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***Social Capital and Risk Sharing: An Islamic Finance
Paradigm***

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The notion of trust has always been considered a central concern over trade and broad economic activities throughout different historical periods. Those societies which established high socioeconomic trust between intra and inter-communal relations enjoyed productive and dynamic economic frameworks; while, lower level of trust embedded in other societies threatened the sustainability of robust economic systems. Thus, trust has a fundamental role in generating economic wellbeing and social welfare through sophisticating and strengthening economic relations. This argument has been uttered strongly in the aftermath of the global financial crisis in 2007 due to the catastrophic consequences of the lack of trust in the global financial system.

Social capital is a term used to address a new form of constructing trust amongst stakeholders of society in the modern period wherein atomised individuals have to contend with a powerful state and self-regulated market understanding. In the financial sector, trust and social capital stipulate the existence of risk sharing atmosphere to pave the way for an equitable financial environment. While conventional financial system has hardly accommodated risk sharing characteristics in its theoretical framework over the decades, Islamic finance has great potential with its inherent features upon shared prosperity and risk sharing nature.

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Published as part of a series of Palgrave Studies in Islamic Banking, Finance, and Economics, the reviewed book '*Social Capital and Risk Sharing: An Islamic Finance Paradigm*' is an original attempt to address distinctive characteristics of Islamic finance from the viewpoint of social capital. In parallel with this, the book aims to deconstruct traditional and modern use of social capital and relate it with risk sharing in the Islamic financial sphere. Then, it envisions an authentic function of social capital in market exchange that reduces financial inequality and enriches risk sharing in Islamic financial operations including crowdfunding, social impact partnerships and the stock market.

Examining its structure and content, the book has nine chapters with three different parts focusing on social capital, its impact on financial area, and evaluation of social finance activities in light of trust, social capital and risk sharing. The first chapter touches upon the significance of social capital and risk sharing throughout centuries by providing historical evidence from risk sharing partnership models prevalent in Islamic and Western world such as *commenda* and *mudarabah*. Later, the authors mention how risk sharing is operationalised in conventional economics from the 1960s to 2000s by giving special reference to stock markets as risk sharing institutions. Since risk sharing requires the establishment of trust, a historical survey is made to focus on the loss of trust over the ages and to bring back trust in the 20th century not in the form of legal rules but on the basis of real trust. The authors claim to regain trust by enhancing social capital.

The second chapter discusses, to a large extent, an ideal society over which social capital is implemented. As the ideal society is constructed in light of *Qur'anic* prescriptions by establishing authentic institutions, the authors develop Archetype model and Meta-framework, where the former model is considered as the institutional framework implemented in Prophetic times of Medina, while the latter benchmarks the Archetype model to gain Islamic authenticity in modern societies. Such an ideal society is mainly driven by rule compliance, and human relations are assumed to exhibit "networks of prescribed rules of behaviour and enforcement" (Ng, Mirakhor and Ibrahim, 2015: 6). Taking such an ideal society granted, the chapter introduces two concepts as the fountain of social capital. The first one is *Walayah* (Love of Creator for His creation) as the foundation of social capital, and the second one is *Tawhid* (Oneness of Creator and His creation) as social capital's fountainhead. These two concepts have significant importance in articulating social capital. *Ihsan* (doing beautiful deeds), similarly, is of special importance in determining interpersonal relations in the ideal society. While *Walayah* brings love and

goodness from the Creator to individuals, *Ihsan* enables to extend the *Walayah* of the Creator to the rest of creation.

After a highly conceptual discussion, Chapter 3 explains how social capital fountains of *Walayah* and *Tawhid* bring out some essential forms of social capital as solidarity, *husn al-dhann* (good faith) and empathy, trustworthiness and trust, and mutual respect for property rights. These forms allow an integrated and unified institutional framework through which the economy and society are strengthened.

The essential role of morality is brought to discussion in Chapter 4. While the importance of social capital is acknowledged over the operations of market exchange, moral capital is recognized to facilitate cooperative and collective actions and to reduce transactions costs and uncertainty. The infusion of morality into the social capital discourse is done by emphasizing the transformative role of religion that enriches the scope of economics through employing moral values. By embedding values into the economy, the functioning of market exchange and society allows for the existence of collective interests between society and individual. An Islamic economic system, in the eyes of the authors, is a market-based system, which is regulated by an 'invisible heart' scattering religious values as part of moral capital. However, neoclassical economics is devoid of embedding moral values into the economic system due to value-neutral understanding and its ramifications, including efficiency-orientedness and Pareto optimality.

The first four chapters in the book constitute the base of the main argument. From Chapter 5 onwards, the authors address some practical problems in the financial and economic areas, and they develop potential solutions against morally alarming issues. Chapter 5, in this regard, deals with income inequality and the significance of social capital in lessening financial inequality. After rendering a historical survey of thoughts on distributive justice, Islamic perspectives on resolving inequality are enriched with the institutionalisation of some instruments such as sound legal framework, transparent collection and distribution of information, *Shari'ah* compliant financial engineering, and a healthy level of social capital (Iqbal and Mirakhor, 2013). An empirical study is conducted in this chapter with a cross-sectional regression over the period of 2000-2010 to evidence the importance of social capital in harnessing income inequality.

Another empirical study is conducted in Chapter 6 to examine the role of ethics and trust over stock market development and economic growth. The stock market is assumed to have formal institutional and informal institutional -known as social capital- determinants. Based on the notion of 'better finance better growth',

the authors empirically examine whether stock market development is widely dependent upon high social capital within the financial sector so that stock markets foster economic growth. Other than the role of stock markets, alternative social financial activities such as equity crowdfunding, macro market participation instruments and *waqf*-social impact partnerships are investigated in Chapter 7 and Chapter 8. The purpose of these chapters is to bring out positive social effects of financial markets. In this manner, social impact bonds, Islamic equity crowdfunding ecosystem and *waqf* sector are given as risk sharing and social welfare generating institutional alternatives within the Islamic financial industry.

The book gains its authenticity by bringing together ethics and economy through developing a functional social capital framework. As the global financial system is criticised due to ethical concerns, several studies attempt to develop financial ethical values and integrate them into the prevailing economic system. This book aims to fulfil this objective by envisioning a hypothetical financial environment surrounded by risk sharing characteristics. In this sense, it is well-structured in rendering the core idea of the need for a value-oriented social capital understanding. Also, the authors adequately concentrate on the link between risk sharing and social capital.

The general idea in this book is based on an Adam Smithian understanding of economics. Thus, it criticises the neoclassical stage of economics due to its ethically neutral position, while classical economics is assumed to reflect Smith's core thoughts elaborated in his first renowned book '*The Moral Sentiments*'. The reader can deduce by reading this reviewed book carefully, if modern economics needs to recourse to Smith's morality understanding he had before his writing of the book '*Wealth of Nations*'. In a similar vein, it is implicitly argued that the success of Islamic finance hinges on the incorporation of ethical values into the financial realm. This envisioning, however, is done without reckoning the ontological and epistemological conflict between Islamic values and secular, materialistic understanding of Western ethics. Once this distinction is neglected, the aspired Islamic economic model cannot go beyond a market-based system. Similarly, morality is integrated into the economy superficially as a constraint rather than as a substantially embedded factor: "It may be possible that some of these Islamic values and goals can be introduced into the conventional behavioral functions of consumers and producers and others can be added as constraints in the maximization of consumer utility and producer profit (Askari et al., 2014, quoted in Ng, Mirakhor and Ibrahim, 2015: 63)."

In relation to the mentioned drawbacks, the book inadequately deals with re-consideration of the core economic concepts such as production, consumption, wealth and market within Islamic ontology. Also, some political economy factors such as distributional justice and power relations within the existing economic system can be further argued since constructing a social capital understanding has to pay attention to political-economic environment.

References

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