Market from Islamic Perspectives

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What is market?

- Market, according to Al-Ghazali, evolve due to natural forces, as part of the natural order of things - as such it is an expression of self-motivated human desires to voluntarily satisfy mutual economic needs (Ghazanfar and Islahi, 1997).
- Market – is an actual place where buyers and sellers could engage in face-to-face/online bargaining. A market should be thought off as a mechanism by which buyer, and sellers can determine prices and exchange goods and services.
- Market are constantly <u>solving the what, how and for whom</u>. As they balance all the forces operating on the economy, markets are finding an equilibrium of SUPPLY AND DEMAND.

- Market should be seen as a platform for honest and trustworthy transactions – this has been clearly stated in several verses of the Quran.
- In Islam, mutual consent is a necessary condition for acceptable transactions. Buyers and sellers must wilfully consider the interest of one another in their pursuit to achieve personal interest.
- Trading must also satisfy three interrelated conditions namely personal benefits, social benefits and fairness.
- Profit making is allowed but should reflect a compassionate and benevolent nature. Market operated with compassion and benevolence will have different results than the one driven by profit and self-satisfaction (Reda, 2013).
- A profit-driven trading encourages unhealthy competition, envy and enmity . Hence, in an Islamic setting, the ultimate goal in engaging in any transactions is to achieve the blessings of Allah and 'profit' in the herafter.

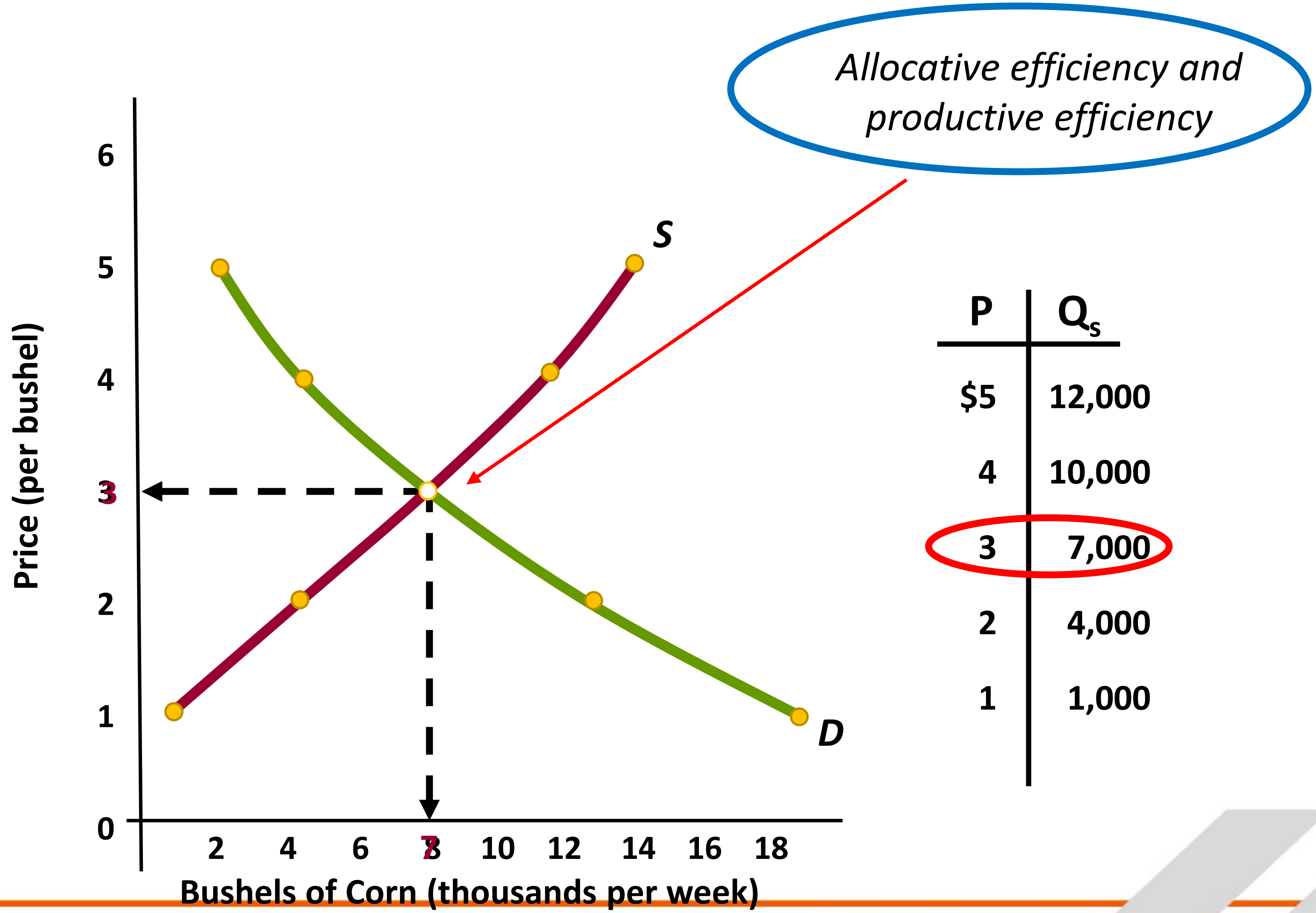
The role of price

- In a market that operates freely without any external interference – price plays an important role in coordinating the market mechanism.
- In Islam, freedom of trade and operation of market forces are highly encouraged and the market is allowed to set the prices.
- <u>Prices</u> – serve as signals to producers and consumers. If consumers want more of any good, the P↑ sending a signal to producers that more supply is needed. E.g. Bus service during *Eid*.
- If a commodity becomes over-stocked – dealers and producers will ↓ lower prices – to reduce their inventory – consumers will demand ↑ - Producers will ↓ supply – as a result, there will be a balance, or equilibrium between buyers & sellers will be restored.
- What is true of the markets for consumer goods is also true for factors of production, such as land, capital and labour

PRICES ARE THE BALANCE WHEEL IN THE MARKET MECHANISM.

Market Equilibrium (Demand = Supply)

P	Q_d
$5	2,000
4	4,000
3	7,000
2	11,000
1	16,000



P	Q_s
$5	12,000
4	10,000
3	7,000
2	4,000
1	1,000

Government's Intervention in the market – reasons and impact

Price Floor Creates Surplus

Objective: to assist producers

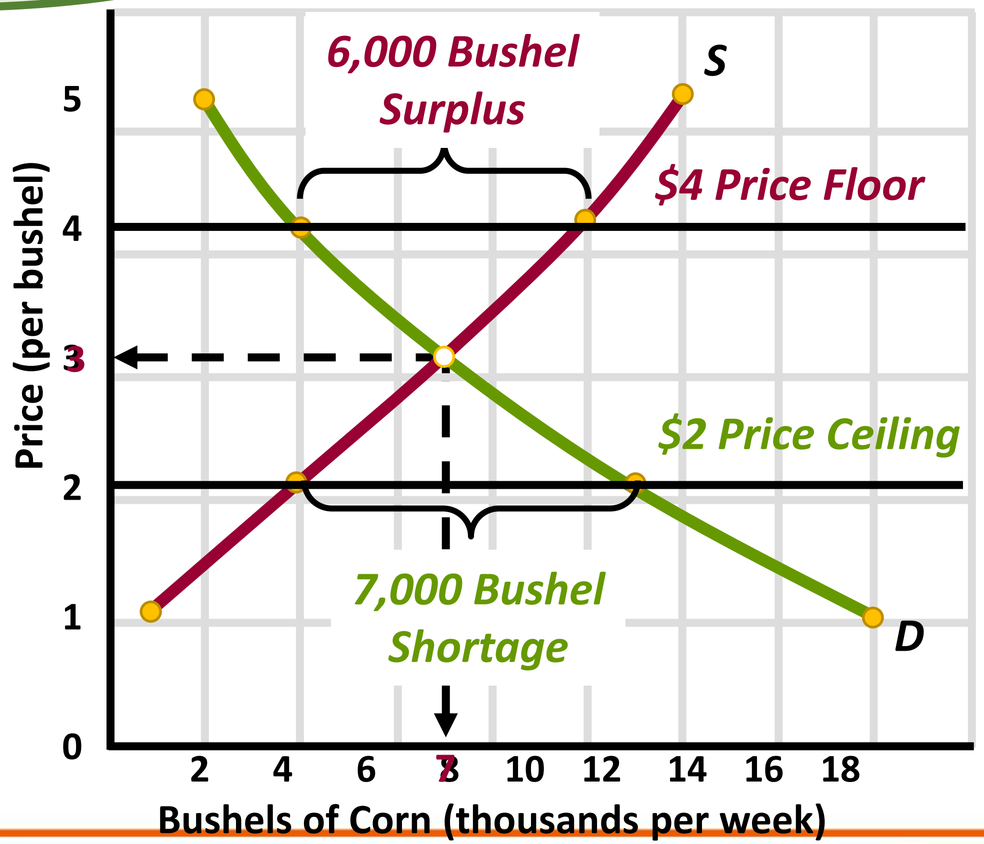
$Q_S > Q_D$

At price $4:

Q_S = 10,000 bushels

Q_D = 4,000 bushels

P	Q_d
$5	2,000
4	4,000
3	7,000
2	11,000
1	16,000



Objective: to assist consumers

Price Ceiling creates Shortages

P	Q_s
$5	12,000
4	10,000
3	7,000
2	4,000
1	1,000

$Q_D > Q_S$

At price $2:

Q_D = 11,000 bushels

Q_s = 4,000 bushels

Can prices be set in Islam?

- Prophet limited interference in the market – especially if the action could affect public interest
- When Prophet was asked to intervene in setting prices in the market – he said – “I will not set such precedence, let the people carry on their activities and benefit mutually” (Abubakr, 1999).
- Nevertheless, government’s intervention in the market is justified in exceptional cases – to protect public interest but must ensure just price.
- Fixation of price by merchants with the objective of making huge profit is prohibited – a few merchants met outside the city and purchased all agricultural products with the intention to sell in the market at high price – Prophet condemned this practice because it causes harm and hardship to the society.

Market Failure

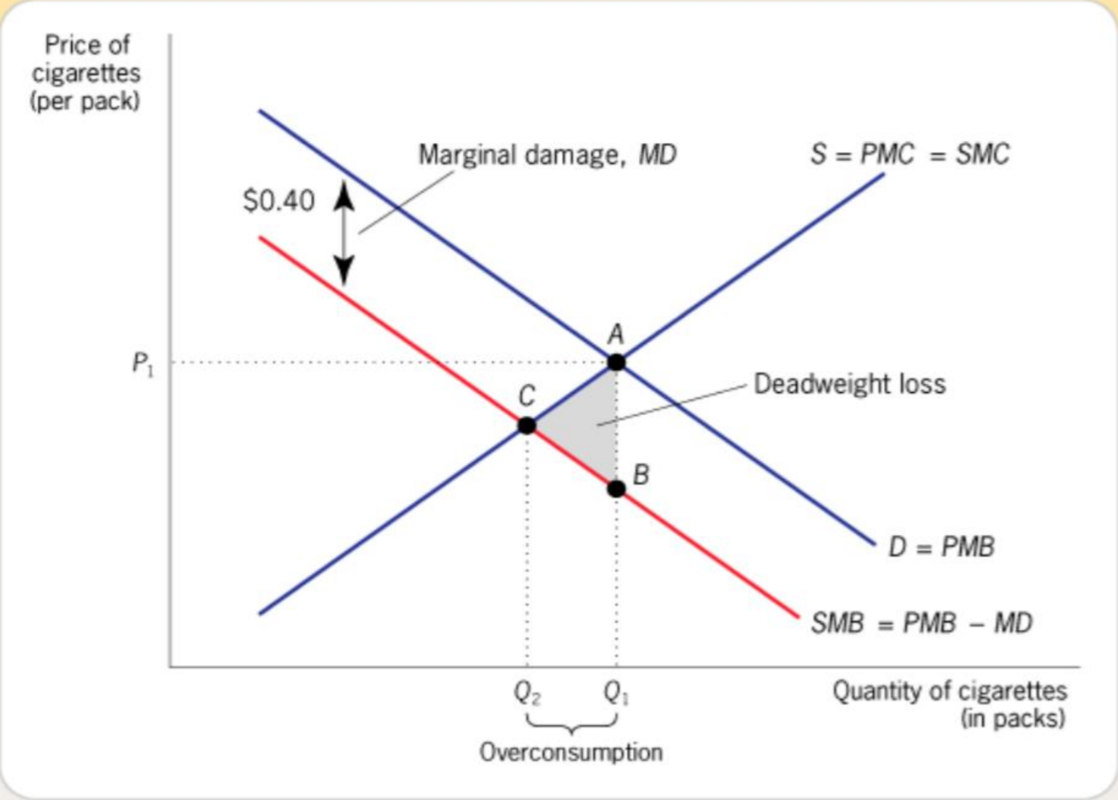
- Market fails when the transactions in the market causes harm or creates benefits to the third party.
- It is called as externalities - the benefits or costs of market activities are borne by some third party external to the market transaction - passed to someone other than the immediate buyer or seller.
- There are two types of externalities:
  - Positive externalities or spillover benefits – can be caused by either consumers or producers
  - Negative externalities or spillover costs – can be caused by consumers or producers
- In Islam – any market transaction that could harm a third party or the society is condemned - happens because of morality failure.
- If a product or service has positive externalities to the society – should be provided and made available – justifies government intervention or provision
- Islamic economic system emphasizes ethics and *amanah* in the utilization of resources and market actors must constantly contemplate the existence of Allah in all daily activities and be always conscious about the impact of their activities on others - public interest.

Positive and Negative Externalities – By Consumers

Negative Externalities – By Producers

Example of Negative Externality caused by consumer

Negative consumption externality: When an individual's consumption reduces the well-being of others who are not compensated by the individual.



Market Failure Due to Negative Consumption Externalities in the Cigarette Market • A negative consumption externality of 40¢ per pack of cigarettes consumed leads to a social marginal benefit that is below the private marginal benefit, and a social optimum quantity (Q_2) that is lower than the competitive market equilibrium quantity (Q_1). There is overconsumption $Q_1 - Q_2$, with an associated deadweight loss of area *ACB*.

https://eml.berkeley.edu/~saez/course131/externalities1_ch05.pdf

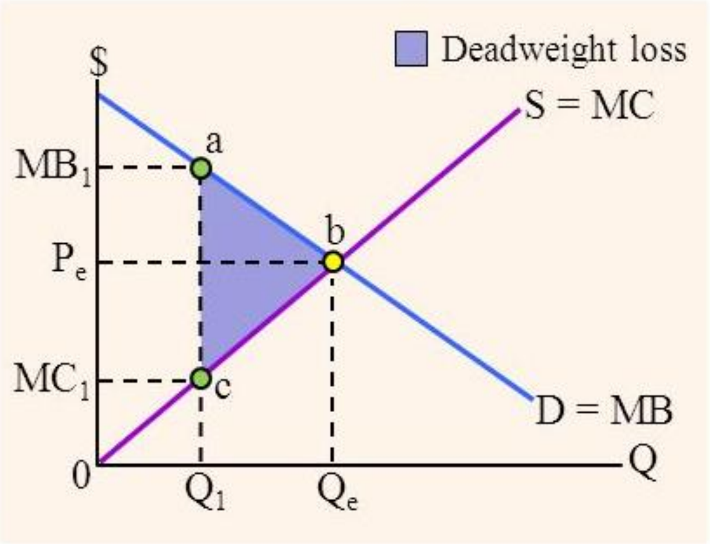
Example of Under-Production of Covid Vaccine due to intellectual property protection

When the output level is ***below*** the efficient level, there is ***underproduction***.

Suppose the output level is Q_1, which is below the efficient level Q_e.

For units from Q_1 to Q_e (except for Q_e), MB > MC.

A deadweight loss (Area abc) exists as some potential gains are not fully captured.



Market Failure – Impact on Allocation of Resources

PROBLEM	RESOURCE ALLOCATION OUTCOME
Negative externalities (spillover costs)	• Overproduction of output • Overallocation of resources
Positive externalities spillover benefits)	• Underproduction of output Underallocation of resources

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