

ISLAMIC ECONOMIC THOUGHT AND THE SOCIAL MARKET ECONOMY

BERLIN – ABU DHABI – ANKARA

SEPTEMBER-OCTOBER 2010

The global financial and economic crisis continues to impact the international economy. The battle over the effects of the crisis and how to address its causes is ongoing. The existing mechanisms of the financial world have come under repeated criticism and there have been many calls for change. In this context the question of common elements in the economic concepts of different cultural areas is raised. In a series of conferences the Konrad-Adenauer-Stiftung (KAS) dealt with the commonalities of the principles of the Social Market Economy and those of an Islamic economic concept.

Mandatory rules are the prerequisite for acting in a socially responsible manner and promoting the common good in a free and market-oriented economic structure. What is needed is a reform of the financial system that, for example, is geared along the ideas of economic concepts like the Social Market Economy; concepts that have proved their value at the national level. That is why the KAS wants to make a constructive contribution to the debate on the future of a social and market-oriented economic system.

Since the critical events beginning in 2007, the media have repeatedly pointed out how stable and crisis-resistant Islamic banking institutes have been compared to the Western financial system. At the height of the crisis even renowned experts called for a reorientation toward financial systems shaped by Islamic values. In September and October 2010, the KAS held three experts' talks in Berlin, Abu Dhabi and Ankara on the topic "Islamic Economic Thought and the Social Market Economy."

The central issue at the event on September 30, 2010 in Berlin was to analyse if and to what extent a Social Market Economy and an Islamic financial system shared common principles. Zaid el-Mogaddedi of the Institute for Islamic Banking and Finance (IFIBAF) in Frankfurt, Germany, Professor Volker Nienhaus of



In the course of the financial crisis principles of Islamic economic thought have attracted increased attention.

Philipps University in Marburg, Germany and Dr Mehmet Asutay of Durham University, United Kingdom, all took part in the event as speakers.

PRINCIPLES OF AN ISLAMIC ECONOMIC SYSTEM

El-Mogaddedi argued at the beginning of his speech in support of the advantages of a "sustainable, ethical and socially responsible" approach to investing; conditions which in his view Islamic banking fulfils. In Germany, Islamic financial products have been gaining ground because of the 4.4 million Muslims living in Germany.

GUIDELINES FOR PROSPERITY, SOCIAL JUSTICE AND SUSTAINABLE ECONOMIC ACTIVITY

In 2009 the Konrad-Adenauer-Stiftung edited, with the assistance of experts, a basic document that lists ten principles explaining the contemporary conditions for a successful Social Market Economy. The analysis defines the position of the KAS on structural economic matters. The Guidelines are supported by leading representatives of politics and science in Europe and have since been translated into more than 20 languages.

www.kas.de/leitlinien

A devout Muslim always bases his actions on the *Koran* and the *Sunna*, which pass on the word and traditions of the Prophet, as well as on the *Sharia*, which sums up Islamic rules. When engaging in economic activity, devout Muslims must still act in accordance with their religion and base their behaviour on their responsibility towards God. That in turn is said to lead to a certain set of principles. The best-known principle of Islamic banking is the ban on charging interest, or ban on *Riba*. But Islam was not the first to introduce this principle – Martin Luther and Jewish scholars already postulated it. The resulting economic system is therefore one based on real economic value and not primarily upon interest-generated income, which makes it more resistant to crises. A further principle of an economic system shaped by Islam is *Zakat*, which el-Mogaddedi described as a kind of tax on the rich that amounts to 2.5 percent of financial assets and income upon investments and can make up to 20 percent in other areas. The rich are supposed to pay this at the end of a lunar year – once their income has risen above a certain level and is not flowing back into the economic system, but is instead used for investment. *Zakat* is supposed to provide the needy with financial assistance.

Trade is welcomed under Islamic values. But certain kinds of investment are disapproved, as el-Mogaddedi pointed out. "Each investment comes with certain risks, but highly speculative risks are not desired." Islam is principally opposed to financial deals that can hurt another person, which is why a devout Muslim should not invest in goods such as alcohol or tobacco, or in sectors such as the weapons industry. Ethics commissions, known as *Sharia* boards, must in the end evaluate, grade and issue permits for the financial products that Islamic banking plans on introducing. If the investment violates Islamic tenets it will not be introduced in the market, el-Mogaddedi said.

Because of the Koran's ban on any type of interest, Islamic countries have developed alternative means of financial transactions. The director of the IFIBAF gave three different examples. One is *Murabaha*, which provides customers with an alternative to interest-based loans. Here the bank acts as middleman, and the process is a type of business contract agreed on by the bank and the customer. The bank can levy fees for risks it assumes at the time of the contract signing – e.g. price increases or if the customer withdraws from the deal – which is how it earns money. *Mudabarah*, the second principle, is the equivalent of participating as a silent investor. Here entrepreneurs look for investors to help realise their business plans. Investors assume all risk for providing their capital. But if the business concept is successful, profit is shared out along previously agreed-upon percentages. The third financial product is *Sukuk*, also referred to as an Islamic bond but without the attendant debt element of a classic bond. Rather, it is used to define a level of co-ownership of assets permitted under Islamic law. This is used in particular in financing larger-scale projects, for example an airport expansion. With a *Sukuk*, the funds are collected on the market, and a specific amount is then deposited into a special-purpose company. Those signing the *Sukuk* then profit from the returns of this specific asset. One such example according to el-Mogaddedi is a *Sukuk* designed by the financial administration of the German state of Saxony-Anhalt. It won over investors from the Gulf region, offering them to share in real estate revenues. But with a volume of 116 billion US dollars the *Sukuk* market is currently fairly restricted and the issuing volume collapsed in 1998 since the renowned Islamic scholar Taqi Usmani deemed a special form of *Sukuk* which included a repurchase agreement for the date of maturity of the *Sukuk* on emission as un-Islamic. The scholar had criticised the set prices established for buy-back rights, since Islamic banking frowns upon price agreements of this kind. But a buy-back right at future market prices would not violate *Sharia* law.

Zaid el-Mogaddedi
of the Institute for
Islamic Banking and
Finance in Frankfurt.



Asked about the decision-making process of *Sharia* boards, el-Mogaddedi said that product managers consult with Islamic scholars early in the development process so as to jointly develop the product according to Islamic rules. As the rejection by a *Sharia* board is definitive the involved actors coordinate extensively in the run-up of the launching of the product.

ISLAMIC FINANCE – AN ALTERNATIVE FINANCE SYSTEM?

At the beginning of his lecture, Volker Nienhaus made clear that a market economy with Islamic aspects was nothing more than a theoretical construct, in contrast to the existing Social Market Economy. Only countries such as Iran and Sudan have so far established an Islamic economic system. "Islam is not just a religion but a comprehensive world view," he said. The key difference is that an Islamic economic system needs to explain the market economy using principles taken from the *Sunna* and the *Koran*. An Islamic economic system per se does not exist – instead there are different forms of an Islamic market economy growing out of different interpretations of the *Sunna* and the *Koran* and out of different historical and cultural contexts.

Nienhaus explained three widespread misunderstandings about Islamic finance: first, that there were no loans but always risk-sharing; secondly, that financing was according to the charity principle rather than profit maximisation; thirdly, that Islamic finance proved to be more stable in times of financial crisis than the Western financial system. The concept of an Islamic economic system based upon charity comes from British India of the 1930s and 1940s. Upon Pakistan's founding as a homeland for the Muslims the search began for an alternative economic system since capitalism and socialism were rejected. So the attempt was made to create an economic concept guided by Islamic values. The current common practice of Islamic finance, however, originated in the Gulf Region, where the first Islamic

banks were developed in the 1970s. Arab trading companies had always used liberal principles in their dealings with traditional banks. In order to do business with Islamic banks they asked scholars to redesign their business practices in accordance with Islamic tenets.

The bottom line was that Arab traders were able to maintain the same business practices but with a different kind of legal basis. According to Nienhaus, the ideology of a third way is very different from a system that might present itself officially as "conforming with Islam and therefore different," but where, in the end, the distinction is only that business deals aimed at profit maximisation simply need to conform to *Sharia*. "So functionally we have the same system as in the West," he said. "That's not about charity, it's commercially oriented."

Scholars arrive at their economic pronouncements, which must be relevant over the long term while conforming to *Sharia*, through the prism of legal history. That means that Islamic legal scholarship is the basis to establish normative rules for an Islamic market economy. But in order to find a prescriptive approach to the economy, the general consensus among economists is accepted. It used to be Keynesianism; today the trend is towards neoclassical economics. But the general orientation clearly follows the trends of the secular world. "As a result, concepts of a market economy developed on which everybody agrees," said Nienhaus. During the 1960s, however, there were extensive discussions on whether an Arab-Islamic socialism with public control over the economy might be a better idea. Today there is widespread agreement that an Islamic economic system needs to be based upon private property and competition. The state only has a responsibility to intervene if the market fails to provide public goods and services such as infrastructure or education. That leads to the development of an economic system which gains its legitimacy from religion and bases its functionality on conventional economics.



Professor Volker Nienhaus, economist and member of the Governing Council of the International Centre for Education in Islamic Finance (INCEIF) in Kuala Lumpur.

COMPATIBILITY OF SOCIAL MARKET ECONOMY AND ISLAMIC FINANCE

The "Guidelines for Prosperity, Social Justice and Sustainable Economic Activity" drawn up by the KAS include 10 basic principles such as the aforementioned supply of public goods by the state, the establishment of an economy guided by the principle of private property and stable economic conditions. In his analysis, Nienhaus first affirmed that these elements were also among the main features of Islamic finance before directly comparing the elements that make up a Social Market Economy and an Islamic economic system.

Islamic banking also relies on a system that promotes open competitive markets and competition policy – a structure that works against monopolisation and cartel agreements. The social dimension of a Social Market Economy means that even those losing out to the competition can still rely on a social safety net. That issue is still intensely debated in the context of Islamic economics, with experts disagreeing over whether the special social contribution *Zakat* itself provides enough protection for those in need, Nienhaus said. Those in need can only draw upon *Zakat* if they are unable to provide for themselves – so your own efforts are crucial, said Nienhaus. You are granted *Zakat* if you become disabled or if your income is insufficient to survive. But this demand is neither made of the state nor of the family – instead it is a demand directed at society at large, which results in a kind of self-administration. This kind of social welfare is proving problematic because of its countercyclical nature. Indeed the need for *Zakat* increases during economic crises – yet people earn less and less, leaving them without enough money to pay *Zakat*. "Individual insurance policies have only recently become acceptable on a mutual basis since with conventional insurances the service provided and the service received in return are not clearly stipulated, which is illegal according to Islamic contract law," Nienhaus said. Mutually supportive

groups have also been established where people offer each other assistance. Islamic contract law does not apply since they all pay into a fund using an instrument called *Takaful*, an Islamic insurance.

According to Nienhaus, the main obstacle to overcome between an Islamic economic system and the Social Market Economy is the ban on interest payments in the financial sector (ban on *Riba*) – since the world economy is largely constructed around the notion of interest. But even without interest charges, one should not believe that Islamic finance lacks indicators of money supply scarcity. Instead of using interest rates to indicate such limitations, Islamic finance takes the average return of securities portfolios into account. This profit is achieved through "largely risk-free forms of financing," said Nienhaus – quasi the economic equivalent of a market interest rate.

According to Nienhaus, *Mudabah* is not the right tool to allow entrepreneurs to access the liquidity necessary for larger projects, since investors could fear a loss-sharing arrangement. Instead an alternative has been developed where the bank acts as the middleman for at least three or four parties. This way of doing business is called *Tawarruq*. "*Tawarruq* is used for goods and transactions different from the ones expected at the time of the Prophet – an elegant legal solution," Nienhaus said. At the same time, he criticised that this kind of substitution – replacing loan agreements with trade deals – resulted in the accumulation of excessive debt and leverage.

Nienhaus then moved on to explain the last of the three big misunderstandings about the Islamic banking system. "Luckily for the Islamic market economy, papers for risky transactions between banks had not reached full market maturity when the financial crisis hit." That is one important reason why Islamic banks had not been affected as badly by the financial crisis as Western banks. If it had not been for the crisis,



said Nienhaus, then the Islamic world would have just continued to replicate the Western financial world. In addition, the strong growth of Islamic finance is not based upon the newly founded Islamic banks but on the fact that major Western actors such as *Citibank* or *Deutsche Bank* have begun offering their products in the Islamic markets, or that conventional banks have been restructured and turned into Islamic banks. Nienhaus emphasized that *Sharia* scholars were less the ones developing new financial products but rather that Western experts were trying to modify already existing products to comply with *Sharia*. This development is of some concern as it reminds of erroneous trends in European financial markets.

Nienhaus concluded that Islamic value systems could be compatible and work with the principles of a Social Market Economy. But aside from remarkable changes, like the introduction of insurance for individuals, there was also proof of certain deformations in the system that led him to conclude that Islamic finance could not come up with the demands of social reforms associated by many with the adjective „Islamic“. In fact, it rather reflects a legalistic alternative to the conventional financial system. The legitimisation of certain structural elements by taking recourse to the Islam would not automatically imply substantial changes.

A BAN ON INTEREST – A WAY OUT OF THE CRISIS?

At the centre of the second panel – possible solutions to the financial crisis – stood the lecture by Dr Mehmet Asutay of Durham University (UK). The panel analysed the extent to which Islamic finance could serve as a point of reference for Western economic models so that they could develop more resistance against crisis situations in the financial sector. The participants also underscored the importance of Islamic values to ensure the success of Islamic finance.

The final discussion addressed remaining questions about the crisis in the financial markets, the Islamic banking system and its future.

At the beginning of his speech, Asutay laid out the growing importance of Islamic finance within the global financial system. Currently, assets of Islamic banks amounted to just a trillion US dollars, but a huge volume of capital was available in the Gulf region for *Sharia*-conform financial products. He pointed out that Islamic banking should be viewed as a socially constructed institution and therefore be assessed critically. He saw particular deficiencies in the area of moral values and in an insufficient understanding of the system that constitutes the basis of an Islamic moral economy. „Islamic finance cannot fulfil our expectations as a moral system since it has been turned into a financial instrument rather than being the financing tool of an Islamic moral economy,“ he said. This requires a consequentialist attitude in assessing the operations of Islamic banks and financial institutions. Therefore, rather than only focusing on whether Islamic financial products are *Sharia* compliant, the focus should be on whether these products or instruments fulfil the expectation of creating a moral economy as Islam expects. Thus, the focus should be on the substance rather than only on the form. While el-Mogaddedi and Nienhaus underscored the importance of the ban on *Riba* within an Islamic system of values, Asutay contended that moral values could affect the economy far more than with just a simple ban on interest charges. He also stressed that Islamic finance in its current form and operations could not be seen as an equivalent to the Social Market Economy model as in its current form Islamic finance and banking works as heterogeneous products and instruments of the prevailing financial system. However, the Islamic moral economy as a carefully structured concept aims at the similar objective function as the Social Market Economy model; and when Islamic finance is reconstructed as social banking within the Islamic moral economy, only then Islamic finance will internalise the



*Dr Mehmet Asutay, expert
for Islamic banking at
Durham University (UK).*

objectives of the Social Market Economy. Asutay further stated that moral values are what turn an economy into a social economy, and therefore in the beginning of the financial crisis politicians as well as religious circles indicated the moral deficiency in the financial system. Asutay called for a paradigm shift in the financial world. „The current crisis shows that we must establish ethical rules, regardless of whether they are Christian, Jewish, Muslim or Hindu.“

GROWTH ACCORDING TO MORAL VALUES

In Asutay's view, an Islamic moral economy is founded upon vertical equality. Being the initial part of social justice, vertical equality refers to equality of individuals in the sights of God. This includes accountability to this God. In addition, he stated that another important axiom of the Islamic moral economy is horizontal equality, and achieving beneficence as the highest moral level in one's economic activities alongside other activities. People needed to understand the importance of these two values so they can help create greater harmony. Greater harmony would mean less socio-economic problems – and a possible way out of the crisis. The Islamic moral economy thus aims at such an economy in which the conflict between individual and social interest can be moderated so that social justice and good can also be achieved. In other words, individual progress is insufficient while social commitments that promote the common good – *Zakat* being one example – are aiming at mitigating and moderating the consequences of the crisis. Thus, Islamic finance has to be located within such a moral economy in order to serve the social justice and social good. While creating prosperity is of course desirable in an Islamic economy, the activities leading to prosperity should be subject to a moral filter. The interests of the community as a whole should be served. In any way, in the Islamic moral economy, prosperity, property and all the resources are *Amanah* or trust from God; and there-

fore those who have richness should return the right of the society to society through various means, including *Zakat*.

Asutay then turned his attention to the moral rationales for Islamic finance and stated that it cannot only be understood as an economic entity, but must always be viewed in a moral context. So the conclusion is that Islamic finance is not a financial *system*, but merely a financial *tool*. In its attempt of creating morally oriented embedded financing tools and practices, the Islamic moral economy provides further moral filter for financial activity by prohibiting uncertainty, speculation and gambling in financial activity, he said. A further pillar is responsible financing in terms of fulfilling individual, social and environmental expectations and needs. In the Islamic moral economy, responsible finance aims at being a moral compass, preventing debtiness on an individual and organisational level, fulfilling regulative expectations and fulfilling the aspirations of community in terms of expanding the capital base of the society – thus making ethical investments possible. Applying those moral criteria would mean a ban on hedge funds, derivatives and other exotic financial products. In Asutay's view, the effects of the crisis would have been much less serious if these rules had been implemented and independent oversight bodies had enforced them. He, therefore, stated that: "The potential of Islamic banking lies in operating within the framework of the moral pillars."

Islamic finance was widely praised at the height of the crisis because of these moral pillars. This is due to the fact that the current crisis was not just of a financial nature, but of an ethical kind as well, as it could be traced back to a moral deficiency in the banking industry. But problems also plagued Islamic finance – in the oversight of the finance sector, for example. While Islamic finance has oversight bodies similar to the Financial Stability Board, the same problems as in the Western world emerged: firstly, because regulations



were not mandatory, and secondly, because of a lack of authentic Islamic products. At this stage, the performance of Islamic banking and finance against the financial crisis is important to explore. It is true that despite the social and moral failures of Islamic banking and finance in relation to the expectations of an Islamic moral economy, its performance during the financial crisis has shown its resilience. In other words, despite the crisis, Islamic banks and financial institutions have performed well; and in most parts of the world, their asset sizes have increased with two digits. However, such performance should be explained by external factors rather than the internal dynamics of Islamic banking and finance. In the countries where Islamic finance and banking is popular and prevailing, we have not seen the real and the damaging impact of the crisis – except for Dubai. The performance of Islamic banks and financial institutions is still high. But the debt based financing of *Murabaha* causes problems in the Muslim countries because it is so intertwined with the traditional Western financial world. Asutay said these problems could be solved through the integration of real Islamic rules into the economic system.

Thus, a great discrepancy currently exists between the utopia of an Islamic moral economic system and the reality of Islamic finance, which is moving ever closer in the direction of neoclassical economics, he said. Asutay described this situation as the social failure of Islamic finance. Instead of establishing itself within the Social Market Economy and claiming the Islamic moral economy, Islamic finance has just taken over many aspects from the capitalist system. While it was expected that Islamic finance and banking with its moral economy appeal can help to moderate the excessiveness of the capitalist economy, the realities show that Islamic finance converged towards capitalist economy by prioritising profit and efficiency over equity. Thus, looking into extreme practice of Islamic banking and finance, in certain aspects we can see that the Islamic financial sector could still learn a

great deal from a Western social economic system – for example with respect to corporate social responsibility. With its current practice, thus, Islamic finance is no longer an alternative system that can help address economic and financial problems, but merely a part of the conventional financial system. It is deficient in developing authentic products and helping shape the entire system despite its potential as expressed by the foundational axioms and principles of an Islamic moral economy. As explained so far, the Islamic moral economy aims at being an alternative system by creating an authentic systemic approach to economy and finance rather than pursuing the *Halal* approach of the existing financing methods. Because of the current gap between the aspirations of an Islamic moral economy and the actual behaviour of Islamic finance, it is difficult to consider Islamic banking and finance as part of a moral economic system.

Asutay was asked what needed to happen so that the Islamic financial system could develop its moral potential. His view is that *Sharia* scholars first had to change their perspective and conceptualisation of Islamic finance. Currently, they just review whether the contracts conform to *Sharia* in terms of forms, but ignore the substance of the products – something that would surely have led to a crisis under any circumstance. *Sharia* scholars usually lack the necessary economic expertise, but also because they focus on the mechanistic of *Sharia* compliancy, they lack the consequentialist method. However, there are some positive developments: a *Sharia* board in one of the Islamic banks in the Gulf region admitted an economist into its ranks and is seeking his advice. As an economic expert, he relies on a broader and different range of perspectives to support the reflections, thus helping the *Sharia* board to reach better decisions. As the Islamic banking has since the 1970s been structured by commercial banks, those commercial Islamic banks should not be dismantled as they play an important role in terms of pooling funds, regardless of



Fahad Saeed Al-Raqbani, Director General of the Abu Dhabi Council for Economic Development, and Frank Spengler, Deputy Head of the KAS Department for European and International Cooperation, gave the opening speeches of the Abu Dhabi conference.

their social failure. But rather they should be strengthened in their own efforts to conduct their activities as socially as possible, and importantly they should be encouraged to create social bank subsidiaries, through which then they could, for example, do microfinancing as a response to the development needs of Muslim societies and communities.

EXPANDED DIALOGUE IN ABU DHABI AND ANKARA

The Konrad-Adenauer-Stiftung did not limit its interest for the topic to the conference in Berlin. It also organised two experts' talks in Abu Dhabi and Ankara at the end of September and early October 2010, where participants reflected on the consequences of the financial and economic crisis, as well as on the concept of the Social Market Economy and on an economic model influenced by Islamic values. At both events, international experts from the political and the economic world looked for a possible solution to the crisis that could transcend cultural barriers.

ABU DHABI: APPROACHES FOR A VALUE-BASED ECONOMIC POLICY

The economic policy conference in Abu Dhabi from October 11 to 13, 2010 was titled „After the Crisis – Approaches for a Value-Based Economic Policy.“ Looking for the common ground between the Social Market Economy and an economic system based on the Islam was on the agenda. Further topics were adapted to the dynamic region along the Arabian Gulf. Because of the central location and the nature of the Gulf region as the meeting point for different cultures, the conference welcomed experts on Islam not only from the Arab world, but also from other Muslim countries – especially from South and East Asia –, significantly enriching the discussion. Participants debated the value systems of Western and Islamic societies, compared the image of business people in both cultures

and discussed the regulatory framework of financial policy according to Western and Islamic concepts.

Keynote addresses at the conference were given by Frank Spengler, the Deputy Head of the KAS Department for European and International Cooperation, and by Fahad Saeed Al-Raqbani, Director-General of the Abu Dhabi Council for Economic Development. The KAS Regional Program Gulf-States worked with the council as well as with the German-Emirati Joint Council for Industry and Commerce on organising the conference. Holger Haibach MP, the Development Policy Spokesman for the CDU/CSU parliamentary group in the German Bundestag, gave the keynote speech. All three speakers agreed that the way out of the crisis depended on devising a sustainable economy with a strong value base – and that the Social Market Economy model as well as an economic system based upon Islam could both be guides along the way.

At a total of six panels experts discussed the fundamental aspects of both approaches to economic policy, along with issues concerning social and environmental policy, competition, financial policy and the image of business on each side. Professor Marcus Marktanner of the American University Beirut began this part of the conference with a lecture on the „Social Market Economy Perspective of Ibn Khaldun,“ in which he spoke about the Arab historian Abdul Rahman Ibn Khaldun, considered a pioneer by today's Islamic economists. In his book *„Mugaddima“*, published in the 14th century, he already addresses fundamental economic issues that are also principles of the Social Market Economy. The most important elements were private property, liability and property rights. Ibn Khaldun developed structures to control interest groups and recognised the importance of independent market oversight and of an autonomous central bank. Marktanner was able to demonstrate with this example how much a Social Market Economy and an Islamic economic concept share from a governance perspec-



*Holger Haibach
MP discussing
with experts from
the Gulf region.*



tive, and that both approaches are much more than just economic systems. They are most of all societal models based upon solidarity and the social cohesion created by private property. Marktanner explained the fundamentals of the Social Market Economy and stressed how freedom of contracts, freedom to set prices and free trade were necessary for it to function. He called for interventions by the state in line with the market – but only interventions designed to prevent the abuse of market power, guarantee equality of opportunity and cushion social inequality. At the end of his talk he called for a broader dialogue between the Islamic and Western schools of thought.

Professor Mohamed Aslam Haneef of the International Islamic University Kuala Lumpur took on “The Role of the Market and State in the Economy” in his lecture. His central thesis was that the value system that underlies both economic approaches is a good base to tackle the current crisis and prevent future ones from occurring. The free markets on their own are unable to guarantee the well-being of society, he said, which is why it was particularly crucial to find alternatives to the liberal economic system.

Today’s Islamic financial system is not up to this task, said Dr Kilian Bälz of Amereller Legal Consultants in his contribution to the discussion. All this even though the entire Islamic world has been promoting the concept of an Islamic financial system as the only solution to the crisis, claiming that a real estate meltdown like the one that began in the United States in 2007 would never have been possible in a system of this nature. Bälz asked whether the success of *Sharia*-conform financial products in the past was not caused by other factors as well. In addition, he pointed out that many countries in the Islamic world had not largely been spared in the financial crisis because of Islamic banking, but because their economies were only barely integrated within the global economy. Expanding on the view of how Islamic finance defines itself – and

how *Sharia*-conform banks operate – he concluded that Islamic banking could only assume a leading role in the global finance markets if it moved away from its formalistic approach to adopt an ethically-guided system. Bälz also found it remarkable that individual scholars were certifying Islamic financial products despite the lack of a universal set of rules. In the Islamic financial world the tendency is to concentrate on individual cases instead of taking a look at the overall picture. In his opinion, the system lacks regulatory criteria that could thwart a future financial crisis. The Islamic banking world may have the potential to be a part of an economic system whose values overlap with those of the Social Market Economy. But in practice, there is a long way to go.

Manuela Kasper-Claridge, Head of the Business Department of Deutsche Welle in Berlin, spoke in her lecture titled „German Family Businesses and Their Entrepreneurial Approaches” of German family-owned businesses and how they confronted the economic crisis – considering the socially responsible image of companies within the Social Market Economy. The 40 largest German family businesses are an essential component of the German economy as they represent a turnover of 543 billion euros and 57 percent of workers employed in the German economy. Citing a study by the Centre for European Economic Research, Kasper-Claridge showed that while the economic crisis had severely affected family-owned companies, they had not suffered as much from the fallout of the recession. She said reasons included the high identification of employees with their companies as well as the high level of trust these companies enjoy.

Dr Stephan Roll of the German Institute for International and Security Affairs – SWP presented a very different point of view in his talk. Using Egypt as an example, he characterised the composition of Arab business elites and analysed their role in reforms of the Arab world. He showed how the Arab economies



have changed in the last two decades. Protectionism, which had been very much in evidence beforehand, had dropped in many Arab countries. Furthermore, new economic policy incentives were being introduced in order to promote economic stability and growth. In addition, structural adjustments have led to the privatisation of many public companies.

Roll stressed that Arab business elites had profited a great deal from the reforms. But he made clear first that in the Arab world, family companies were not a new phenomenon, but that their roots extended back into colonial times. In modern times, these companies are taking advantage of their extensive networks. Many businesspeople hold political office or assume strategically important positions that allow them to secure their economic interests. Roll said that these economic elites were currently taking on important roles in the region; their influence has grown hugely in the last 20 years. But he left it open whether this development had always benefited the respective economies.

Dr Halah El-Sokari of the Khalifa Fund for Enterprise Development of Abu Dhabi provided insights in her lecture on the image of entrepreneurs and the promotion of entrepreneurship in the United Arab Emirates. First, she introduced the fund's efforts, which has placed at the centre of its work targeted economic support for small- and medium-sized businesses and aid for start-up companies. She thought that financial products were needed to support these companies and open the way for a culture of innovation thanks to financial independence.

One of the participants of the panel titled „Limits of Markets? Social and Environmental Policies in Western and Islamic Thought“ was Cornelia Richter, the Head of the Planning and Development Department at Germany's Gesellschaft für Technische Zusammenarbeit (GTZ). She introduced the work of the GTZ in Islamic

countries, where the organisation works according to Social Market Economy principles. She stressed, however, that these principles could not just be transferred wholesale from one country to another. Instead, the adaptation had to occur gradually by taking local principles into account. Another participant in the panel was Brian LaRiche of Lariche Community and Academy of Responsible Management in Malaysia: he gave a presentation on corporate social responsibility and environmental programmes. Further important contributions were made by Dr Heiko Fritz of the German University in Cairo, Dr Abdul Qayyum of the Pakistan Institute of Development Economics, Velid Efendić of Sarajevo University as well as Habibullah Khan, professor for economics and finance at Singapore's University U21Global.

Following the presentations, panellists and participants debated the link between the type of government running a country and the consequences of the financial crisis on the national economies. The conclusion was that the economic and financial world needed to behave in an accountable and responsible manner towards the people and the state. That was viewed as essential for political and economic stability, and by extension also for social stability given its inherent link to a value-driven economic concept.

ANKARA: THEOLOGICAL ROOTS OF VALUE-DRIVEN ECONOMIC ACTIVITY

The KAS cooperated with the Department of Theology of Ankara University to organise a German-Turkish experts' workshop from September 23 to 24, 2010 on the subject of "Social Market Economy and its Perception in Islam." It focused less on technical aspects, instead addressing ethical issues and normative reasons behind economic activity – since many legal issues are dealt with in a more comprehensive manner in a relatively secular country such as Turkey than in other Islamic countries.



Experts at
the conference
in Ankara.



Two lectures by Professor Gerhard Kruij of the Department of Theology at Mainz's Johannes Gutenberg University attracted a great deal of attention and spurred a controversial debate. First, Kruij outlined the basic elements of the Social Market Economy, stressing the illegitimacy of a market economy without a social component. Markets are unable to sustain themselves on their own but are in need of protection. Trust is also necessary – not just to ensure contract stability but to take into account the weaker links in a society such as older and sick people as well as the socially disadvantaged, who should not be excluded because of market conditions. The conference participants agreed with his views on certain established norms: since markets did not always work the way they should of their own volition, the state had to create the necessary general conditions. He needed to guarantee certain public goods as well as a social safety net. To ensure this the state also had to maintain a certain measure of regulatory oversight. Democracy and the rule of law guarantee the interdependence of market and political systems.

Kruij was also commended for his second contribution about making the Social Market Economy part of the church social doctrine. He first drew attention to certain roots that helped establish a socially just economic and social system in Germany (e.g. the views of Bishop Wilhelm Emmanuel Ketteler on worker's rights in the 19th century and the subsequent social encyclicals of the Catholic Church). He also repeatedly made reference to a pluralistic and rational thinking, stressing that "the decisive principles are neither Catholic nor Protestant, rather they are right or wrong in regards to social or economic policy." While Christianity had shaped a great deal of the roots of the Social Market Economy, he said, these roots were both compatible with Islam and reasonable.

In his address, Professor Ali Riza Gül of the Department of Theology at Osman-Gazi University Eskişehir largely agreed with Kruij's thesis. While Islam has not established a coherent economic policy, it has drawn up a variety of individual rules for nearly every situation in life. The *Koran* accordingly does not have such a thing as a closed system but rather a number of lessons guiding the way, and which certainly are compatible with the concept of the Social Market Economy. Professor Ahmet Tabakoglu of the Faculty of Economics and Administrative Sciences of Marmara University in Istanbul added that many discussions about a state economic system had only begun in Islamic countries after the discussions had already taken place in the West. But Islam had also come to certain basic realisations over the course of 1,400 years that today are clearly supported in other religions as well. Among them are that there should be no wages without work, no consumption without savings, no wealth without responsibility and no societal equilibrium without competition. Furthermore, goods should essentially never be wasted and interpersonal relationships should primarily be based upon trust.

Criticism was raised in the ensuing discussion, however. The principles Tabakoglu mentioned, for example, had not been used in a uniform manner, and if then, only between Muslims. Business ethics in practice were often a different matter as self-interest remained a very important aspect. Within Islam competition should only exist if something "good" is being produced. Individuals are only entrusted with prosperity – which means the accumulation of wealth is permitted, but not to the point where one is dominated by it. In the end both Christianity and Islam first developed in pre-modern times, while many notions of what constituted social justice only took shape in the 20th century.

SOCIAL MARKET ECONOMY

GUARANTOR OF ECONOMIC SUCCESS
AND SOCIAL STABILITY



Further thematic sections addressed contemporary issues and the Islamic call for worldwide political co-participation. Professor Mustafa Acar, Dean of the Faculty of Economic and Administrative Sciences at Kirrikale University, stressed the importance of addressing all issues in a global system. The primary concern was not interreligious dialogue but rather access to natural resources, global population issues and the worldwide flow of migrants. Islam both would like to and can commit itself to a global economic system that could prevent crises like the one of the last two years. There are no inherent obstacles for Islam to come to terms with issues such as private property, free enterprise, international competition or fair international trade. As administrative expert Professor Enver Alper Güvel of the faculty of Economic and Administrative Sciences at Çukurova University said, Islamic countries are also interested in establishing a liberal, global and socially just economic system, and would like to help shape it with their own efforts and experiences. In conclusion, the Turkish side generally agreed that those in charge in most Islamic countries have recognised the necessity for international rules – as long as they are on an ethically sound basis, politically legitimate and can be rationally communicated. A general alignment exists on issues concerning social justice, generational justice, environmental and climate protection issues as well as on the, in the end, limited skills of each individual, issues which are both originally Christian and originally Muslim.



**Konrad
Adenauer
Stiftung**

Publisher

*Konrad-Adenauer-Stiftung e.V.
Rathausallee 12
D-53757 Sankt Augustin*

Text

*Nora Enzlberger, Thomas
Birringer, Dr Helmut Reifeld*

Editor

Susanna Vogt

Pictures

*German Emirati Joint Council
for Industry & Commerce
(AHK), Konrad-Adenauer-
Stiftung e.V.*

*All rights reserved. No part of
this publication may be repro-
duced for utilised in any form
or by any means, electronical-
ly or mechanically, without
written permission of the
publisher.*

Printed in Germany.

© 2011

*Konrad-Adenauer-Stiftung e.V.,
Sankt Augustin/Berlin*

SOCIAL MARKET ECONOMY – GUARANTOR OF ECONOMIC SUCCESS AND SOCIAL STABILITY

On this website KAS has collected basic information in English explaining the concept of the Social Market Economy. Furthermore, topical reports on the worldwide activities of the more than 80 international offices of KAS are to find. A video clip on the concept of the German economic and societal model as well as contact details to KAS experts on the subject complete the informational offer.

www.social-market-economy.org

www.kas.de