

Economic Growth And Falah

Mohd Dali, Nuradli Ridzwan Shah (PhD)

Senior Lecturer, Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia (USIM),
Bandar Baru Nilai, 71800, Nilai, Negeri Sembilan, Malaysia.

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Abdul Hamid, Hanifah

Lecturer, Faculty of Science and Technology, Universiti Sains Islam Malaysia (USIM), Bandar Baru
Nilai, 71800, Nilai, Negeri Sembilan, Malaysia.

&

Mohd Zohdi, M.A.

Senior Lecturer, Faculty of Quranic and Sunnah Studies, Universiti Sains Islam Malaysia (USIM),
Bandar Baru Nilai, 71800, Nilai, Negeri Sembilan, Malaysia.

&

Baharun, Hazleena

Senior Lecturer, Faculty of Language Studies, Universiti Sains Islam Malaysia (USIM), Bandar Baru
Nilai, 71800, Nilai, Negeri Sembilan, Malaysia.

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Tun Nur Afizah Zainal Ariff

Lecturer, Faculty of Language Studies, Universiti Sains Islam Malaysia (USIM), Bandar Baru Nilai,
71800, Nilai, Negeri Sembilan, Malaysia.

Abstract

Economic growth is important in determining the overall economic condition of a country. The objective of this paper is to identify if the Islamization of the conventional growth theory can be applied towards the theory of Islamic economic growth. The findings revealed that the application of the existing growth model might not be appropriate in measuring growth according to the Islamic goals of growth. Therefore, the introduction of a unique measurement of economic growth according to Islamic perspective is warranted. This is because an attempt to introduce a comprehensive growth model in attaining *falah* maximization for OIC countries according to the Islamic perspectives using the conventional growth theory is unsuccessful.

Keyword: Islamic Economic Growth, Economic Development, Human Resource Development, Falah Maximization, OIC Countries.

1. INTRODUCTION

When Adam Smith wrote his famous 1776 treatise, he called it *An Inquiry into Nature and Causes of the Wealth of Nations* (Smith, 1904, 2001). Many researchers have taken this as an indicator that he was the father of economic growth theory. However, about more than 300 years before the *Wealth of Nations* was published, Ibn Khaldun (1332-1406) has introduced the growth theory in his book "*Muqadimmah*" or known by the western scholars as "Prolegomena" or "Introduction". Ibn Khaldun noted that the population growth, human capital development and technological advancement affect the economic growth. Another important contribution of his theory is the concept of *Assabiyah* (social cohesion) to the division of labor which increase the economic growth (Khaldun, Rosenthal, & Dawood, 1967). Perhaps there are many more of his precedents regarding the growth theory that could not be identified.

The introduction of the growth theory by the Islamic scholars was long before the European enlightenment era in the 17th centuries (1700-1800). For example, Siddiqi (1976) mentioned that two scholars Akram (483) and Fanjari (477:478) were evidenced to put main emphasis on the transformation of man, and the ethos of an Islamic society, which could relate to the earlier work of

economic growth. Ibn Khaldun, Akram and Fanjari were some examples of the scholars who have contributed to the growth theory during the Islamic era. Even though, there are evidences that there are early works in growth theory by the Muslim scholars, there is a very long gap before the Muslim scholars try to revive the Islamic economy.

There is a very limited study that has been done in the Islamic growth theory (Shatzmiller, 2011). The rest of this paper is organized by presenting a review of the literature in section two. It is followed by a discussion on the research method employed in section three. The empirical results are discussed in section four and followed by the conclusion section in section five.

2. LITERATURE REVIEW

Similar to Ibn Khaldun theory of economic growth, Smith in 1776 posited a supply-side driven model of growth in which the output is derived from labor, capital and land inputs. Ricardo (1817) modified Smith's model by including diminishing returns to land. Output growth requires growth of factor inputs, but, unlike labor, land is "variable in quality and fixed in supply". This means that as growth proceeds, more land must be taken into cultivation, but the land cannot be "created". The above are mainly what the economists called the Classics. The Keynesians such as Harrod who concurrently with Domar introduced the "Harrod-Domar" Model of growth (Domar, 1946; Harrod, 1939), developed that the growth rate is equal to the marginal propensity to save divided by capital output ratio and these ratios are constant. In the Harrod-Domar growth model, steady-state growth was unstable. In the popular term of the day, it was a "knife-edge" in the sense that any deviation from that path would result in a further move away from that path.

The neo-classical theories, started from Solow (1956), Swan (1956) and, a bit later, Meade (1961) contested this conclusion. They claimed that the capital-output ratio of the Harrod-Domar model should not be regarded as exogenous. In fact, they proposed a growth model where the capital-output ratio was precisely the adjusting variable that would lead a system back to its steady-state growth path. The resulting model has become famously known as the "Solow-Swan" or simply the "Neoclassical" growth model. Extension to the Solow model is the two-sector model introduced by Uzawa (1961, 1963), Meade (1961) and Kurz (1963). This model led to an explosion of research in the 1960s, conducted primarily in the *Review of Economic Studies*, then, as suddenly as it had appeared, this line of research evaporated in the 1970s.

Now all of the models developed by the Classical, Keynesians, and neoclassical are looking at quantitative variables only neglecting the qualitative aspects. In Islam, the qualitative aspects are important variables in achieving *falah* maximization. Therefore, in Islamic economics, one should not look into growth from material aspects but also at spiritual aspects. This aligns with believing in resurrection in the day's hereafter.

2.1 Islamic Economic Development

Economic development, according to the current literature on development, consists a "series of economic activities causing an increase in the productivity of the economy as a whole and of the average worker, and also an increase in the ratio of earners to total population" (Ahmad, 1976). A simple definition of the Islamic economics as doing good deeds in the name of Allah and not being self-centered and work for the benefits of self and the *ummah*. In addition, avoiding interest and *in the sale* must be avoided by Muslim and the overall Islamic economy must be based from Al-Quran and As-Sunnah i.e. teachings and tradition of Prophet Muhammad.

The conventional economy is a system, which promotes self-interest and materialism (M. U. Chapra, 2000, 2007; U. Chapra, 2009). He mentioned that the people must have restrictions and self-freedom as contradicts to the capitalist economics which only uphold self-freedom and whereas for the socialist restricts the human freedom. He also lined out several problems in Islamic economics, which must be taken into consideration by the OIC countries, which are data unavailability, failure of the political system etc. He also suggests that since the Islamic economics is a normative economics, therefore effort or jihad for the restructure of the economics is the focus. He also suggests the methods used by

Ibn Khaldun should be implemented in our current economic system using a multidisciplinary model (M. U. Chapra, 2000).

Table 1 in the appendix shows the economic growth of the OIC countries using GDP per capita (in USD) as an indicator. Table 1 shows the average growth in the GDP per capita¹ from 1975 until 2003 according to data availability. Libya, Iran, Uganda, Kazakhstan, Azerbaijan and Maldives have a higher average growth and Brunei, Mozambique, Djibouti, Cote, Gambia, UAE, Tajikistan, Niger, Uzbekistan and Guinea Bissau have negative average growth.

Table 2 show in the appendix shows the GDP per capita in the OIC countries from 1975 until 2003. Data was collected from SESTRCIC and the data is the major problem for OIC countries. Many of the data were unavailable. The highest was UEA in 1979 with GDP per capita of USD 1,284,109 and the lowest was Nigeria with a GDP per capita of USD2 from 1975 to 1978. Table 3 in the appendix shows that percentage of growth in the respective OIC countries as compared to the previous year from 1975 until 2003.

2.2 *Falah* from Divine Revelation

Falah or success is a very important concept in Islam. For instance, the word *falah*, *aflihu*, *tuflihu*, *tuflihun*, *yuflihu*, *yuflihun*, *muflihun* and *muflihin* are mentioned in 40 verses in the *Quran*. 70% of them are related to acts required to be observed, while the other 30% are related to those prohibited. In order to accomplish success, there are several concerns/matters that need to be addressed as outlined in the *Quran*:

- a) *Imaan* (a Muslim's faith in the metaphysical) 20%
- b) *Syariat/Ibadah* (Islamic rules and decree/acts of worship) 36%
- c) *Da'wah* (propagation of Islam) 30%
- d) *Akhlak* (practice of virtue, manner and morality) 9%

There is a total of 45 items that contribute to the accomplishment of success. They are 5 items in *Imaan*, 9 items in *Shariah*, 9 items in *Da'wah*, 5 items in *Akhlak* and 15 items in prohibitions. The total number of repetitions for all the items above is 99 times. This provides an evidence that the concept of *Falah* is very important for every Muslim because it includes all aspects of life including material and spiritual.

2.2.1 *Falah* Maximization

Islam is deeply concerned with the problem of economic development, but treats this as an important part of a wider problem, that of human development. The primary function of Islam is to guide human development in the right direction. It deals with all aspects of economic development but always in the framework of total human development and never in a form divorced from this perspective (Ahmad, 1976).

Ahmad (1976) set out the philosophic foundations of Islamic growth that are *tauhid*, *rububiyah*, *kilafah* and *tazkiyah* (purification plus growth). From *tazkiyah* then would be developed for the Islamic growth based on the Islamic principles.

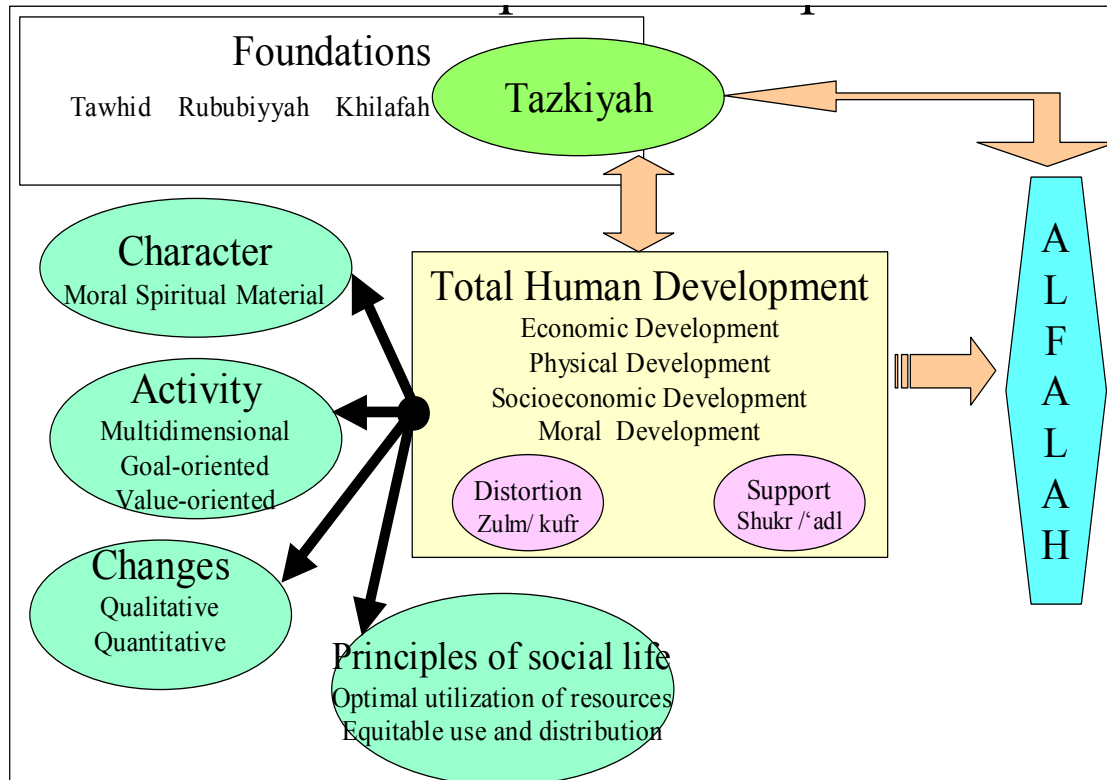
Based on the framework above, it can be understood that the economic growth is part of total human development. Islam views all developments as a whole total human development. For example an empirical study was conducted by Meisami et al. (2011). The *tazkiyah* concept is applied to the development of human.

The result of *tazkiyah* is *falah* - prosperity in this world and the hereafter. This development will mainly focus on a man as the heart of the process. The total human development has its comprehensive character, which includes moral, spiritual and material aspects.

The moral and material, the economic and social and the spiritual and the physical are all inseparable. In Islam, the welfare objective is for the world and the hereafter. This is really in contrast with the contemporary concept of development; for it only supports the welfare in the world.

¹It is calculated by dividing "GDP" by "Total Midyear Population"

Figure 1: Islamic Concept of Development by Ahmad (1976)



The economic development is a multidimensional, goal and value-oriented activity. It also involves a number of changes, which is quantitative and qualitative. In general, while people are trying to meet the quantity, they often neglect the aspect of quality. Islamic development would try to rectify this imbalance.

Among the dynamic principles of social life, Islam has particularly emphasized two: the optimal utilization of resources and the equitable use and distribution and promotion of all human relationships on the basis of support – *shukr* and *'adl* ; and distortion – *kufr* and *zulm*.

The Goals of Economic Growth as stated by Ahmad (1976)

1. Human Resource Development
2. Expansion of useful production
3. Improvement of the quality of life
4. Balanced development
5. New technology
6. Reduction of national dependency on outside world and greater integration within the Muslim world (Ahmad, 1976).

Usmani (2005) mentioned that the Muslim must be self-reliant and try to restructure the Islamic economy according to Al-Quran and As-Sunnah (Usmani, 2005).

However, the analysis of the total export from one OIC countries to other OIC countries shows that the integration between OIC countries is low. The OIC countries are depending on the rest of the world as compared to the OIC countries itself. The intra OIC trade is only 18% of the total trade of the OIC countries in 1995. It decreased to 16 percent in 1996, and then increased by 1 percent in 1997 and to 18 percent in 1998. In 1999 and 2000, the total intra OIC export decreased to 16% and 17% respectively. In other words, the trade of the OIC countries with the non-OIC countries is 3 times the size of the intra-OIC trade.

The total volume of the OIC countries is only 17% of the total international trade, although 60% of the natural resources of the world are found in the OIC countries. Another example is the case of Malaysia. The percentage of Import from OIC countries as compared the total import from the rest of the world is small.

A famous quote from the existing Malaysian Finance Minister II, Mohammad Nor Yakcob, "Lebanon and Turkey export butter to Belgium, the United Kingdom and some other European countries, while Iran, Pakistan and Syria import butter from Europe. Egypt is a big exporter of textiles, but Algeria, Indonesia and Iran purchase textiles from Europe"(Yakcop, 2002).

3. RESEARCH METHODOLOGY

As mentioned earlier, the goal of economic growth is human resource development, expansion of useful production, and improvement of the quality of life, balance development, new technology and integration within the Islamic countries.

This could be done if the OIC countries implement the common currency such as the Gold Dinar to increase trade among the OIC countries. However, it is not an easy task to quantify human development since it would require labor, time and money.

However, in this paper, an attempt to include some other determinants to GDP. The determinants are mostly derived from the goals of Islamic development as stated by Ahmad (1976). He stated that the Islamic countries should adopt a multi-objective approach to development instead being bogged down in econometric approaches whose usefulness is doubtful.

He further commented that the Islamic policy makers should develop to a more problem-oriented approach and evaluate the success of planning and development efforts on the basis of improvements in specific problem areas (Ahmad, 1976, pg. 183).

Another paper written by Metwally (1997) also stressed the implication of the Islamic economics to the existing models such as Keynesian, neoclassic is not practical. These models may not be appropriate in studying the implications of the applications of Islamic principles. These tools suggest that Islamic societies are likely to face many problems if they free their economies completely from interest, impose the *zakat* and abandon all kinds of speculations. He also said that the Islamic banking is interest free as claimed and *zakat* is not enforced in Muslim countries (Mokhtar M Metwally, 1997). Despite of all the comments on econometric, in this paper however, the researcher is trying to use the econometric modelling i.e. regression to see the determinants of the national output considering the goals which are set out by Ahmad, using the Solow model.

The output equation is as specified:

$$\begin{aligned} \text{GDP} &= h(L, K, \text{GDP}(-1), \text{HRD}, \text{QL}, \text{RX}, \text{RI}, \text{NT},) \\ h(L) &> 0; h(k) > 0; h(\text{gdp}-1) < 0; \\ h(\text{HRD}) &> 0; h(\text{QL}) > 0; \\ h(\text{RX}) &> 0; h(\text{RI}) > 0; h(\text{NT}) > 0. \end{aligned}$$

Where:

LNGDPG = growth rate of the GDP at market prices.

LNLABOR= employed labour force.

LNK= Capital

LNLAG1 = lagged level of gross domestic product.

LNLADULT= Human Resource Development (Adult Literacy²)

² Adult Literacy Rate: The percentage of person aged 15 and above who can, with understanding, read and write a short, simple statement on their everyday lives.

LNQL = Improvement of the quality of Life (Motor Vehicles)

LNXCICWL = Ratio of Export to OIC over the rest of the world

LNIOICWL = Ratio of Import from OIC over the rest of the world

LNNT = New Technology (Telephone³)

The first two variables are expected to make a positive impact on economic growth; whereas a higher level of lagged GDP implies a slower current growth rate. The rest of the impacts are positive.

The Data

In this paper, the Malaysian data are collected for the model from 1981 until 2000. The data required to estimate the equation in the preceding section are taken from different sources, which are SESTRCIC and Asian Development Bank. Economic growth is measured as the growth rate of GDP.

FINDINGS

The model specified in the previous section has been estimated by regression method. The results of are presented below:

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.895 ^a	.800	.572	.4578

a. Predictors: (Constant), LNLABOR, LNIOICWL, LNXCICWL, LNQL, LNLADULT, LNK, LNNT, LNLAG1

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	5.883	8	.735	3.509	.058 ^a
	Residual	1.467	7	.210		
	Total	7.350	15			

a. Predictors: (Constant), LNLABOR, LNIOICWL, LNXCICWL, LNQL, LNLADULT, LNK, LNNT, LNLAG1

b. Dependent Variable: LNGDPG

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-61.870	37.482		-1.651	.143
	LNK	2.521	.704	2.228	3.579	.009
	LNLADULT	3.429	3.033	.639	1.130	.296
	LNQL	.163	.643	.126	.253	.808
	LNNT	.793	1.628	.501	.487	.641
	LNXCICWL	-1.283	2.032	-.187	-.631	.548
	LNIOICWL	.533	.536	.297	.993	.354
	LNLAG1	-8.023	2.250	-6.682	-3.566	.009
	LNLABOR	12.618	6.448	3.382	1.957	.091

a. Dependent Variable: LNGDPG

³ Number of main telephone line in operation per 100 person

Labor and capital as expected have a positive impact to the GDP, however the ratio of export and import to and from OIC countries compared to the world were not significant. Even though the relationships were not significant, the integration among the OIC countries and the lessen dependency with the outside world is seem to be one of the goals of Islamic development. All other variables were also not significant except for the lagged level of gross domestic product.

Even though the result does not show as what has been suggested by Ahmad, it has been anticipated because the Islamic development does not emphasis on the econometric analysis which does not really reliable its useful(Ahmad, 1976). Instead of econometric analysis, input output objectives should be implemented to achieve goals.

5. RESEARCH LIMITATION

The sample of the study is Malaysia only out of the 57 OIC countries. Inclusion of more samples into the study is recommended. However this goes back again to the problem that has been laid out by Chapra (2000) which is the data availability of the OIC countries.

6.0 DISCUSSION

Islamic Economic development could not use econometric analysis solely but a multidisciplinary approach should be implemented. This is in line with the study done by Metwally (1997) and suggestions by Chapra (2000). Metwally (1997) found that the Keynesian and neoclassic models are inappropriate in evaluating the implications of the Islamic principles while Chapra (2000) suggested that the Islamic economics could use the approach used by Ibnu Khaldun. In addition, the issues of making the econometric results to be consistent with the econometricians needs could be done by the usage of higher sophistication models and tools.

The level of integration of OIC countries could be achieved if the common currency i.e. gold Dinar could be implemented among OIC countries to increase the level of integration between the OIC countries, high level of unity and solidarity(Mohd Dali, 2009; Mohd Dali, Hamid, & arRazi, 2004; Mohd Dali & Mat Husin, 2004a, 2004b).

The Islamic economic growth should not depend only on quantitative aspects but also qualitative aspects in achieving *falah* maximization. More research should be conducted in the area of Islamic economic development in order to ensure that the Islamic economic development could be implemented in the OIC countries.

Unsurprisingly the capital and labour do have a positive impact to the national output, which is consistent with the Solow model. This again is consistent with Metwally comments that the conventional capitalist models are not appropriate in applying the Islamic principles because it will show that the Islamic economics will have many problems.

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