unitarity), *al'adl wal ihsan* (justice and equilibrium), *fardh* (responsibility), and *ikhtiy'ar* (free will) are the main foundational axioms that form this *falah* process.
- ☞ Two dimensional utility function: the concept of *falah* and *ihsan* together with *akhirah* in shaping the preference ordering.

The Methodology of Social Welfare Analysis



✧ The methodology of Arrowian social welfare analysis is based on:

- structures of preferences,
- tastes of individuals who comprise society,
- societal preferences of rational alternatives.

Here, there exists a critical question:

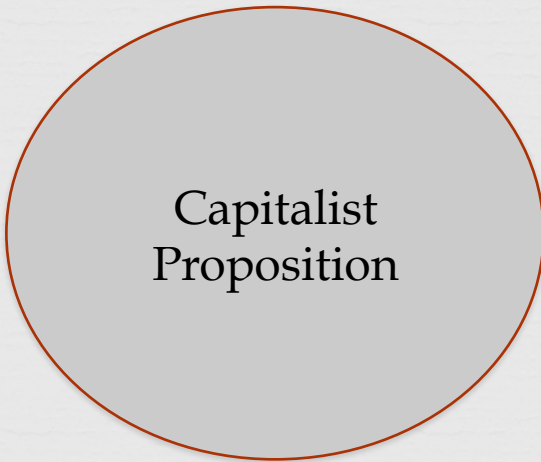
How to Amalgamate/Aggregate Individual Preferences into Social Preference Ordering so that Public Choice Would Be Established and Social Welfare Can, thus, Be Achieved?

Producing Social Preference Ordering

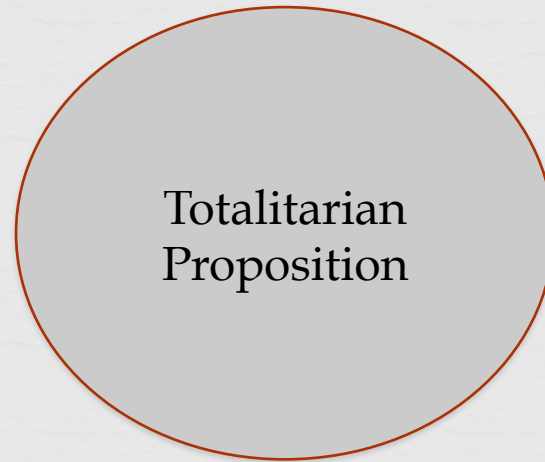


- ❧ **In the capitalistic framework**, consumer sovereignty reigns supreme and through this, market exchange is believed to complete the amalgamation process in a best way in order to produce social welfare function.
 - According to Adam Smith: invisible hand itself spearheads for the contribution to the general welfare insofar as market players behave with their self-interest motivations and consequently contributing to social welfare.
- ❧ **In totalitarian forms**, market mechanism of allocating resources and aggregating individual preferences through price mechanism are ignored. Instead, social ordering are established by imposition of states or by any dictatorial way.

Producing Social Preference Ordering (2)



OR



Is there an Islamic alternative for producing social preference ordering



Aims



- ❧ to demonstrate market economies' failure in its attempt to meet expectations about aggregating individual preferences for individuals' wellbeing, reducing inequality and poverty, and enhancing social welfare and economic development;
- ❧ to examine the possibility of developing an Islamic Social Welfare Function in the light of IME teachings by focusing on preference ordering and utility issues;
- ❧ to explore the constituents of such an ISWF through critical evaluation of and by developing counter argument to Arrow's impossibility theorem;
- ❧ In doing so, this study goes beyond the narrow definition of *fiqh* and expands such attempt with IME's proposition.

Research Questions



- ❧ Why do the postulates of mainstream economics contradict to the teachings of Islam in the sense of developing an ISWF?
- ❧ What makes Arrow's impossibility theorem significant and how is the theorem responded in IME context?
- ❧ What are the distinctions between *fiqhi* and IME-based moral approach in constructing ISWF?
- ❧ In what ways do Islamic axioms contribute to the possibility of developing an ISWF?

Reviewing the Literature



1. Bergson Samuelson Social Welfare Function (BS-SWF),
2. Contractarian Social Welfare Function,
3. Utilitarian Social Welfare Function,
4. **Arrow's Axiomatic Social Welfare Function**

Arrow's Axiomatic Social Welfare Function



- ❧ A functional relation that Kenneth Arrow calls as 'social welfare function'
- ❧ The derivation of social state ordering from individuals' orderings is provided through establishing appropriate rules and processes. This is what Arrow (1963) calls '**general possibility theorem**'
- ❧ His stipulation of an axiomatic approach in articulating the SWF: Four conditions
 1. Unrestricted domain,
 2. Pareto principle,
 3. Independence of irrelevant alternatives,
 4. Non-dictatorship.
- ❧ **Arrowian Conclusion: There is NO WAY to Amalgamate Individual Preferences in Order to Produce Social Preference Ordering Based on the Satisfaction of His Four Axioms**

Unrestricted Domain



- Each individual should be free to have any preference ordering he might select and the collective choice process should be capable of reflecting these preferences in accordance with the other axioms (Mueller, 1989: 392).

Pareto Principle



- ❧ The condition states that the Pareto optimality is achieved as long as in the circumstance in which a person cannot be made better off without making the other worse off.
- ❧ Thus, in a society, if everyone prefers one state to the other, then this preference of the state over another has to be generalised for societal level (Black, 1969: 230).
- ❧ It is mainly this condition what makes Arrow's SWF impossible to satisfy; as more generally, all conditions require a harmonious, non-conflictual relationship among themselves so that one satisfaction of a condition does not leave another violated.
- ❧ However, Arrow proves the impossibility of such a relationship. Thus, many scholars relax the Pareto assumption by giving more weight to the others.

Independence of Irrelevant Alternatives



It requires that only the relevant social states can be considered on the ranking of individuals, and the irrelevant alternatives should be excluded from the domain (Arrow, 1963: 27), thereby any alternative external to the individual's set should not affect the ordering.

Non-dictatorship



non-dictatorship assumption does not let any situation which allows imposition of a state to the individuals. In other words, society cannot be compelled to choose an outcome by any single individual since the individual sovereignty plays a major role over Arrow's SWF.



Islamic Moral Economy
Conceptualisation of Social Welfare
Function: Possibility vs. Impossibility

IME: A Synopsis



- ❧ IME is a particular kind of economy where moral values and norms are the driving forces of the whole economy and they are embedded in the economic system
- ❧ Market exchange/price mechanism is not the sole determinant of economic activities, as economic and financial activities were also embedded within the norms and values of the society,
- ❧ IME suggests *homolIslamicus* individual whose behavioural norms remain same as a Muslim regardless of the (political, economic, *etc.*) spheres that is a non-dichotomous life, which does not have a separation in the form of divine and non-divine or profane and sacred. By doing so, people reach *falah* in this world and in the *akhirah*.
- ❧ IME sees the *homolIslamicus* as a 'socio-tropic, God-conscious and hereafter concerned' individual, who seeks to employ "intra-and intergenerational social justice...with the aim of forming an authentic Muslim identity as opposed to global dominance of capitalism" (Asutay, 2007: 3).
- ❧ IME: Objectives
 - to develop an *ihsani social capital (society's optimality)* through *falah process (individual optimality)*;
 - to achieve distributive justice for harmonious growth (*tazkiyah*) by recognising and enabling individual and society nature of IME for sustainability (*rububiyyah*).

Social Welfare in Islam



- ❧ The creation and circulation of wealth
 - cooperation and mutual help vs. competition and rivalry
- ❧ Under this operational framework, wealth keeps on circulating continuously among the people and does not unnecessarily accumulate at any particular point.
- ❧ The *falah* process, which Muslims ultimately aim to reach, requires the maximisation of *ihsani* social capital in the society. Therefore, Muslims need to increase *ihsan* as a social capital among themselves to reach *falah*, which, then, promotes the wellbeing of each member of society leading to social welfare, as a consequence.

Social Welfare in Islam (2)



- ❧ The preference ordering of Islam, hence, is not merely determined by economic variables, but non-economic variables also have substantial role in shaping this ordering (Choudhury, 1986: 112) because the vital concept of *akhirah*, for instance, affects individuals' preference orderings through examining their non-economic choices. Welfare is, for this reason, conceptualised with regards both to this world and to the hereafter.
- ❧ Islam suggests a social welfare model which aims improving individuals' material wellbeing and, at the same time, leads them to the attainment of spiritual uplift.
- ❧ Thus, embedded nature of Islamic moral economy requires economic and financial choices to be also defined by non-economic factor, such as Islam; and therefore, individual objective function is defined by *falah* leading to *ihsan* as a social welfare.

Foundational Axioms (I)



- ❧ **Tawhid (unitarity and complementarity):** This axiom implies a ‘**vertical dimension**’ between Allah and individual, and it determines the rules of God-man and man-man relationship.
- This axiom suggests that individuals are equal in their distance to Allah regardless of their differences in gender, nation, colour, wealth and etc.; and therefore, they would have **equal access to the resources** created by Allah for them;
 - It also suggests that in the universe everything is linked with each other to actualise the divine optimality; therefore individual well-beings are linked; one’s well-being or *falah* is only possible when *ihsan* is also developed and shared as an overall objective;

Foundational Axioms (II)



- ❧ *al‘adl wal ihsan* (justice and beneficence): This axiom reflects “horizontal dimension of equity” which declines any system engendering a hierarchical classification among individuals, but *taqwa* is the only distinguishing feature that differentiates people in the *akhirah*.
- In line with these considerations, Islam essentialises social justice and encourages people to establish justice and equilibrium in society;
 - But also complements the absolute justice and expands it by linking to *ihsan* as an objective.

Foundational Axioms (III)



- ☞ ***Amanah* (Trust):** This axiom emphasises that no individual has the **absolute ownership** in the contractual sense but this is temporary ownership, as everything belongs to Allah. Individuals, as *khalifa* in this world, act as trustees and use the trust of Allah (*amanah*) to **reconstruct the old and un-Islamic institutions**.
- With this consciousness, appropriate use of the trust contributes to both self-development and social development. This insight, also, differs from the conventional view of **private ownership** in which **an absolute possession over goods** reigns supreme (Chapra, 1992: 207).

Foundational Axioms (IV)



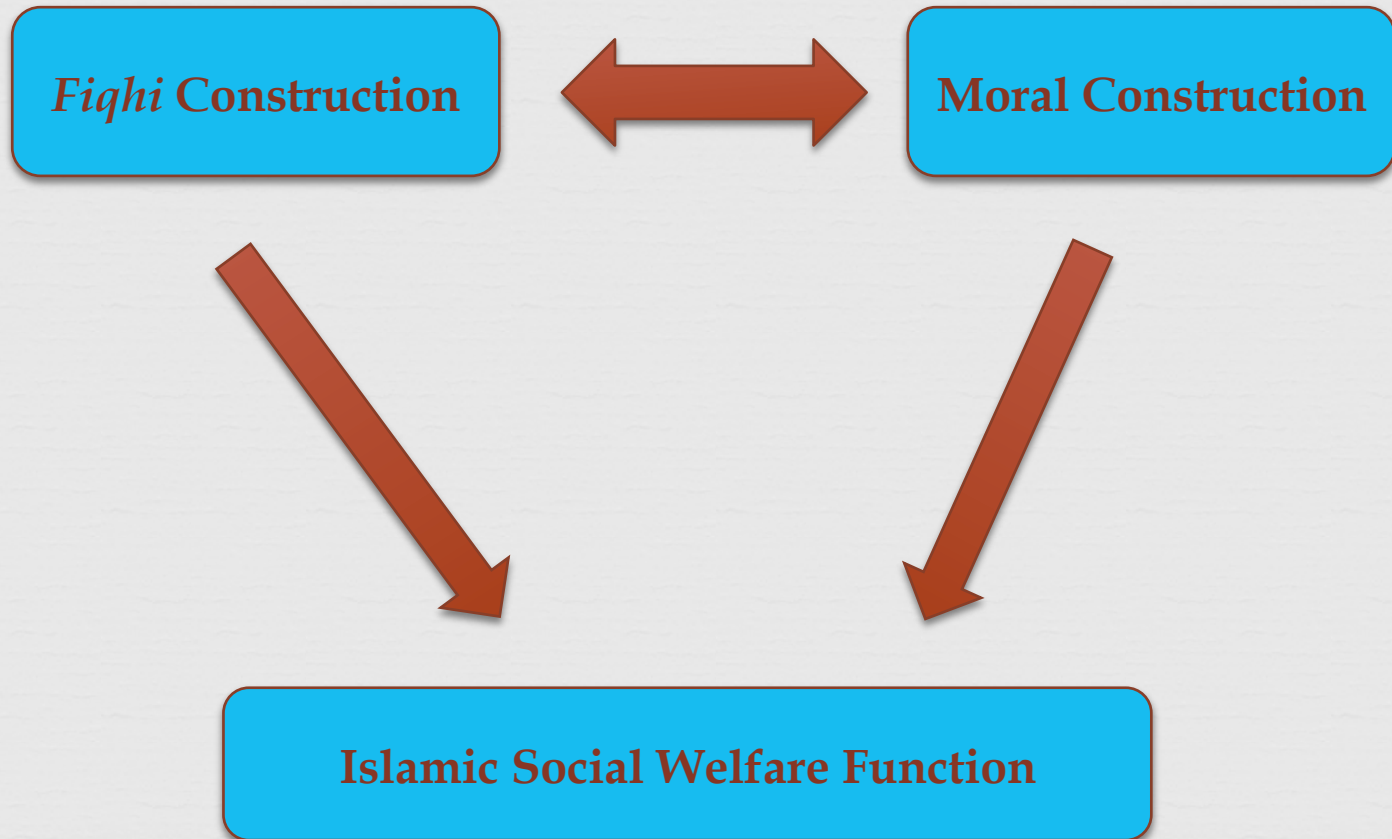
- ❧ **Khilafah (Vicegerency):** Conventional economics treats human nature as if “human beings are ... passive and helpless; they have no mission for live” (Chapra, 1992: 204).
- However, Islam has expectations for individuals **to revitalize the existing institutions within the light of objectives of Islam.**
 - Therefore, every Muslim, as part of the *Ummah*, has the essential responsibility to develop both for his self-wellbeing and social welfare.
 - While doing that, he “holds *amanah* as Allah’s representative on the earth” and endeavours to settle distributive justice. Thus, this axiom suggests solidarity among people through the social accountability as being the vicegerency of Allah requires;
 - This also essentialises shared nature of the prosperity of the generated wealth in the sense of ‘individuals being witness onto human being’, which requires expansion of the *ihسان* beyond individual *falah*.

Foundational Axioms (V)



- ❧ **Ukhuwwah (Solidarity):** As a consequence of *khilafah* and other axioms, Islam, hence, suggests its adherents to construct a **social fabric amongst them** so that an authentic Muslim identity can be built up.
- Every member of Muslim *Ummah* acts with solidarity irrespective of the wealth, gender, race, colour and so on; due to being ‘witness onto human beings’.
 - Therefore, “solidarity in Islam carries a wider concept, which suggests **collective cooperation and guaranteeing the safety of each other’s well-being**.”
 - The implementation of *ukhuwwah* would lead to a better society with an emphasis on shared prosperity and social welfare motivated by commitment and love towards fellow brothers, even those of different beliefs”.

Constructing the Islamic Social Welfare Function



Construction of Islamic Social Welfare Function: *Fiqhi* Approach (I)



- ❧ Hallaq, Said. (2002). “Individual, Society, and Social Choice in Islamic Thought”, in Habib Ahmed (Eds.), *Theoretical Foundations of Islamic Economics* (pp.103-124). Jeddah: Islamic Development Bank
- ❧ His *fiqhi* approach which classifies individual actions in five ordinances:
 1. *Wajib* - Mandatory - Must do – W
 2. *Mandub* - Recommended - Should do – M_a
 3. *Mubah* - Permissible - May do – M_u
 4. *Makruh* - Undesirable - Should not do – M
 5. *Haram* - Prohibited - Must not do - H
- the universal set [$U=U (W, M, M_a, M_u, H)$]

Construction of Islamic Social Welfare Function: *Fiqhi* Approach (II)



- ❧ From 5 to single domain: *mubah* related set of potential areas.
- ❧ Introducing a new axiom: ‘Islamically imposed axiom’ which is interpreted as adherence to the Islamic tradition.
- ❧ Critique of Said:
 - Muslims *do* have a choice even in *wajib* and *haram* activities;
 - **partial solution** for the social preference ordering;
 - a need for reconsidering the five ordinances as the layers of preferences and focusing on the implications of these ordinances in the society through the axioms of IME;
 - no identical preference ordering scheme between 5 ordinances, but rather prioritisation of some sets over another.



How to Incorporate Moral
Complementarity into the ISWF
as a Dynamic Model?

Moral Complementarity to *Fiqhi* Construction



- ❧ *Tawhidi* Framework
- ❧ Ethical Endogeneity
- ❧ Bounded Rationality
- ❧ *Maslaha* Criterion
- ❧ *Maqasid* Provision
- ❧ *Shuratic* Decision Making Process
- ❧ Axioms providing substance and contents
- ❧ *Ihsan* as the main objective function

Tawhidi framework



- ☞ It determines individual-individual, individual-environment and individual-Allah relationship
 - **Individual-individual relations** are determined by *al'adl wal ihsan*, *ukhuwwah* and *khalifah* axioms within the *Tawhidi* paradigm and *shuratic* process, in which every individual promotes his wellbeing without a violation of others'; and also aims to promote the well-being of others according to his/her constraints
 - **Individual-environment relations** are concerned with the development of both intra and intergenerational justice and the *islah* (reform) of the old institutions. This requires a "continuous reproduction [of resources]" in lieu of searching for an optimal resource allocation within a competitive environment (Choudhury, 2009: 225).
 - As for **individual-Allah relations**, the bidirectional fabric between Allah and individual constructs the ontological basis for an ISWF. With this insight, individual consciously makes preference orderings in line with the *Qur'anic* teachings, which necessitate the consideration for the *akhirah*, for individual's mission in this world through *khilafah* and for individual's conscience of his role as trustee of Allah in the meaning of *amanah* within the *Tawhidi* paradigm and *shuratic* process.
- ☞ These three-pronged relationships under the umbrella of foundational axioms should be considered as the constituents of ISWF and, at the same time, they correspond to the implications of the five ordinances of Said (2002).

The Principle of Ethical Endogeneity



- ❧ Choudhury (1991: 267): **polity-market interactions**
- ❧ There is an intrinsic two way relationship between polity (policy variables) and the market system (state variables) in an ethicoeconomic order.
- ❧ In such interrelationships, both policy variables and state variables feed back upon each other in a dynamic labyrinth of social transformations. Such a property of the polity-market interaction generates locally, but not globally, stable solutions for state and policy variables in an ethicoeconomic general equilibrium system.
- ❧ the polity-market interactions have to be in harmony with each other as the outcome of the *tazkiyah* process (inclusive growth)
- ❧ Western economic thought lacks of such an endogeneity

Individual Preference Ordering



IPO

Falah

*Bounded
Rationality*

Maqasid

Khilafah

Shura

Ikhtiy'ar

For individual
development
and wealth
generation



Bounded Rationality



- ❧ Contrary to the conventional meaning of rationality, IME stresses the bounded aspect of it by stating that any individual act has to be in accordance with the *Shari'ah*. As such, there is bounded and also broadened concept of rationality which incorporates *akhirah* in the form of social accountability into its construct
- ❧ Therefore, non-monetary rewards become also a part of rational behaviour, since “the act of sacrifice is itself seen as enhancing the individual’s expected welfare” (Naqvi, 1983: 31).
- ❧ Thus, the Islamic concept of rationality, in the social welfare context, does not accept individual preferences as ‘supreme and feeding into the social choice’ (Choudhury, 1991: 268). This is one of the main distinguishing features of IPC construct from the Arrowian sense of rationality, which strictly bases the individual sovereignty in his SWF.

Shuratic Decision Making Process



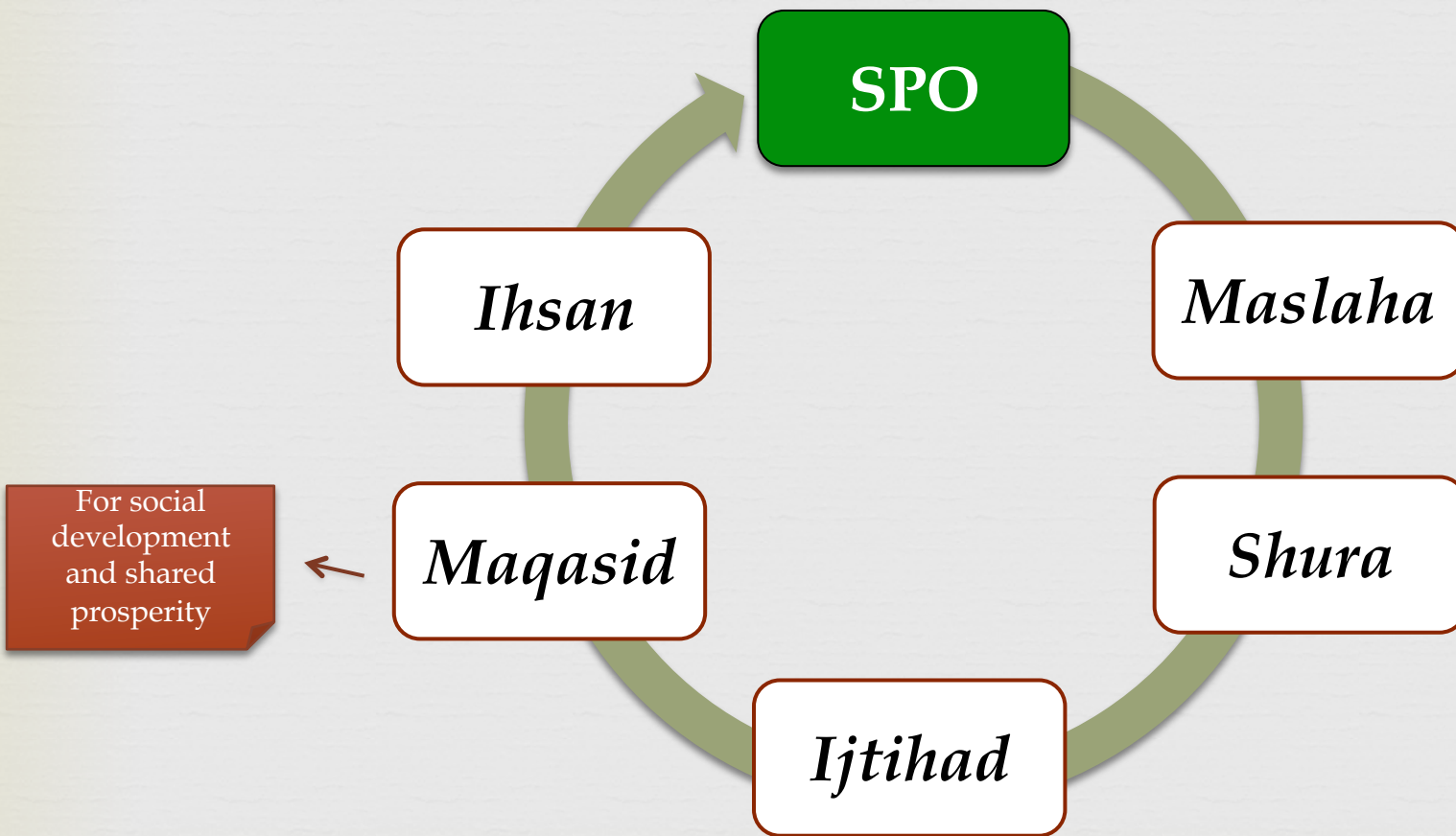
- ❧ *Shuratic* decision making process should be introduced through *ijtihad* mechanism' (Choudhury, 1980: 9) as the strength and priority of *shura* in the decision making process is vital for constructing individual and social preference ordering
- ❧ Hence, we should put *ijtihad* into the process for the derivation of social preference ordering
- ❧ a deductive, imposed consensus as contrast to Buchanan's inductive consensus

Maqasid al-Shari'ah Provision



- ❧ *Maqasid* beyond the narrow definition of Ghazalian world should be considered as the articulation of axioms and their realisation;
- ❧ Ghazalian ‘individual’ *falah* oriented *maqasid* should be merged with ‘*ihsani*’ oriented approach to define Islamic social welfare;
- ❧ Ghazalian frame should be re-considered to be made ‘pro-active’ rather than ‘*hifz* or protection’ into ‘develop and sustain’ so that ‘*ihsan*’ can be generated.

Social Preference Ordering



Maslaha Criterion



- ☞ *Maslaha* (looking into public benefit) criterion: It goes beyond the form based understanding of *Qur'an*. According to this criterion, the layers are ordered and prioritised by considering their benefits to the society and their avoidance from the *mafsada* (harm).
- ☞ The application of form based or linguistic approach to *Qur'an*, in this respect, comprises the partial solution for the social preference ordering.

Ihsan: Essential Pillar for Completing ISWF



- ❧ The ultimate goal of all human beings is to achieve Allah's consent, but the way to actualise this goal has to address the *falah* process through the accumulation of *ihsani* social capital.
- ❧ Islam, therefore, strongly recommends taking responsibilities (*fardh*) and becoming vicegerents (*khalifas*) of Allah to embed the beneficence or *ihsan* amongst members of a society. This is considered to be the only way for human beings to achieve *falah* in the *akhirah*.
- ❧ The construction of ISWF, in this sense, is established by completing *falah* process.

Conclusion



- ❧ There is a need for paradigm shift about the possibility of creating a SWF, which does not necessarily have to fulfil Arrow's conditions
- ❧ Without defining *as to how and why the prosperity to be shared* imposing on financial, economic institutions and individuals to share it does not provide any foundational base beyond borrowing the new languages and debate developed; therefore social welfare needs to be develop to provide a base;
- ❧ This requires a different ontological and epistemological base for social welfare modelling.
- ❧ IME based SWF, therefore, has distinctive characteristic than those proposed as an in-paradigm alternatives to the establishment of SWF; and social justice through *ihsani* process remains the essence of this paradigm;

Conclusion (2)



- ❧ The application of moral filtering dissolves the heterogeneity of individuals' orderings with the assumption of *homoIslamicus* and creates an environment where differences in individual orderings are minimised and every ordering does not contradict each other as experienced in the zero-sum game.
- ❧ In conclusion, both the individual preference orderings and the subsequent social preference ordering are expected to work in harmony with the moral economy understanding of Islam.

THANK YOU!

Arabic Terms



- ❧ *Sunnah*: Sayings, actions and attributes of the Prophet Mohammad (pbuh);
- ❧ *Falah*: salvation - happiness
- ❧ *Fiqh*: the knowledge of the practical *Shari'ah* injunctions and the evidence cited in their support
- ❧ *HomoIslamicus*: Sociotropic - God conscious individual
- ❧ *Ihsan*: comprehensive excellence - beneficence
- ❧ *Maslaha*: looking into public benefit
- ❧ *Shura*: to reach a decision in consultation
- ❧ *Ijtihad*: independent reasoning