Globalization's Vulnerabilities and the Response of Islamic Economics

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Abstract

The philosophical-theoretical premise of globalization is ignorant of the values of justice, equity, and oneness of humanity, hence it leads to vertical integration of humanity, systemic vacuum in global governance, drastic erosion in national policy autonomy, and accountability-free empowerment of global capital. The Islamic worldview provides an alternative paradigm for globalization and offers wide scope for reform of contemporary globalization by re-exploring the interrelationship between the concepts 'Ummah' and 'one humanity.' This suggests that operational re-orientation of Islamic economic institutions is greatly needed to protect the Ummah and humanity against the vulnerabilities of contemporary globalization.

Introduction

Globalization, or global integration, is the policy paradigm symbolizing the post-cold war era of global capitalism. Having taken the shape of a windstorm, particularly since the fall of communism in 1989 and with the worldwide enactment of WTO (World Trade Organization) rules, the forces of globalization are seemingly unstoppable. For the first time in history over 85 percent of the world's population has been bound together in a global capitalist system through world-wide relaxation of governmental intervention into economic life; humanity seems to have no escape from accepting globalization as the only policy paradigm. Globalization is not a new phenomenon. Being a consequence of capitalist industrial technology, it has been an inevitable feature of western capitalism ever since the 1860s. What

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is new is the massive unleashing of its forces in the wake of the demise of communism.

Although globalization, or global integration, can be defined in a variety of ways, we can characterize globalization in terms of its most basic assertion. It is asserting upon the international economic system a tendency towards converging into an 'autonomized' global market 'free' from the governance of nation-states. The process of globalization not only leads to a state of exclusive empowerment of the market in governing trade and investment flows but also causes institutional harmonization with regard to trade policy, legal codes, public finances, ownership patterns, and other areas of regulations and governance. Most of the Third World countries have accepted this and launched a drive for global integration of their economies. Through undertaking the 'reforms' prescribed by the International Monetary Fund (IMF), the World Bank, and more importantly by the World Trade Organization, they hope to dissolve their economies into the global market place, thus bringing development and prosperity.

This article aims to highlight the perspective and philosophical-theoretical premise of liberal global integration and the basic flaws therein (Section I), and points out that such globalization is bound to generate financial and banking crises, fragmentation of national economies, and immiserization of the world's poor (Section II). In the light of these implications and challenges, the role of Islamic economics, both in promoting Islamic integration and in responding to challenges of contemporary globalization, is discussed in Section III.

Section 1

Assumptions of Global Integration

It is often said that we are living in a global village.[1] The term 'globalization,' heard so often, reminds us that no country in this modern world can survive as an isolated island. Globalization, or global 'integration,' may be defined as a globally integrated system of knowledge, production, exchange, and governance that is fundamentally different from the one obtained under 'international integration.' Under international integration, the nation-states serve as principal entities and actors in the process of integration. Still, nations become more and more interdependent through increasing trade and investment flows. Compared to international integration, global integration is a stage higher. Under this stage of integration the 'international market' tends to become autonomous and socially disembed-

ded as the transnational corporations increasingly liberate themselves from national constraints and design their production and marketing strategies in view of economic locations spread throughout the globe. Global integration is centered on the global market wherein ethnic, lingual, cultural or geographical, and territorial frontiers are rendered obsolete. This is not a system of markets defined within and under the territorial jurisdiction of states; rather, it is an autonomous or self-governing market system defined in a borderless world and accepting political jurisdiction of, or accountability to, no state.

Globalization, or global integration, defined and understood in whatever manner, is generally considered to have originated from such political factors as the expansion of western powers to Africa and Asia throughout the nineteenth and early twentieth centuries. It was also helped by breakthrough inventions and explosive expansion in the technology of transport and communication. But, although these are major contributory factors, they are definitely not at the root of the contemporary process of globalization.

Globalization's true implications cannot be understood through the lenses of technology or political history. Rather the most relevant factors which decisively determine the implications of global integration the for socioeconomic problems of the Third World countries are the ideological roots of globalization and the typical edifice of global integration. In the first instance it can be said that the origin of globalization lies in the expansionary nature of the capitalist system, more specifically the capitalist market. A "continuous and unhindered expansion of the market" is a necessary condition without which the capitalist economic system cannot survive.

Thus the expansionist characteristic of the capitalist market can be singled out as the fountainhead of globalization. The expansion of the market and global integration are inseparable. Both Liberals and Marxists foresaw the emergence of 'one world' as a result of the spread of global commerce, or the emergence of a 'great republic of world commerce' in which "national boundaries would cease to have any great economic importance and the web of trade would bind all the people of the world in the prosperity of peace."[2]

The expansionary nature of the market is explained by such classical economic logic: "in proportion as the market is extended the people of every country are enabled to make the best division of their labor and the most advantageous use of their exertions."[3] This classical logic implicitly

asserts that the growth and development of national economies is essentially dependent on the expansion of the market. This relationship was later established emphatically through the development of the law of 'comparative advantage.' Most of the assertions that global integration promises development of nations are based on the understanding of this principle.

But the socioeconomic implications of globalization cannot be understood merely through the process of market expansion. More important than the process itself is the 'control' of the process. Hence it is essential to identify the force and spirit that control the process of market expansion. As the history of capitalism suggests, the instrument of market expansion has been the business firm which, ever since the Industrial Revolution, has expanded "from the workshop to the factory to the national corporation to the multidivisional corporation and now to the multinational corporation." It is through this process of self-expansion that the business firms have demolished the economic significance of the political boundaries of nations.[4] Expansion of the business firm is a crucial factor in identifying control over the process of global integration. Since the Industrial Revolution, the business firm has been shaped by a very special kind of entrepreneurial spirit. Without understanding that spirit, the expansionist nature of the business firm and the market is unimaginable, and globalization is inconceivable. Hence for a comprehensive understanding of the process of globalization, the classical economic logic of market expansion must be combined with Max Weber's sociological explanation. The expansion of the business firm and the market is largely attributable to special kinds of entrepreneurs and capitalists who were never found before the Industrial Revolution. Using Max Weber, the 'uniqueness' of these capitalists lay in their immoral greed, which was generated and sustained by the Protestant Ethic that called upon the capitalists to devote themselves to the drive for acquisition, the constant accumulation of capital, and the continuous reproduction of social capital.[5] Given the greed-driven expansion of the business firm and the resulting interconnectedness of the world economy, globalization can be described as a process that is intrinsically fueled by greed, rather than by any global political campaign, conscience or consensus, and is primarily moved and controlled by transnational corporations.

The philosophical-theoretical premise of contemporary globalization rests on the philosophy of liberalism. Apparently, this premise seems to be different from the one advanced by capitalists or corporations. But this

premise could not sustain itself without the force of greed. Historically, the capitalists' demand for internationalization emanated from their own self interest; it lacked a moral basis for making it an agenda to be shared by humanity. The liberal philosophy retrospectively provided an ethical basis to capitalist-led internationalization, and subsequently to TNC-led globalization, by formulating its two main principles, namely, the doctrine of utilitarianism, and the principle of comparative advantage.

The utilitarian doctrine, by serving as the most comprehensive representative of the philosophy of liberalism and as its source of moral principles asserted that "pain and pleasure are the only sovereign to govern mankind," implying that, first, all motivation is self-interested in which one can act only to promote one's own happiness; and second, the only relevant factor in deciding whether any action or practice is morally right or wrong is its overall consequences, viewed impersonally. That is, the standard of right and wrong is relative to the utilitarian effect of an action in terms of its contribution to, or taxing of, pleasure. Hence maximization of pleasure and minimization of pain should be the only objective of man and society. The purpose of government or the state can only be to secure general happiness. Acknowledging the cosmopolitan nature of man, utilitarianism asserts that the citizen of a nation is also a citizen of the world whose basic duty is to the good of mankind in general; hence, the goal of private and public activities need only be "the most extended welfare of all the nations on the earth."[6]

The principle of comparative advantage explains that the goal of maximum national and global growth can be accomplished only if division of labor is carried out internationally. Presented by the classical economists such as Adam Smith, David Ricardo, and John Stuart Mill, and refined by Eli Heckscher and Bertil Ohlin, the principle suggests that a country should specialize in the production and export of goods for which domestic opportunity costs are lower than those prevailing in foreign countries, and should import those goods for which domestic opportunity costs exceed those prevailing in foreign countries. This specialization of production should be carried to the point where domestic opportunity costs become equal to those in foreign countries.

The theory further explains that goods of lower domestic opportunity costs are those whose production requires intensive use of her abundant and relatively cheaper factors, and goods of higher domestic opportunity costs are the ones whose production requires intensive use of her scarce and rel-

atively expensive factors. Thus the domestic opportunity costs, and hence, commodities of specialization, tend to be determined by the relative factor endowments such as labor abundance or capital abundance.[7]

The theory also explains that such an international division of labor and specialization of production will lead to 'increased efficiency' in two ways: by optimization of trade and by maximization of production. The theory of comparative advantage helps explain how efficient division of labor and factor-endowments based on specialization through international trade yields an increase in the combined output and in individual consumption of the countries involved.

Thus, the doctrine of utilitarianism and the principle of comparative advantage serve as the bedrock of the liberal premise of global integration, and provide the ethical-moral foundation for the process of global integration. Considering international division of labor as the exclusive instrument of generating worldwide prosperity, it then becomes a necessary moral obligation for nations to broaden the scope and size of the global market by opening themselves up to foreign goods and capital.

The Basic Flaws in Liberal Premise

Hedonism and Injustice

The philosophical-theoretical foundation of globalization, though it apparently does not seem to be irrational, is in fact a very weak and conflict-producing foundation for the integration of humanity on a global level.

First of all, it is wrong to assume that the objective maximization of pleasure is exclusively dependent on the maximization of wealth. Thus the doctrine of utilitarianism is a very narrow basis for defining the collective behavior of over 5 billion human beings spread over the vastness of this planet, subscribing to different cultures, traditions, faiths and philosophies of life. No one can deny the fact that the goal of maximization of wealth does have a trade-off with other factors that contribute to general happiness. A logic that does not recognize man's nature in its totality and comprehensiveness cannot ensure maximization of general happiness. Therefore, mere expansion of the market or unfettered integration of the national market into the global market may not lead to increased general happiness or welfare. Even if the distinction between general happiness and wealth is ignored, we confront theoretical and empirical arguments that suggest that expansion of the market through liberalization of an underdeveloped country (and her technical progress in the labor-intensive good industry) may

even lead her to immiserization.[8] As such, utilitarianism fails to generate an adequate logic for the dissolution of the political boundaries of nations.

The weakness and contradictory nature of the doctrine of utilitarianism is even more visible when focus is shifted from the 'rational' side to the 'operational' side of global integration. Sidwick called the utilitarian doctrine that asserts that moral principles are the deliverance of reason, that is, we pursue general happiness because it is the rational thing to do, the Principle of Rational Benevolence.[9] This, however, may not always be compatible with one's rational act of pursuing self-interest. Why should a transnational corporation sacrifice for consumers while no authority is assumed to exist for granting a reward? When we look at the transnational corporations—the actual 'movers' of globalization—this rationale is nowhere observed in their behavior. Rather, they are governed by greed, as has been discussed earlier.

Moreover, the law of comparative advantage—upon which liberal integration is structured—is itself faulty. This principle inherently approves only a vertical edifice of integration wherein great imbalances in production structure and a highly skewed scope of technological advancement are promoted, as among the integrating economies. The theory argues that capital-abundant countries (capitalist countries) should specialize in products that require intensive use of capital and high-grade technology. On the other hand, labor abundant countries (the poor countries) ought to specialize in products like food, raw materials, and minerals that require intensive use of labor. Such division of international labor, which discriminates against labor-abundant nations in the distribution of high value-added products, destinies labor-abundant countries to permanent poverty and underdevelopment. The vast majority of Third World countries have ended up with production structures wherein exports of primary commodities contribute to over three-quarters of their total export earnings, while industrial development is hampered and the benefits of economies of scale and technological progress remain forbidden.

Evidently, the philosophical-theoretical premise of liberal global integration is ignorant of the value of justice. The liberal capitalist wisdom offers no model of international trade wherein the issue of a just distribution of gains is incorporated. Liberal theoreticians recognize that distribution of incomes and gains resulting from market expansion are inherently unjust and that the countries that had more wealth to begin with gain disproportionately. A powerful argument is contained in the Singer-Prebisch hypoth-

esis, and supported by the widely observed secular decline of the trade of underdeveloped countries.[10] Even worse, they refuse to consider this an issue of importance on the basis that liberal integration makes the countries move toward Pareto-optimality (which supposedly has not yet been attained) and therefore, an integration guided by the principle of 'efficiency,' which will cause all nations to gain though some nations could gain more than others.[11] This blatant disregard for equitable distribution conflicts with human nature and is very difficult for disadvantaged nations to accommodated politically. On the other hand, advantaged nations find it politically irrational to make a 'sacrifice' out of disproportionate gains arising from market expansion. This situation naturally warrants that the disadvantaged nations do not remain dependent upon market expansion alone in their pursuit of the maximization of economic welfare. State-led industrialization has therefore been the option followed by most Third World countries until the late 1980s.

Hegemony and Vertical Integration

Confrontational dynamics between nationalism and internationalism do not allow globalization to proceed smoothly or remain stable. Hence, imposing a hegemon that exerts coercive power is considered necessary to ensure the stability of a liberal global order. The liberals, neomercantilists, realists, and neomarxists commonly agree that hegemony has played a historical role in producing and stabilizing liberal international economic orders, and that the decline of hegemonic power leads to disintegration of the global order.

> History indicates that the viability of an international economic order presupposes the presence of a leader nation powerful enough to impose a common code of conduct upon other nations. In the absence of such a hegemon the system is destined to disintegrate as each nation attempts to practice its own rules, not necessarily consistent with those of others.[12]

Moreover, a liberal global economy in itself suffers from systemic instability. According to Charles Kindleberger, the hegemon is required to provide five public goods: counter-cyclical or at least stable long-term lending, policing a relatively stable system of exchange rates, ensuring coordination of macroeconomic policies, offering a market for distress goods, and being lender of last resort. The proximate cause of the Great Depression, according to him, was that the "international economic system [was] rendered

unstable by British inability and US unwillingness to assume responsibility for stabilizing."[13] Hegemonic leadership runs contrary to liberalism's own ideal of creating impersonal and automatic systemic governance, and has been a source of instability rather than stability for the rest of the world.

In the first instance, the very presence of a hegemon tends to put asymmetrical constraint on other states. The national achievements of an arbitrary or asymmetrical nature by the hegemon become more profound due to the influence of her structural dominance (such as a disproportionately high share of economic power, resources, and military might) that constrain other nations' potential actions with regard to their welfare and prosperity. Even if the hegemon does not engage deliberately in such exercises, the very size and weight of the hegemonic country substantially affects the conditions under which all other states and interests must operate just as the presence of a price-leader, oligopolist, or monopolist conditions the behavior of other firms. When systemic stability is made to hinge upon any individual nation, the autonomy of the remaining nations' policies definitely become conditioned to the economic policy environment created by the hegemon. Thus, because of this structural asymmetry, economic fluctuations in the US economy affect those of the rest of the world to a much greater extent than vice versa.[14]

Many more vulnerabilities emerge from the typical order of global integration. Just like its pre-World War British-centered version, the liberal integration currently in place has ended up in a integration edifice comprised of three layers: the apex is occupied by the US—a large developed country that was also a large net creditor until the end of 1970s and acts as hegemonic leader ; the second layer consists of several smaller, developed countries that are only marginally net creditors or perhaps even marginal net debtors and are the allies of the hegemon ; and the rest of this edifice is the bottom comprising of a large group of highly indebted, developing countries that mostly are primary product exporters.[15] This vertical structure owes its existence to the structural power of the hegemonic nation and to the business, financial, and research and development strategies of the transnational corporations. This structure directly affects the pattern of global wealth distribution through the flow of capital and technology.

Anarchic Global System

A hegemony-centered globalization is bound to create a systemic vacuum when some of the leadership functions are taken over by the empowered market itself. The transformation of the international monetary system from

the Bretton Woods era to the present is inseparable from the process of globalization. The international monetary system carved out at Bretton Woods worked on a dollar exchange standard with a fixed exchange rate wherein the United States assumed the function of providing international liquidity in the form of her national currency through incurring deficits in her balance of payments and their settlement in dollars. The Bretton Woods system, while making the expansion of international liquidity dependent upon the expansion of the short-term external liabilities of the United States, carried a dilemma:[16] a steady increase in her short-term external liabilities made her gold reserves inadequate to discharge the dollar-gold convertibility obligation; alternatively, a curtailment in her short-term liabilities tended to dry up the major source of international liquidity. The United States sought to resolve this dilemma first through such measures as the interest equalization tax in 1963, voluntary restrictions on bank lending to foreigners in 1965, and further mandatory restrictions on capital exports in 1968. But these measures greatly stimulated the massive growth of market-controlled 'stateless' liquidity in the form of offshore currency deposits (mainly Eurocurrency deposits). The ever-increasing global financial integration contributed to the enlargement of the offshore banking network wherein the stateless money could multiply many times through the deposit multiplication process. Compared to its $7 billion size in 1963, the Eurocurrency market stood at around $6 trillion by the early 1990s. Financial liberalization programs of the 1970s and the 1980s, mainly under the increased competitive pressures from the expanding Eurocurrency market, caused domestic financial markets to become less segmented while the major financial centers became more integrated. This structural transformation of finance left the U.S. a totally incapable lender of last resort. Thus the process of globalization now proceeds without a systemic stabilizer—without any crisis management capacity. On the other hand, gigantic amounts of stateless international liquidity can flow to any extent unexpectedly into or out of countries due to the integration of domestic financial and banking sectors with the global market, and floating exchange rate regimes. Obviously, liberal globalization ends up in a system that is purely anarchic, wherein the emergence of financial/banking crises becomes a norm rather than an exception.

Supremacy of the Global Market over the Nation-State

The most crucial flaw of taking global integration as a focal point is that it empowers the global market and ends the sovereignty of the nation-state.

While international integration resulting from increased trade and investment flows caused erosion in the national sovereignty of states, yet the nation-state stayed as the principal actor within an interstate system governed by liberal international institutions and regimes. Contrary to international integration, global integration demands that the nation-state cease altogether as a unit of political governance, to become subservient and yield its citizens to the governance of the global market. As the transnational corporations become free to design their production and marketing strategies only in view of economic locations spread throughout the globe, the global market becomes socially 'disembedded' and autonomized, accepting political jurisdiction of, or accountability to, no state. Thus the nation-state is led to extinction.[17]

The liberal global regimes specially designed after the fall of communism, such as the Uruguay Round accord of the GATT and subsequently the World Trade Organization (WTO), leave very little authority for states to govern their economies. These liberal global regimes force the state to forfeit its sovereign right to use a range of policy options intended to diversify its economy and build its domestic industrial base; capital control that could protect its economies from speculative and destabilizing movements of foreign capital; and restrictions on and screening of foreign investment that could protect it from unacceptable social and environmental impacts.[18]

Section 2: Major Implications and Challenges for the Third World and Islamic Countries

Financial and Banking Crises

If globalization is allowed to proceed with these flaws, then the Third World and Islamic countries are most likely to find economic security and territorial integrity to be their main concerns. They will face a definite trade-off between these concerns and the concern for development. Because the process of globalization will subject these economies to recurring financial crises and ever-increasing regional and sectoral imbalances in domestic growth, these states, with drastically reduced policy autonomy, will find it too difficult to escape the threat of internal violence, resulting in either an increased spending on internal security or the fragmentation of the state itself.

Highly motivated for fast development, Third World countries have always sought foreign capital. But a high prospect of financial crises

remains associated with the inflow of foreign capital due mainly to the structural power of the hegemonic nation—the United States—and globally integrated financial capital. At least two-thirds of IMF member countries have experienced significant banking crises, which have been far more severe for developing countries, over the 1980–96 period.[19] It is easy to see that the main villain behind the Developing Countries' (DVCs) financial/banking crises of the 1980s and 1990s is the structural power of the U.S. and the globalized financial market. The economic policies of Reagan era led to massive budget deficits causing interest rates to soar upward, not only in the U.S. but worldwide. Apart from aggravating the debt-servicing problems of developing nations, high interest rates depressed world investment, while simultaneously the U.S. attracted a vast inflow of capital. While the rest of the world went into recession in the 1980s, the US economy continued to flourish. Though it was claimed that Reagonomics was promoted in response to the high inflation rate in the U.S., there is evidence to suggest that its purpose was also to project America's structural economic power and set the conditions for its economic relations with other states.[20]

More recently, the origin of the worst economic crises facing East Asian economies can be traced again to the domestic economy of the U.S. It can be suggested that the artificially low US Fed prime rate of 3 percent during the 1992-93 period, causing interest rates in the East Asian economies to fall as low as 6 percent due to their currencies remaining effectively pegged with the US dollar, caused a massive flood of capital and credit expansion that central banks were unable to sterilize, and subsequently fueled an economic growth that could not be sustained without the continuous inflow of funds at a similar rate.

The role of the globalized financial market in the context of these crises is even more significant. A stateless, and socially disembedded financial structure, acquiring tremendous power from financial innovation and conglomeration, may undoubtedly mobilize global savings in gigantic amounts, yet it cannot allocate them efficiently on a global scale or according to the genuine needs of a national economy. Large scale use of new instruments of credit-creation and risk-transferring has drastically altered the technique of financing and consequently has made the debt structure highly vulnerable. Large scale replacement of bank credits and syndicated loans, which were not tradable, by securities and bonds which are treated as tradable assets, enables a debt pyramid to assume an unimaginable

height and international stretch without a solid foundation. Moreover, such hedging instruments as financial options, financial futures, and interest rate and currency swaps permit various risks to be unbundled, separately priced, and sold to new portfolios willing to assume risks. This encourages investors to acquire additional risks. Equipped with these innovative instruments, the globalized financial market is well empowered to lead the inflow of financial capital in any country to a level much more than what could be absorbed by the domestic economy in the short- or medium-term, thereby build up a growth bubble that grows with currency and stock prices' appreciation but bursts when the worsening of the trade balance and the current account reaches a critical level, causing capital flow to reverse and currency and stock prices to nose-dive.

The gross misallocation of money capital by the globalized financial market mostly remains unchecked because the innovative instruments have greatly reduced transparency of financial institutions. As such, the market lacks any mechanism to foresee an impending crisis, and the government regulatory agencies are not in a position to know what misadventures might be going on in the various sectors of the economy. Ironically, even if a national government could know of an impending crisis, its capacity to undertake preemptive measures or to manage the crisis through a fiscal-monetary mix remains highly impaired in the face of the structural power of the globalized financial market.

Greater capital market integration helps countries in the short run to finance fiscal and current account deficits with greater ease. But such financing also causes delays in adjustments to underlying structural imbalances in fiscal and current accounts, making way for a financial crisis. In the aftermath of a financial crisis, when the economy has already gone into recession, the use of an expansionary fiscal policy becomes hazardous since it could further aggravate the depreciation of local currency.

Even far greater damage has been inflicted upon monetary policy by the structural changes in the global financial market. Innovative financial instruments have led to confusion in terms and definitions of various monetary aggregates, and the control of these aggregates by means of traditional monetary tools has become more difficult. While the use of variable interest rate instruments and interest rate hedging techniques tends to force monetary authorities to resort to greater changes in interest rates to ensure the same overall impact on the economy, the domestic borrowers' easy access to foreign financial markets, due to removal or relaxation of capital

controls, makes the desired impact upon the economy unachievable even by means of higher interest rates.

Fragmentation

Liberal global integration poses yet another threat that is just as important as the periodic economic destruction caused by financial crises. This is the threat of social and political fragmentation facing many large and medium-sized developing nations such as India, Pakistan, China, and Indonesia. A rapid development fueled by foreign investment will, by its nature, concentrate only in certain sectors and regions. If the national economy is not small like Singapore or Hong Kong, certain sectors/regions can face a relative backwardness or even destruction accompanying a rapid development in other sectors or regions. Latin American countries such as Brazil and Mexico witnessed this dual process: Exclusion and marginalization of large parts of the rural economy in the 1960s and 70s led to a relative decline in income of the peasantry, prompting them to migrate to urban areas, producing an underemployed class of slum-dwellers who help to hold down urban incomes and retard growth in all but the most advanced sectors.

In the case of China, an economic growth averaging 9 percent in the 1980s has led to wide differences in per capita income. While people in Shanghai earn an average of 6675 Yuan, an average person in Guizhou receives only 890 Yuan per year.[21] The ever-growing income and wealth disparities essentially weaken the social fabric and nationalistic loyalties, creating a high potential for political turmoil and fragmentation. The threat of fragmentation may become real in the aftermath of a financial crisis. The segments of the population that are marginalized during the phase of expansion and partially supported by subsidies will be the victims of crisis and post-crisis reforms. A great number of these people will find themselves thrown into the jaws of poverty because of the sky-high cost of living, unemployment, and the great reduction in real wages. Indonesia presents the most glaring example of what the liberal globalization ultimately means for a medium-size developing nation. This largest Islamic nation is struggling very hard to defend its social fabric and territorial integrity in the aftermath of a recent financial crisis at home when looting, rioting, ethnic wars, demand for separation and autonomy in various parts have engaged the attention of the government, which is already under tremendous pressure from macroeconomic management issues.

Immiserization of the World's Poor

An equally challenging consequence of globalization is the increasing concentration of global wealth and 'immiserisation' of the world's poor. The past decades of the 1970s and 1980s can be characterized as the era of Third World assertiveness, an era of massive efforts were made to accelerate Third World growth. An economic miracle in East Asia and an expansion of petrodollar wealth in the Middle East, yielded growth rates that exceeded those achieved by upper layer countries. Yet despite of all these achievements, the third layer countries' share in world Gross Domestic Product continues to fall steadily (see table). The twenty upper layer countries, accounting for merely 14.23 percent of the world's population, received 66.23 percent of global Gross Domestic Product (GDP) in 1970. Their share increased to 67.44, and 68.95 in 1978 and 1985, respectively. By 1989 they had grasped 71.39 percent; and in 1995 they had seized 78.15 percent of the world's GDP.

Clearly, the trend in the distribution of world GDP is that the more developing nations integrate with the global economy, the less is their share in the incremental global wealth. Globalization is compelling the world's poor to work hard for the world's rich.

The immiserization effect of globalization is essentially associated with the emerging supremacy of the globalized market over the nation-state. While the market-generated vulnerabilities tend to increase the state's responsibilities, the power of the state in executing its multidimensional tasks related to the achievement of the economic, social, and cultural aspirations of her people has been drastically reduced.

Section 3: The Role of Islamic Economic Institutions

Contrary to its moral banner of "the greatest good for the greatest number," the liberal global integration—creating and reinforcing such characteristic features as a systemic vacuum in global governance, erosion of policy autonomy of states, accountability-free empowerment of global finance, and increasing concentration of global wealth—is perhaps the widest and most sophisticated superstructure ever built in mankind's history for the enslavement of humanity. Though it may seem, in view of the revolutionary changes in the institutional and technological spheres, that the forces of globalization are unstoppable, such an integration canot sustain itself in the long term. How can such a global system remain intact when over two-thirds of humanity is systematically made 'untouchable' and the limited

prosperity it generates remains increasingly concentrated among those who are already in the upper class? Ultimate emphasis on maximization of global GDP and absolute neglect of its equitable distribution, or even mass scale plundering of resources of the world's poor are concrete reasons for the collapse of contemporary global integration in the near future. Hence, the process of global integration needs an alternative paradigm or at least drastic reforms.

In this perspective the role of Islamic economics needs to be evaluated. The role of Islamic economics in globalization can be explored in two ways: first, in promoting global integration within the Islamic paradigm; and second, in presenting solutions to the problems arising within contemporary global integration.

Islamic Global Integration Paradigm and Islamic Economic Institutions

Islam is the religion of unity and integration of mankind on a global level; it negates any vertical or hierarchical order in any scheme of human organization. Allah says: "O mankind! We created you from a single (pair) of a male and female, and made you into nations and tribes, that ye may know each other (not that ye may despise each other)" (49:13). Hajj, the greatest annual convocation of Muslims, is perhaps the most direct and practical instrument for embedding a global perspective in the Muslim mind and behavior.

In Islam, the integrative process begins with the principle of the Oneness of God. Thus, *tawhīd* has tremendous relevance for the Islamic integrational paradigm.

> Say: He is God, the One and Only, God, the Eternal, Absolute: He begetteth not, nor is He begotten; and there is none like unto Him. (112:1–4)

The integrative process comes into operation through the acceptance of His sovereignty, and the submission to His will. "To Him belongs the dominion of the heavens and the earth: It is He who gives life and death; and He has power over all things" (57:2).

Belief in the Oneness of God and His sovereignty is instrumental in infusing coherence and cohesion in the integrational order of mankind. That all creation is by the One and Only God, means that there is no chance of contradiction, confusion, or disharmony in the system and subsystems, including the sociological and economic organizations of mankind, if they

are based on the acceptance of the sovereignty of God and accordingly fulfill the will of Allah.

Hence a just, benign, and humane integration of mankind is possible only if the purpose of integration is to fulfill Allah's will (*'ibadah*). Seemingly, in order to ensure a peaceful and prosperous life for the whole of mankind Allah declares *'ibadah* the sole objective of life. He says: "I have only created Jinns and men, that they may serve Me. No sustenance do I require of them, nor do I require that they should feed Me" (51:56–57). This suggests that a just, benign, and humane global integration of mankind is achievable if its foundation is based on *'ibadah* and not on defiance of Allah.

But *'ibadah* is impossible without divine guidance since *'ibadah* means submission to the will of Allah in all spheres of human activities, not just the performance of obligatory rituals. Human knowledge, being limited, cannot determine righteousness in all decisions and actions. Hence, ensuring the actualization of *'ibadah* remains impossible without the institution of prophethood. "Unto every one of you (mankind) have We appointed a law and a way of life" (5:48). Allah sent His messengers from time to time and to all communities. He sent the Prophet Muhammad (peace be upon him) as last messenger for all humankind until the Last Day: "We sent you not but as mercy for humanity" (21:107). The term 'ummaticization' and a humane integration of humankind becomes contextual with the allegiance to the Prophet Muhammad (peace be upon him).

The concept of the Ummah is central to understanding the Islamic paradigm of global integration since Islam intrinsically obligates the Ummah to address humankind as a whole, and polarizes it around the faith in the Oneness of God (*tawhīd*) and submission to His will (*'ibadah*). "You are the best of peoples, evolved for mankind, enjoining what is right, forbidding what is wrong, and believing in God" (3:110). Ummaticization is a process of human transformation whereby a community forms, expands, and is continuously reinforced with three fundamental characteristics: total submission to the sovereignty of Allah, total allegiance to the Prophet Muhammad (peace be upon him), and the guidance of personal and societal affairs according to the Qur'an and the Sunnah. The term also implies determination of a common approach to, and a common destiny for, this community of people irrespective of their geographical dispersion, ethnicity, or economic differentials. Hence, global integration of humankind and ummaticization must go hand in hand; the two process are inseparable in the Islamic paradigm of global integration.

Ummaticization-led global integration of humankind is never infected with any kind of coercion which remains an inevitable force in liberal integration. The Islamic integrational process is for the highest objective and, accordingly, is conducted in the most humane way. Allah says: "Let there be no compulsion in religion: Truth stands out clear from error" (2:256); and "If it had been your Lord's will, all those on earth would have believed; will you then compel mankind, against its will, to believe?"(10:99) Those who do not want to join the global Ummah are not to be forced. The Ummah is not allowed to expand by forcing nonbelievers to believe, by forcing its beliefs and way of life on others, or by violating the beliefs and life styles of non-Muslims. The Ummah, however, is obligated to demand from them only a minimum which is in the interests of both parties. That minimum demand is that all nonbelievers, as individuals or nations, must be at just peace with each other and the Ummah.

Another indispensable element in the Islamic paradigm of integration is the concept of 'vicegerency' (*khilafah*): "It is He who hath made you (His) vicegerents, inheritors of the earth: He hath raised you in ranks, some above others: that He may try you in the gifts He hath given you: for thy Lord is quick in punishment: yet He is indeed Oft-Forgiving, Most Merciful" (6:165). The basis of global integration in Islam is the human factor, not any material factor, hence an accountability-loaded empowerment of man is a fundamental characteristic of the Islamic integrational paradigm. The human being is not distinguished for being a petty consumer or voter; rather, he/she is addressed in his/her totality and is required to be responsible as vicegerent of Allah.

The Islamic paradigm of global integration is entirely different from that of liberal capitalism. While the liberal process of globlization proceeds with the expansion of business firms and markets in order to realize the mission of capitalists, the Islamic process of global integration proceeds with integrating human beings in terms of their totality of existence—in terms of their status as vicegerents of Allah—in order to realize the mission of *khilafah*. Hence, the Islamic global integration process integrates the responsible, accountable, God-fearing human beings, thus leading to the creation of a harmonious and just global civil society. It must be noted that both the liberal and the Islamic process of globalization are opposed to political borders that may hinder their respective integrational process. Unfortunately, the Ummah is fragmented and divided by over fifty political borders, now gradually weakening to give way to the liberal process of global integra-

tion, and yet remaining too strong, impeding the Islamic integrational process.

So far, Islamic economics has failed to re-initiate the process of Islamic integration. The state-system concept adopted in the constitution of the Organisation of Islamic Conference (OIC) and its program of Economic and Commercial Cooperation among Islamic countries may conform with liberal internationalism; they do not fit into the Islamic integrational paradigm which is essentially centered on human beings (believers) rather than on abstract entities (nation-states).

Islamic banking—relatively the most developed area in Islamic economics—could be of immense help in promoting the Islamic integrational process. The Islamic banking and financial infrastructure developed in the Islamic world and elsewhere, however, has grossly failed to direct itself toward building a population of genuinely Islamic entrepreneurs and trans-Islamic corporations that can be the prime movers of the Islamic integrational process, just as transnational corporations of transatlantic origin have been the movers of liberal integration. The future of Islamic economics in the 21st century cannot be insured unless it is able to create business, commercial, and nonprofit institutions at a grass-roots level. Islamic economics, as merely an academic exercise or as an operational system confined only to the public sector or intergovernmental framework, cannot survive for long. Just as Islamic banking has been the focal point in Islamic economics so far, the focal point of Islamic economics in the next century must be the institutional arrangements for creating a population of genuinely Islamic entrepreneurs and trans-Islamic corporations, who are charged with the mission of *khilafah* in following the footsteps of the Muslim-Arab traders of early Islamic era.

Also crucial is deepening the relationship between Islamic banks and industry to generate forces for Islamic integration. Islamic financial institutions all over the world have accumulated enormous amounts of surplus deposits while waiting for adequate and Islamic opportunities of investment. At the same time small- and medium-size Muslim entrepreneurs are desperately looking for finance to establish their business enterprises or to further expand and diversify. Many such enterprises contribute to trans-Islamic trade investment and technology flows. Islamic economics needs to declare that such negligence in handling the financial resources of the Muslim Ummah is a criminal negligence. The Ummah can no longer afford a financial mobilization system that ignores its own economic transforma-

tion, technological advancement, and employment generation and integration. In addition to focusing on the principles of the Shari'ah, Islamic financial leadership is obligated to focus on the fulfillment of the *maqasid* of the Shari'ah (the goals of the Shari'ah).

Contemporary globalization and Islamic Economic Institutions

The role of Islamic economics in dealing with the problems arising within contemporary globalization is equally important. The concept of money, capital, financial intermediation, market, and state in Islamic economics can be used to develop an alternative structure for the global financial and monetary system and the system of governance. But before discussing the role and contribution of Islamic economics, a basic question must be asked: Does Islamic economics approve of liberal global integration?

Given the most basic assertion of contemporary globalization, namely, the embodiment of governance and power in the global market and the subordination of national sovereignty, the most fundamental question confronting Islamic economics is whether supremacy of an autonomized global market over the state (*shura:* literally, mutual consultation) is acceptable Islamically?

Clearly, liberal globalization—with its inevitable and logical climax in the form of a globalized market that is absolutely liberated from the territorial jurisdiction of state and works as a 'sovereign' or autonomized institution—cannot be acceptable in Islam. An unfettered empowerment of the market at the expense of the power of *shura* seems to carry absolutely no legitimacy in the Shari'ah. Further, if such globalization enables self-interested projects and processes either to seize the Ummah's power of self-determination or to cause a the fragmentation of Islamic people in any sense.

Man is not defined merely as a petty consumer or voter; rather, he is defined as the vicegerent of Allah! Therefore, there must exist a human organization that is based on the totality of the human personality with the purpose of ensuring human accountability to Allah through the Shari'ah and *shura*. It must be supreme over all those human organizations that are based on any partial aspect of the human personality or activity, such as the market. In Islam, the state's supremacy lies in the fact that believers are ordained to run their affairs through consultation: ". . . who (conduct) their affairs by mutual consulation . . ." (42:38) and the fact that the state is the most comprehensive instrument of *shura*. Out of this supremacy the Islamic state institutionalized observation and regulation of market behav-

ior through the instrument of the *hisba*.[22] Hence the Islamic state rather than the market is the empowered institution in Islam. Its concept, purpose, and power is important to understand the process of ummaticization and reason for the interaction of the Ummah with nonummatic projects and processes. Though the territorial boundaries of an Islamic state may not necessarily coincide with those of the Ummah, the Islamic State is an indispensable tool for maintaining, developing, and defending a Shari'ah-driven legal environment and coordinating the activities of the Ummah directed towards *falah,* elevation, and protection against self-degeneration or external threats.

However, the Shari'ah does approve international economic interaction between the Ummah and the rest of the world's nations both bilaterally and multilaterally, provided that the bilateral and multilateral regimes and institutions do not contradict the *ijma'* (concensus) of the Ummah, and conform to Islamic ethical norms "as the Shari'ah does not have separate ethical norms for dealing with aliens, and Muslims are bound by the same rules of conduct irrespective of the beliefs of those they are dealing with."[23]

While Islamic economics seems to reject contemporary globalization, we still need to explore its role because the Ummah has no control over the liberal process and is only on the receiving end.

The recurrence of financial and banking crises—the most devastating consequence of globalization—can be minimalized if the global financial structure is rebuilt according to Islamic norms and values. Liberal globalization has assured financial capital preference over other factors of production. While land and labor's participation in production organization is contractual, and enterprise is centrally involved in taking risk throughout a business venture, the financial capital is not contractually bound to keep itself within the company. It can join or leave virtually any time through the channel of the stock market and currency market. This nonsensical fluidity of financial capital greatly contributes to speculative activities and is the greatest source of uncertainty for the real sector. While a worldwide unfettered convertibility and movement of capital is not objectionable, nonsensical fluidity must not be granted to financial capital. How should Islamic economists respond to this challenge?

First, given the immense structural power of globalized finance, the crises-exporting capacity of the U.S. and other trading block economies, and the drastically reduced effectiveness of domestic fiscal-monetary policy options of the developing countries, it seems that Islamic economists

should emphasize the use of direct controls including capital controls. Second, Islamic banking and financial institutions, by virtue of being based on the profit-loss sharing principle, and with adherence to Islamic principles of *mu'amalat,* could be instrumental in repelling speculative financial flows and ensuring a stable relationship between financial and real sectors of the economy, provided that Islamic banking is properly interlinked with the production sector and is practiced on a wide enough scale in Islamic countries.

To avoid a financial crisis that is caused by foreign exchange crises, foreign investment inflows must be directed appropriately to export-generating sectors of the economy, thereby meeting the foreign exchange demand arising from redemption of foreign investors' incomes or assets. Islamic banking and financial institutions can contribute to this task only when they participate in export sector investments. Most of the Islamic banks are confined to mark-up financing and trade financing types of activities, and hence, remain irrelevant to helping in such financial crises.

Moreover, Islamic banking is far from being practiced on a wide scale. In fact, in this era of financial globalization, Islamic banks themselves stand exposed to threats. Islamic banks and financial institutions, mostly with high costs of operations due to small size, will face very tough competition from their rival multinational conventional banks when Islamic countries liberalize the financial services sector in compliance with WTO rules. The relative incompetitiveness of Islamic banks and financial institutions might cause a switch-over of non-Muslim depositors away from Islamic banks to interest-based banks and might also dilute the commitment of Muslim depositors.

Another serious implication of globalization is the vacuum in the social security system. Empowering market over state means abolishing a whole host of government programs and government interventions in the market, including agricultural price supports, rent controls, minimum wages, and the elimination of the government's role in areas such as social security. The poor masses in Islamic countries, including the peasants and the self-employed in the informal sector, will face great hardship because of market forces while the state remains helpless. Islamic economists need to pay attention to ways and means of filling up the social security vacuum. To achieve this, Islamic economists will have to revitalize the institution of *waqf* (public endowment) on local as well as on trans-Islamic levels. Given the devastating consequences of recurring financial crises, specially in view

of the situation in Indonesia, when a crushing social cost of macroeconomic adjustment falls mostly upon the poor, and also in view of dangerously increasing sectoral and regional disparities that weaken the social fabric, the revitalization of the *waqf* institution deserves to be made an essential ingredient of Islamic response to globalization as an instrument of enhancing both social security and sectoral and regional cohesion.

1st and 2nd Layer Countries' Shares in Global GDP

Countries	Gross Domestic Product at Current US Dollar (in millions) Using Market Exchange Rate (MER)				
	1970	1978	1985	1989	1995
United States	1009220	2218910	3946600	5132001	6952020
Switzerland	20733	84829	92690	181125	300508
Norway	11183	40649	57910	90954	145954
Canada	84734	209974	346030	538245	568928
Sweden	33493	91819	100250	191298	228679
Japan	203736	971322	1327900	2834232	5108540
Denmark	15817	56460	57840	104845	17220
Germany FDR	184508	639781	624970	1176632	2415764
Finland	10891	34825	54030	115219	125432
Australia	39324	123593	162490	283765	348782
France	142873	483623	510320	955175	1536089
Netherlands	33475	137250	124970	225895	395900
Austria	14457	58004	66050	126775	233427
United Kingdom	123758	321958	454300	845350	1105822
Belgium	25075	95033	79080	152992	269081
New Zealand	6297	17487	22140	40069	57070
Italy	107485	298749	358670	865826	1086932
Ireland	3885	12969	18430	34170	60780
Spain	37489	146743	164250	375102	558617
Israel	5714	15543	20270	46428	91965
Group's Total Gross Domestic Product	2114147	6059521	8589190	14316098	21762510
World's Gross Domestic Product	3182000	8985000	12455496	20052000	27846241
1st and 2nd Layer Countries					
(a) Total GDP as % of World GDP	66.23	67.44	68.95	71.39	78.15
(b) Share in World Population	–	–	–	–	14.23
(c) Share of the Third Layer Countries in World GDP	33.77	32.56	31.05	28.61	21.85

Source: World Bank, *World Development Report, 1987, 1997;* and United Nations, *Trends in International Distribution of Gross World Product, 1993*

Notes

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4. See Stephen Hymer, The Multinational Corporation and the Law of Uneven Development, in J.N.Bhagwati (Ed) Economics of World Order New York, World Law Fund, 1970.

5. SeeMaxWeber, The Protestant Ethics and the Spirit of Capitalism translated by Talcott Parson in 1930, New York, Charles Scribner's Sons, 1958.

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12. Robert Ozaki and Walter Arnold, *Japan's Foreign Relations*, (Boulder: Westview Press, 1985), 6.

13. Charles Kindleberger, *The World in Depression 1929–39* (Berkley: University of California Press, 1986), 289.

14. Ibid.

15. Herman Shwartz, "Hegemony, International Debt, and International Economic Instability," in *Perspectives and Issues in International Political Economy*, ed. Chronis Polychroniou (London: Praeger, 1992), 215–34.

16. See Robert Triffin, *Gold and the Dollar Crisis* (New Haven: Yale University Press, 1964).

17. See Kenichi Ohmae, *The End of the Nation State: The Rise of Regional Economies* (London: Harper Collins Publishers, 1996).

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19. Morris Goldstein and Philip Turner, "Banking Crises in Emerging Economies: Origins and Policy Options," *BIS Economic Papers* 46 (October 1996): 5.

20. H. Nau, "Where Reagonomics Works," *Foreign Policy* 57 (1984–85): 22–3.

21. See *China Statistical Yearbook 1993*. These figures are also quoted in Paul Hirst and Grahame Thompson, *Globalization in Question* (Cambridge: Polity Press, 1960), 107.

22. *Hisba* is an Arabic word which means social accountability of market forces—Editor's note.

23. M.N. Siddiqui, "Principles of International Economic Relations in Islam," in *International Economic Relations from Islamic Perspective*, eds. M. A. Mannan, Monzer Kahf, and Ausaf Ahmad (Jeddah: Islamic Development Bank, 1992), 16. The paper provides a comprehensive list of issues related to international economic interaction between the Ummah and the rest of the world's nations, and a preliminary discussion on the Islamic position on these issues.