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The Price Mechanism and Islamic Concept of Price Determination

آلية السعر التقليدي والمفهوم الإسلامي لتحديد الأسعار

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Abstract

The price theory in any economic system is the most fundamental economic phenomenon which determines the prices of all services and commodities and the economic activities are based on these prices. The allocation of resources is also related with price theory. The different economic systems have various techniques for price determination. The price mechanism in the capitalistic system is very common and more compatible but still has some drawbacks and the fair prices are not achieved. The Islamic economic system endorses the market forces, in the context of price determination, and have some advantages in terms of moral aspects and government intervention. The article is based on qualitative research method, critical analysis and comparative study and it shows how the Islamic system can improve the market situation realising the achievement of fair prices rather market prices. The author concludes that fair price system can be achieved in Islamic economics based on Prophetic guidance which acknowledges both phenomena; the open market system and legitimate restricted state intervention.

Keywords: Market equilibrium, Price mechanism, Perfect competition, Incomplete markets, Islamic economic system

JEL Classification : D410, D520, P510.

ملخص

تعتبر نظرية السعر في أي نظام اقتصادي الظاهرة الاقتصادية الأساسية التي تحدد جميع أسعار الخدمات والسلع في السوق، كما تعتمد جميع الأنشطة الاقتصادية على هذه الأسعار. وكذلك يرتبط تخصيص الموارد في توظيفها واستخدامها أيضًا بنظرية السعر. الأنظمة الاقتصادية المختلفة لها طرق عديدة لتحديد السعر. آلية السعر في النظام الرأسمالي شائعة جدًا وأكثر توافقًا ولكن لا تزال بها بعض المشاكل ولذلك لا يتم تحقيق الأسعار العادلة. النظام الاقتصادي الإسلامي يقرر قوى السوق؛ الطلب والعرض في سياق تحديد الأسعار، وله بعض المزايا من حيث الجوانب الأخلاقية والتدخل الحكومي. تستند

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هذه المقالة إلى التحليل النقدي والدراسة المقارنة بين نظام الرأس المالي الاقتصادي والنظام الاقتصادي الإسلامي في تحديد الأسعار، وتوضح كيف يمكن للنظام الاقتصادي الإسلامي أن يحسن أوضاع السوق مستهدفا تحقيق أسعار عادلة بدلاً من أسعار السوق. يصل المؤلف إلى نتيجة مفادها أنه يمكن تحقيق نظام السعر العادل في الاقتصاد على أساس التوجيه النبوي في مجال النظام الاقتصادي الإسلامي الذي يعترف ويقرر بكلتا الظاهرتين؛ نظام السوق المفتوحة وتدخل الدولة المحدود والمشروع للحفاظ على العدل.

كلمات مفتاحية: توازن السوق، آلية السعر، منافسة كاملة، أسواق غير مكتملة، نظام اقتصادي إسلامي

تصنيف JEL : .D410, D520, P510 .

Introduction

The price mechanism plays a very crucial role in determining the prices of any commodity in a capitalistic economy. In economics, price theory and allocation theory are the most important theories concerned with microeconomics (Hans Brems, 1991). The allocation theory is related to the allocation of economic resources. The price theory is related to how the prices are determined in the market system; prices of various goods and services, and factors of production. In the capitalistic free-market economy, the price system is the key factor in deciding on how scarce resources are allocated in the production of various goods and services.

Some economists like Barry Harrison, Charles Smith, and Brinley Davies (1992) suggested that the price mechanism is said to operate where the basic economic problems of what, how, and for whom to produce are determined by market forces; demand and supply. Therefore, in market economies, the price mechanism is the main procedure of the allocation of resources.

The failure of communism in the Soviet Union and Eastern Europe in 1989-90 attracted millions of people towards a free market system where market forces determine the prices of the goods and services through market operation. These people from socialist countries had the conviction that an open market economy has a relatively better system to allocate the resources. In centrally planned economies, the price system worked on rationing, rota, and quota system. The goods were distributed among the people based on these techniques. The long queues of the people for groceries were seen as a normal prospect because the bureaucrats in these economies failed to understand the excessive demand and hence they could not make appropriate decisions about what, how, and for whom to produce. But in a free-market or Laissez Faire economy, the classical economists say that price mechanism ensures the legitimate allocation of resources.

The Islamic economic system does not refute the principle of price mechanism and endorsed the interaction of market forces and their joint interaction to determine the price of goods and services. Adam Smith (1776), the founder of 'market economy' in his famous book

'The Wealth of Nations' explains how the free market system works and why the role of government has to be minimal in the capitalistic economy.

The failures of the market system have been pointed out by the Keynesian school of thought in economics when the Great Depression caused a huge economic crisis in the 30s of the last century. It was in the wake of the Great Depression when J.M. Keynes (1936) wrote his famous book 'General Theory' to discuss the failures of the market system and rectify the imbalances in the economy. He emphasized the fiscal role of the government and shifted to macroeconomic variables. It was a revolutionary thought in economics.

The Islamic economic system does not deny the importance of price mechanism. However, the Islamic system based on divine guidance and revealed knowledge goes further to ensure there is not exploitation of the weaker partner. Based on the ignorance of market situation nobody can take advantage of one another. There are many *Aha'dith* of the Prophet (saws) related to the phenomenon of market mechanism and the determination of prices from the Islamic perspective. In this article, I attempted to explore how the Islamic economic system ensures the just and fair prices and furthermore, the free interaction of the market forces and how the rights of both buyers and sellers are protected.

1. Research Methodology

The qualitative research method in analytical and critical approach has been used in this research paper. The published data and material in the form of books, articles, research papers from periodical journals, and the literature from academic circles have been reviewed carefully and the information has been utilized in the discourse of the critical subject matter, after the authenticity and reliability of these resources have been confirmed. Internet resources have also been used and the originality of the materials has been assured from their original resources on the web pages. Moreover, consultations and discussions with senior faculty members and researchers were also taken into account and their deliberations have been benefitted from, whilst this paper was being written. The comparative analysis was carried out while discussing the determination of prices in an Islamic economic system and classical capitalistic system.

2. Literature Review

The price theory is one of the basic economic theories in the discipline of economics. The earlier classical economists like Adam Smith (1776), David Ricardo, (1817), and John Stuart Mill (1863) discussed the theory of price mechanism and market equilibrium. Alfred Marshall (1890) was also a proponent of the classical theory of price determination. Paul Samuelson (1958) also mentioned about the harmony between buyers and sellers in the open market, that lead to price determination. J.M Keynes (1936) strongly criticized the classical concept of price mechanism.

He presented evidence from the Great Crash (1930s) that prices were not flexible, but rather, they were rigid downwards. The principle of the price mechanism has widely been criticized and the assumptions of perfect competition were declared unrealistic by contemporary economists like; William J. Baumol and Alan S. Blinder (1979), Andreas Stamate, and Radu Musetescu (2011), Ludwig von Mises (1966) are some names who strongly criticized the market phenomenon of price mechanism. From earlier Muslim Economists, Ibn Taymiya (d.728), Ibn Qayyim (d. 751), Ibn Khaldun (d. 808) and some other scholars wrote about the price system and how the prices were determined based on market forces; demand and supply.

3. The Invisible Hand: The Working of Price Mechanism

Adam Smith (1776) who is known as one of the Founding Fathers of economics gave the concept of the invisible hand of the price mechanism. He describes how the hidden hand of the free market system operates in a perfectly competitive market through the pursuit of self-interest of buyers and sellers to allocate the scarce resources in society's best interest. This price mechanism is the essence of economics. Those economists who have classical views of economics they believe in the free market economy and operation of price mechanism in the determination of prices and allocation of resources. Millions of people interacting in the open market as buyers and sellers and based on their demand and supply for various goods and services determine the allocation of scarce resources between various trade-offs.

The price mechanism plays certain important functions, Geoff Riley (2006) describes these functions as following;

- Signaling Function
- Transformation of Preferences
- Rationing Function

First of all, the prices of commodities in any market indicate the signals to the suppliers and producers. When the price of a commodity rises then it gives a signal to the sellers and then ultimately to the producers that there is excessive demand for this particular product and there is more need to produce this product. Therefore, the allocation of resources is adjusted to produce that product for which has excessive demand in the market. So, the rise and fall of the prices is an indication of scarcities and surpluses of the resources. The higher prices lead to the expansion of production to meet higher demand.

The transmission of preferences also indicates that there is a transformation in the demand for a particular product in the market. The expression of preferences also works as another significant channel to send important information. The preferences indicate where the resources are required to be allocated based on the excessive demand. The higher demand gives opportunity to earn higher profits based on higher prices. The strong demand leads to expansion of the supply and weak demand leads to a contraction of the supply. So, the producers do respond to these market signals which are based on the preferences of the consumers, and these expressed in terms of higher prices of the products.

Furthermore, the market price is a rationing device that helps to make decisions about rationing scarce resources. The shortage of the product indicates the demand is more than supply. In this situation, there will be a tendency to push the price upwards and it is an indication that more resources have to be allocated in the production of this product. On the contrary, the surplus of the product in the market indicates that supply is more than demand and this condition has a tendency for the price to go down up to the equilibrium point in the long run. So, the market price according to classical economists is the rationing device which makes demand and supply equal to each other. To them, the market price indicates the best allocation of scarce resources and the equilibrium is concerned with a concept of efficiency called Pareto -optimality. It means a state of affairs if and only if there is no alternative state that would make some people better off without making anyone worse off. The competitive market equilibrium is the primary condition for this situation according to classical economists (Sean Ingham, 2010).

Demand for any product is a dependent variable and it depends upon the price of the product and some other factors which include;

- Price of the product
- The income of the consumer
- Price of the substitutes
- Price of the complementary products
- Tastes and preferences of the consumer
- Advertisement expenditure
- The future expectation of the changes in the price
- Composition of the population

Symbolically we can write this as follows;

$Q\ (d) = f\ (P, Y, Ps, Pc, T, Ae, Fe, N)$

Where Q (d) stands for quantity demanded, P for the price of the product, Y for the income of the consumer, Ps for the price of the substitute, Pc for the price of the complementary product, T for tastes of the consumer, Ae for the advertisement expenditure, Fe for the future expectation of changes in the price and N for the population.

The classical theory assumes that all other variables remain constant and there is only one single independent variable that can affect the dependent variable, symbolically $Q(d) = f(P)$. In the real world, of course, all the aforesaid factors can affect the quantity demanded but for the sake of simplicity and accuracy in the economic model of demand and supply, the economists use the assumption of Ceteris Paribus which is a Latin phrase that commonly translated into English as 'all else being equal'. For example, in the law of demand, it is stated that all else being equal, there is an inverse relationship between demand and the price of a product. It means that if the price goes up the quantity demanded will decrease and vice versa remaining other variables constant.

On the supply side, we also have certain variables that affect the quantity supplied.

Some of the significant factors affecting quantity supplied include;

- Price of the product
- Price of the related goods
- Cost of production
- State of technology
- Natural factors
- Means of transportation, communication, banking, and insurance
- Time period

Symbolically we can write that quantity supplied is a function of all these variables in the following way.

$Q(s) = f(P, Pr, C, Tec, Nf, Tr, B, Ins, Tp)$

Where Q(s) stands for quantity supplied, P for the price of the product, Pr, for the price of the related product, C for the cost of the production, Tec for technology, Nf for natural factors, Tr for transportation, B for banking, Ins for insurance and Tp for the time period.

In the discussion of supply, the classical economists also assume that all the aforesaid factors remain constant except price. So, there is only one independent variable and that is the price, it affects the quantity demanded. Symbolically, $Q(s) = f(P)$. In the law of supply, it is stated that all else being equal, there is a positive relationship between price and quantity supplied.

In equilibrium condition there is always $Q(d) = Q(s)$.

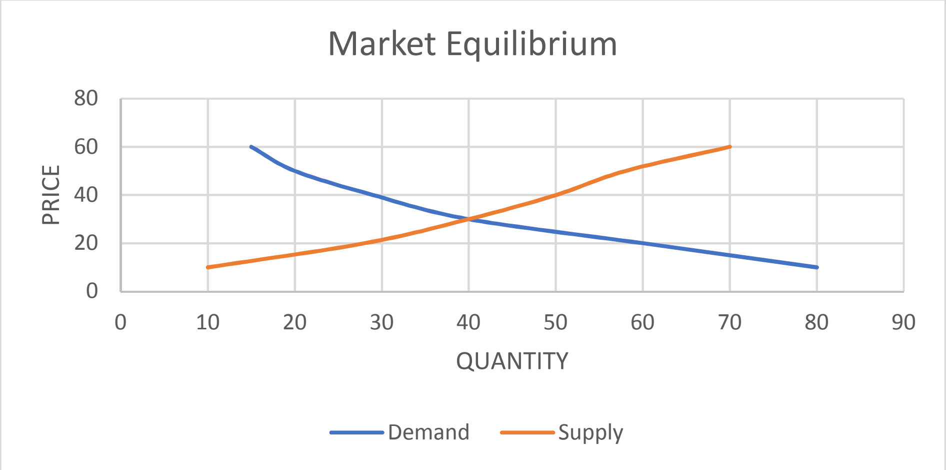
Table1. Demand and Supply Schedule and Market Equilibrium

Demand and Supply Schedule and Market Equilibrium				
Price (in Rs) (in hundreds)	**Demand (in thousands)**	**Supply (in thousands)**	**Market Position**	**Effect on Price**
10	80	10	Shortage	Rise
20	60	28	Shortage	Rise
30	40	40	Equilibrium	Stable
40	29	50	Surplus	Fall
50	20	58	Surplus	Fall
60	15	70	Surplus	Fall

Source: Market Equilibrium by Natasha Kwatiah (2017) available at www.economicdiscussion.net

The table shows that when the price is Rs.300 then the market is in equilibrium. At the equilibrium price, both quantity demanded and quantity supplied are equal to 40 thousand. When the price is less than the equilibrium price, Rs.300, then the demand is more than supply and this situation is called 'shortage' in the market. In this situation, there is a tendency in the market price to go up, because the sellers will raise the price and the process continues until the price reaches the equilibrium price. On the other hand, when the price is more than the equilibrium price, then the demand is less than supply and this situation is called 'surplus' which indicates excessive supply and less demand. In this situation, there is a tendency in the price to come down. Because the sellers lower price to sell the stock. So, they decrease the price and the process continues until the price reaches the equilibrium price. This mechanism is called 'invisible hand' by Adan Smith (1776) and his followers. The market equilibrium, shortage, and surplus in the market and operation of the price mechanism have been shown in the following diagram.

Diagram No.1 Market Equilibrium and Price Determination.



Source: The data taken from Market Equilibrium by Natasha Kwatiah (2017) and diagram presented by the author.

In the diagram, the negative slope curve with blue colour falling from left to right is the demand curve which shows the inverse relationship between the price of the product and the quantity demanded. The positive slope curve with orange colour rising from left to right is the supply curve and represents the positive relationship between the price of the product and the quantity supplied. The intersection of both demand and supply curves indicates the equilibrium point where both quantities are equal at a price which is called the equilibrium price. The quantity at this price is called equilibrium quantity and demand and supply are always equal at this point. The equilibrium price is Rs.300 and the quantity demanded and supplied is 40,000. If the price is above Rs.300 then it shows surplus; higher supply and lower demand and the price tends to fall. If the price is less than the equilibrium price Rs.300 then it indicates shortage, higher demand, and lower supply and the price tends to rise. In both situations; surplus or shortage, the price either falls or rises and this movement continues until the price reaches the stable point of equilibrium price.

There are two important differences in the changes in demand and supply; change in quantity demanded and supplied and shift in demand and supply. If the working factor behind is the price of the product, then it is called 'expansion and contraction' or 'increase or decrease' in quantity demanded or supplied. If the reason behind the change is any other factor not price, then it is called rise and fall or shift in demand and supply. In the case of shifting, the demand or supply curves either shift to right or left. In the case of expansion and contraction the demand and supply move on the same curves depending on the price (Landsburg Steven E., 2012).

The classical economists like Adam Smith (1776), David Ricardo, (1817), and John Stuart Mill (1863) are the founders of classical economics, they all believe in the perfectly competitive market and the invisible hand of the price mechanism. Alfred Marshall (1890) was also a proponent of the classical theory of price determination through invisible hand and market forces. But he also contributed the concept of time factor in the market price like short period and long period etc. in which the supply could change. He presented the view that the value of any product was determined by how much labour force was used in the manufacturing of it. So, in the 19th century, the classical economists were thinking that value was based on the labour involved and not demand and supply interaction. Paul Samuelson's (1958) mentions the harmony among the competitors and this harmony is the result of their incapacity to alter the price of the product. So, all the participants are price takers and not in a position to change the price. From the features of perfect competition is that marginal revenue, marginal cost, and price are equal.

Perfect competition refers to a market situation where the following conditions are fulfilled.

- A large number of buyers and sellers
- Homogeneity of the product
- No legal, social, and technological barriers on the entry or exit
- Perfect knowledge of the market
- Perfect mobility of factors of production

These are the assumptions of the free competitive market and the price mechanism is based on these assumptions. But virtually, as we know the perfect competition is not compatible with the real world. The perfect competition model has been criticised because of these unrealistic assumptions. On the basis of these assumptions, the classical school believes that prices are flexible and market equilibrium leads to full employment level in the long run. They that government intervention needs to be minimal in the market. Economic freedom is one of the distinguished and the most prominent feature of classical economics and capitalism. The buyers and sellers have complete freedom to make the decisions. Their decisions are based on the price mechanism and market equilibrium which is an essential component of full employment. The role of the government is merely as a law enforcement agency to safeguard the sanctity of life and property.

J.M. Keynes (1936) criticized the classical school of thought on certain points. He argues that the prices are not flexible but they are rigid, flexible to upwards and rigid to downwards. He disagrees to the classical view that full employment equilibrium will be obtained in the ling-run. He said this concept was unacceptable because in the long run we all would be dead. We have to take care of the present and current situation and not wait for the future that it would be rectified itself. In the context of the Great Crash 1930s, he suggests that the invisible hand does not work and the price mechanism is not functional in the economic system. The unemployment level was at its highest point and the rate of inflation was also high. It means the prices were going up continuously and not falling down. It was a clear failure of the free market system and the price mechanism. He advised that the role of government was significant and essentially it had to be played effectively for the rectification of macroeconomic imbalances. He suggests that unemployment is due to deficiency in the demand so there is a need for effective demand through the fiscal role of the government. The effective demand is determined by the aggregate supply function (representing the cost of entrepreneurs) and aggregate demand function (representing receipts of entrepreneurs) when they both are equal. The government expenditure on social goods and infrastructure will provide the labour force higher purchasing power and hence the aggregate demand will increase and it will lead to a higher level of employment. He vigorously criticized the classical concept of self- regulating economy. He suggested that the role of government is essential.

The principle of the price mechanism and assumptions of perfect competition have widely been criticized by economists, for instance, William J. Baumol and Alan S. Blinder (1979), Andreas Stamate, and Radu Musetescu (2011), Ludwig von Mises (1966) are just few names in this regard. The critics of the price mechanism and free-market operations have raised the following points to criticize the price theory of classical school.

a. The concept of a perfect market is not realistic.

The price mechanism depends upon the assumptions of perfect knowledge, free entry and mobility of factors of production. But in reality, these assumptions are not realistic, so, there is not a perfect market either in the products market or factors product. The future is uncertain and the operation of the price mechanism is not realistic.

b. The sellers do influence on prices in the market.

The price mechanism depends upon perfect competition assumptions. But in real words, these assumptions are not realistic and both the product and factor market are not perfect. There are monopoly and monopolistic competition markets and the producers influence the prices. The producers want to make a maximum profit so they normally restrict the supply and push the prices higher.

c. The price adjustment is not automatic.

In the real world, monopoly and monopolistic competition exist commonly and prices are not determined by interaction of market forces. The sellers are mostly in a position to influence the market price by reducing the supply and restricting production. Therefore, the price adjustment is not automatic.

d. Consumers' sovereignty is unrealistic.

The consumers are not sovereign and they are forced to buy the products at the given price and also preferences and tastes are influenced by conspicuous advertising. So, these are the producers who make the decisions and not the consumers. The consumers' sovereignty is nothing but an illusion.

e. The competition leads to monopoly.

The competition in the long run leads to a situation where there is the emergence of monopoly business and the resources are not utilized at the level of Prato Optimality and the consumers do not get the right product at the right price.

f. Wastage of resources may occur.

In the case of monopolistic competition and monopoly market, there is always advertisement expenditure and other activities to restrict the production and supply to keep the prices higher. All these things lead to a waste of resources which is the loss of the overall economy. So, it is very difficult to gain the highest level of satisfaction and welfare in society.

g. It causes instability

The free and unregulated market can cause many fluctuations like booms and recessions and they lead to economic instability and macroeconomic imbalances in the economy. This situation is severely detrimental to the growth of the economy and it creates socio-economic problems.

h. It creates inequality

The imperfection in the market leads to inequality in the distribution of income and wealth. The consumers buy the products and services by paying money votes. The votes in the market are based on money power. The one who has more money can have more voting power. So, this market system breeds inequality in income and wealth and ultimately creates social disparities in the society.

i. Failure of the market.

The price mechanism is not a just system of pricing. The consumers are forced to accept the higher prices. The inequality in income and wealth and socio-economic problems do not let the economy to gain social efficiency. Therefore, the level of Prato Optimality is no achieved.

4. The Islamic Concept of Fair and Just Prices

In this section, we discuss how the Islamic economic system works in the determination of prices. Does the Islamic system endorse the market system? What is the significance of free consent in sale contract? What measures has the Islam taken to ensure the free interaction of market forces? These are some of questions we will find the answers exploring the teachings of the Quran and Sunnah. The teachings of Quran and Sunnah are based on divine ideology and covers all aspects of human life. The divine teachings of the Quran and Sunnah could guide humans in the best way to deal with their commercial and financial transactions. The concept of prices indicates the true value of goods and services. The price theory in classical economics is based on the market forces and its equilibrium. In Islamic economic system, there is concept of fair price rather than just market price. Because Islam is a religion of justice and integrity and it ensures justice and fairness in all the social and economic aspects of human life.

The most fundamental phenomenon in price determination is the interaction of buyers and sellers. The mutual consent of both buyers and sellers in Islamic Shari'ah is the same as in conventional economics, there are impersonal forces of demand and supply in the open market. In Islamic Shari'ah the consent of both buyers and sellers is based on the phenomenon of *Ija'b* and *Qabo'ul.* The phenomenon of mutual consent has been mentioned in the Quran very clearly. Allah the Almighty said,

يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِنْكُمْ ۚ وَلَا تَقْتُلُوا أَنْفُسَكُمْ ۚ إِنَّ اللَّهَ كَانَ بِكُمْ رَحِيمًا (النساء- ٢٩)

O you who have believed, do not consume one another's wealth unjustly but only [in lawful] business by mutual consent. And do not kill yourselves [or one another]. Indeed, Allah is to you ever Merciful (4:29).

In another verse, in the same context, Allah the Almighty said,

وَلَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ وَتُدْلُوا بِهَا إِلَى الْحُكَّامِ لِتَأْكُلُوا فَرِيقًا مِنْ أَمْوَالِ النَّاسِ بِالْإِثْمِ وَأَنْتُمْ تَعْلَمُونَ (البقرة-١٨٨)

And do not consume one another's wealth unjustly or send it [in bribery] to the rulers so that [they might aid] you [to] consume a portion of the wealth of the people in sin, while you know [it is unlawful] (2:188).

Apart from these Quranic verses, about the mutual consent, there is also mention in Hadith as following, the Messenger of Allah (pbuh) said,

إنما البيع عن تراض. (رواه ابن ماجة- رقم ٢١٨٥)

Verily the buying and selling are based on mutual consent (Ibn Majah- 2185).

In these verses and Hadith, there is mention that the only lawful and permissible way is the trade and exchange of property based on mutual consent. The sanctity of life, property, and honour is virtually very important in Islamic Shari'ah and the Messenger of Allah (pbuh) warned the people about the sanctity of life, property, and honour in farewell Hajj speech. He said,

فإنَّ دِماءَكُم، وأمْوالَكم وأعْراضَكُم عَلَيْكُم حرامٌ كَحُرْمة يومِكُم هَذَا، في شهرِكُمْ هَذَا، في بلَدِكُم هَذَا، ألا هَلْ بلَّغْت (البخاري-١٨٣٩)

Indeed, your blood, your property, and your honour have sanctity, like the sanctity of; the Day of Sacrifice, the month of Hajj, the holy city of Makkah. Beware, did I convey (Al-Bukhari-1839).

The unlawful consumption of property of each other is regarded as a major sin and the acceptance of acts of worship depends upon eating Halal. The only permissible way of acquiring money is the trade or exchange of property based on mutual consent. So, the interaction of demand and supply and the phenomenon of mutual consent provides the basic foundation of price determination in the Islamic economic system.

It is worth mentioning that Muslim sociologist Ibn Khaldun (d. 808/1406) has long time ago discussed the interaction of demand and supply and its role in price determination in his scholarly and renowned book, Muqaddamah Ibn Khaldoon as explained by M Umer Chapra (2000). M Umer Chapra argues that Ibn Khaldun recognised the influence of both supply and demand on the determination of prices. He also talks about the law of demand. Ibn Khaldun emphasised that both an increase in demand or a fall in supply leads to a rise in prices, while a decline in demand or rise in supply contributes to falling in prices. If the prices continuously and excessively fall then it would discourage the traders and craftsmen and they would quit the market. On the other hand, the continuous and excessive rise in the prices would hurt the consumers. Therefore, according to Ibn Khaldun, moderate prices between both extremes are desirable because it would allow the traders a socially-acceptable level of return and also lead to the clearance of the market by promoting sales and hereby generating a given turnover and prosperity (M Umer Chapra, 2000).

Ibn Taymiyyah (d. 728/1328) another great jurisprudent prominent scholar in Islamic history, also discussed the significance of demand and supply in the determination of prices. M Umer Chapra also mentioned Ibn Taymiyyah a renowned Muslim theologist and jurisprudent, who wrote about demand and supply and price determination as following; the rise or fall of prices may not necessarily be due to injustice by some people. They may also be due to the shortage of output or the import of the commodities in demand. If the demand for commodity increases or the supply of what is demanded declines, the price rises. If, however, the demand falls and the supply increases, the price falls (M Umer Chapra, 2000).

Why there is significance of market forces in Islam because there is ruling of the Messenger of Allah (pbuh) about the interaction of market forces. As we find in the following hadith,

قال النَّاسُ يا رسولَ اللَّهِ ، غلا السِّعرُ فسعِّر لَنا ، قالَ رسولُ اللَّهِ صلَّى اللَّهُ عليهِ وسلَّمَ :
إنَّ اللَّهَ هوَ المسعِّرُ القابضُ الباسطُ الرَّازقُ ، وإنِّي لأرجو أن ألقَى اللَّهَ وليسَ أحدٌ منكُم يطالبُني بمَظلمةٍ في دمٍ ولا مالٍ (سنن أبي داود – ٣٤٥١)

The people said, O Allah's Messenger, the prices have risen so please determine the prices for us, the Messenger of Allah (pbuh) said that indeed it is Allah Who lets the prices determined, the one Who holds and opens and gives provisions. And I hope that I meet Allah in a state that nobody from you demands from me about any injustice in terms of life and property (Sunan Abi Daud-3451).

The Hadith tells us when the prices went up in Madinah, people asked the Messenger (pbuh) to fix them and he denied and said I would not like to meet my Lord without any oppression upon anyone.

The hadith is a clear indication that the Islamic economic system does accept the significance of market and also endorses the free interaction of demand and in price determination. The difference between a conventional system and the Islamic economic system is that the later does not depend merely upon market forces, but it involves some other factors to ensure justice for all participants in the market mechanism. The injustice takes place on the basis of uncertainty and ignorance about market conditions. The perfect market is based on the assumption of perfect knowledge about market conditions but in reality, it do§es not exist. In this scenario, the Islamic economic system has clear guidance and rulings so that nobody takes the advantage of anyone due to the lack of knowledge about market situation. The Messenger of Allah (pbuh) forbade from chasing the sellers outside the market and buying the products before they reach in the market so someone may not be deceived and sell at a lower price than the market. The Messenger of Allah (pbuh) said as narrated by Ibn Abba's may Allah be pleased with them in Sahih Bukhari,

عَنِ ابْنِ عَبَّاسٍ رَضِيَ اللَّهُ عَنْهُمَا، قَالَ: قَالَ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ: لاَ تَلَقَّوُا الرُّكْبَانَ ، وَلاَ يَبِعْ حَاضِرٌ لِبَادٍ ، قَالَ: فَقُلْتُ لِابْنِ عَبَّاسٍ: مَا قَوْلُهُ لاَ يَبِيعُ حَاضِرٌ لِبَادٍ قَالَ: لاَ يَكُونُ لَهُ سِمْسَارًا (أخرجه البخاري-٢٠٧٤)

It is narrated from Ibn Abba's may Allah be pleased with them, he said; the Messenger of Allah (pbuh) said: Don't meet the riders of camels (traders outside the market) and let the resident of the city not sell for the Bedouin. The narrator said I asked Ibn Abba's what does mean to let the resident not sell for the Bedouin. He said it meant that there was no brokerage (Al-Bukhari-2074).

The assurance of market knowledge through this prophetic guidance makes the Islamic economic system a better way of the open market mechanism to determine the prices based on market forces of demand and supply. In a capitalistic market mechanism, there is only assumption that the buyers and sellers have perfect knowledge of the market. But in reality, the buyers and sellers are unaware of the situation of the market and other assumptions are also incredible so the ignorance about the market situation can allow anyone who has an edge in the market to take advantage of the weaker participant.

The prohibition of samsara (brokerage) in the field of trade is not an absolute ruling for all the circumstances, meaning it is prohibited in all circumstances. It's prohibition is related with market situation, the ignorance of buyers and sellers. Whereas there is not any possibility of taking advantage of the ignorance of the market situation of other participants then samsara is allowed according to the unanimous view of the jurisprudents of Islamic Shari'ah. If for any reason somebody has taken the advantage of seller's unawareness about the market situation and has purchased the commodity before it arrived in the market, then the Messenger of Allah (pbuh) permitted the seller to nullify the contract and take the commodity back and refund the money to the buyer. As it is clear from the following Hadith,

عن أبي هريرة أن النبي -عليه السلام- نهى عن تلقي الجلب، فإن تلقاه متلقٍ فاشتراه، فصاحب السلعة بالخيار إذا وردت السوق. (سنن أبي داود، رقم ٣٤٣٧)

It is narrated by Ibn Abbas (may Allah be pleased with him) he said the Messenger of Allah (pbuh) forbade the purchase from Bedouin until he comes into the market. If any local trader buys the product beforehand, then the seller of the product has the choice to invalidate the sale contract on arrival in the market (Sunan Abi Daud-3437).

This Hadith provides apparent ruling that the seller has the right to nullify the sale contract in case he was deceived based on ignorance. The choice of nullifying the contract is not only for seller but also for buyer, as in the following hadith,

عَنِ ابْنِ عُمَرَ، أَنَّ رَجُلاً، ذَكَرَ لِرَسُولِ اللَّهِ صلى الله عليه وسلم أَنَّهُ يُخْدَعُ فِي الْبَيْعِ فَقَالَ لَهُ رَسُولُ اللَّهِ صلى الله عليه وسلم " إِذَا بَايَعْتَ فَقُلْ لاَ خِلاَبَةَ ". فَكَانَ الرَّجُلُ إِذَا بَايَعَ يَقُولُ لاَ خِلاَبَةَ . (سنن أبي داود- رقم ٣٥٠٠)

It is narrated by Ibn Umar; A man told the Messenger of Allah (pbuh) that he was being deceived in business transactions. The Messenger of Allah (pbuh) then said: When you make a bargain, say: There is no attempt to deceive. So, when the man-made a bargain, he said: There is no attempt to deceive (Sunan Abi Daud- 3500).

The prohibition and nullification of sale contract validates in case of any deception, falsification, forgery and telling lies. The Messenger of Allah (pbuh) gave the choice to the buyers to return the dairy animals and reverse the sale contract, in case the animals were not milked for some time to pretend that their milk is more. The Messenger of Allah (pbuh) said,

وَلَا تُصَرُّوا الإبِلَ وَالْغَنَمَ، فَمَنِ ابْتَاعَهَا بَعْدَ ذلكَ فَهو بخَيْرِ النَّظَرَيْنِ بَعْدَ أَنْ يَحْلُبَهَا، فإنْ رَضِيَهَا أَمْسَكَهَا، وإنْ سَخِطَهَا رَدَّهَا وَصَاعًا مِن تَمْرٍ (رواه مسلم- رقم ١٥١٥)

Don't keep the camel and sheep un-milked, if someone has bought such an animal then he has the choice to return it after milking if he likes he can keep, and if does not then return it with a Sa'a (measure) of dates (Muslim- 1515).

In another Hadith, there is prohibition of Najash or what is called raising the price based on false demand in an auction, etc. It has been mentioned in the following Hadith of the Messenger of Allah (pbuh),

نَهى رَسولُ اللَّهِ صَلَّى اللهُ عليه وسلَّمَ أنْ يَبِيعَ حَاضِرٌ لِبَادٍ، ولَا تَنَاجَشُوا، ولَا يَبِيعُ الرَّجُلُ علَى بَيْعِ أخِيهِ، (أخرجه البخاري- ٢١٤٠)

The Messenger of Allah (pbuh) forbade the resident to sell for the Bedouin, don't raise the price (based on false demand), and let a Muslim not intervene in the transaction of another Muslim (Al-Bukhari- 2140).

Najash is another false and tricky way of rising the prices based on the false and artificial demand. The sole purpose of bidding is just raising the price. In numerous Aha'dith the Messenger of Allah (pbuh) forbade from Najash which is absolutely Haram. It creates false demand. In another Hadi'th the Messenger of Allah (pbuh) said as follows,

عَنِ ابْنِ عُمَرَ رَضِيَ اللَّهُ عَنْهُمَا ، قَالَ : نَهى النَّبِيُّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ عَنِ النَّجْشِ (أخرجه البخاري ٢٠٥٨)

It has been narrated from Ibn Umar (may Allah be pleased with them) he said, The Messenger of Allah (pbuh) forbade from Najash (Al-Bukhari-2058).

This act of Najash creates hatred among the people in any society. Islamic society is based on the principles of brotherhood and fraternity. Injustice and exploitation are not allowed. The devil wants to create discrimination and hatred among the Muslim brethren of Islamic society. Injustice and wrongdoing to anyone cause hatred, prejudice, inequality, instability, and social discrimination which results in the demise of the Islamic brotherhood. In the context of hatred and prejudice among Muslims in an Islamic society is the utmost desire of Shatin, as mentioned in the Quran in the following verse.

إِنَّمَا يُرِيدُ الشَّيْطَانُ أَن يُوقِعَ بَيْنَكُمُ الْعَدَاوَةَ وَالْبَغْضَاءَ فِي الْخَمْرِ وَالْمَيْسِرِ وَيَصُدَّكُمْ عَن ذِكْرِ اللَّهِ وَعَنِ الصَّلَاةِ ۖ فَهَلْ أَنتُم مُّنتَهُونَ (المائدة- ٩١)

Satan only wants to cause animosity and hatred through intoxicants and gambling to divert you from the remembrance of Allah and prayer. So, will you not desist? (5:91)

The Najash is one of those factors like gambling and intoxicants that create hatred among the Muslims and it is inconsistent with the principles of Muslim brotherhood and social integration in a Muslim society. The Islamic economic system places magnificent emphasis on creating a peaceful, stable, and just society where all the brethren are supporting and strengthening each other in society. The insignia of Islamic society is based on the Muslim brotherhood and social integration which is an integral part of Muslim fraternity all over the world. The sole purpose of all these Aha'dith which have been mentioned afore in various context containing the prohibition of transactions is the maintenance of social and economic justice in the society. Justice is the foundation of Islamic ideology and Islam lays profound emphasis on the maintenance of justice in every sphere of life. The reason why the Messenger of Allah has prohibited the resident of the city to not accomplish the transaction for the Bedouin has been mentioned in the following Hadith. The Messenger of Allah (pbuh) said,

لا يبيع حاضرٌ لبادٍ دعوا النَّاسَ يرزقُ اللَّهُ بعضَهم من بعضٍ (أخرجه ابن ماجه- رقم١٧٨٣)

Let the residents of the city not sell for the Bedouins, abandon the people, Allah provides them provision of life one from another (Ibn Majah-1783).

Likewise, the shortage of supply based on hoarding has also been declared prohibited in the text of Ha'dith, the Messenger of Allah (pbuh) said,

لايحتكر إلا خاطئ (صحيح مسلم. ١٦٠٥)

Nobody does hoarding but a wrongdoer (Muslim-1605).

So, the Ha'dith is clear indication that hoarding is regarded as a sin in Islamic Shari'ah.

Badru Din Al-Aini in his book Nukhub Al- Afka'r described that the followers of Imam Shafi explained the word 'Talaqa Ar- Rukba'n' by saying that the market people go outside to buy the products and commodities from the Bedouins who do not have the knowledge of the market and they buy cheaper from them and sell at higher prices in the market (Badru Din Al-Aini, d. 855).

These Aha'dith reiterate the prohibition of any transaction where one participant is taking the advantage of another one based-on ignorance, unjust and unfair interaction in the market economy.

The hadith narrated by Anas bin Malik as following is amazing,

عن أنس ابن مالك عن النبي صل الله عليه وسلم قال: "لا يؤمن أحدكم حتى يحب لأخيه ما يحب لنفسه" (أخرجه البخاري- رقم الحديث ١٣)

Anas Bin Malik narrates that the Messenger of Allah (pbuh) said: None you can be a true believer unless he loves for his brother what he loves for himself (Al-Bukhari-13).

It is a comprehensive moral guidance for all the believers to deal with justice and fairness and not doing any injustice. If a higher price is not acceptable for himself, then he should not a charge a higher price from others.

Apart from the moral teachings and revealed guidance where Quran and Sunnah educate the followers to abstain from injustice in financial transactions, the Islamic state also has the responsibility to maintain this justice. The role of the state is minimal and demand and supply forces are free to play their role to determine the prices as it has been discussed before, but when the unjust and unfair transaction occurs in the market then it is the responsibility of the state to stop the injustice. Allah the exalted explained the role of the state in Quran as following,

الَّذِينَ إِن مَّكَّنَّاهُمْ فِي الْأَرْضِ أَقَامُوا الصَّلَاةَ وَآتَوُا الزَّكَاةَ وَأَمَرُوا بِالْمَعْرُوفِ وَنَهَوْا عَنِ الْمُنكَرِ ۗ وَلِلَّهِ عَاقِبَةُ الْأُمُورِ. (الحج- ٤١)

And they are] those who, if We give them authority in the land, establish prayer and give Zakah and enjoin what is right and forbid what is wrong. And to Allah belongs the outcome of [all] the matters (22: 41).

The verse mentions the role of the state in Islam. The capitalistic economic system does not endorse the intervention of the state in economic activities except in very rare and extraordinary situations. Whereas, in the Islamic economic system, the open market demand and supply forces have proper freedom of interaction, but if there is exploitation, then the Islamic state has a positive and responsible role to play so that all the stakeholders of the market deal fairly and justly with each other. There are several practical examples of such intervention from the state during the time Prophet (pbuh) and 'The Rightly Guided Caliphs'. The example of second Khalifa Umar Bin Khattab is worth mentioning when he was patrolling the market in Madinah and realized a prominent companion of the Messenger of Allah (pbuh) Hatib Bin Abi Baltah was selling the raisins at a cheaper price than the market. Umar Bin Khattab asked him either to sell at the market price or take his commodity away and sell it somewhere else outside the market (Al-Bahlan, Abdullah Fareeh, 1424). It is a marvelous example of state intervention in the open market phenomenon to maintain the fair price system as established in the Islamic economic system.

5. Conclusion

The author has discussed the various methods of price determination in different economic systems, namely communism, capitalism, and the Islamic economic system. The communism or centrally planned economy does not recognize the market forces and the price is determined by the planning authority of the state. It was an unrealistic and illogical way of transactions and that's why the system collapsed within only 70 years.

The capitalistic economic system is based on the phenomenon of self-interest and profit-motive. The system gives importance to the free market interaction but the absolute economic freedom, the least intervention of the government and minimal role of the sate created problems. It endorses the significance of the role of market forces like demand and supply in the determination of prices. But the unrealistic assumptions of perfect competition and unsatisfied, so price mechanism of invisible hand never persuaded stakeholders of the market to interact in a proper, just and fair way to avoid exploitation. The situation is either monopoly or monopolistic competition where the customers are forced to accept the price.

The Islamic economic system is a combination of moral teachings and legal system. There is economic freedom but also legitimate state intervention. It endorses the interaction of market forces. The phenomena of self-interest and profit motive are also recognized. There is moral and ethical teaching to deal fairly and justly, but if there is exploitation then the state intervention takes legal action to remove the harm from the society. So, the fair price system can be materialized on the basis of revealed knowledge in the Islamic economic system.

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