

## 3. The Islamic economy

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### 3.1 INTRODUCTION

Islamic jurists have by and large been silent on the financial system for centuries until interest revived after the second world war (Chapra 2007, p. 346). Then Maududi and his contemporaries stood up and sought ways to Islamize the economy. Islamic economics is about the rules that should be followed by Muslims. It is normative economics. There have also been calls to develop an Islamic theoretical system of economics, including Islamic microeconomics and Islamic macroeconomics (Chapra 2000), but these have met with little success. Masudul Alam Choudhury (2007) would have liked to see such a system to be based on a specifically Islamic epistemology, itself founded on *tawheed*, the oneness of God. His own attempts, however, go no further than the pious wish that ‘In the end, by combining the totality of the *sharia* precepts with financing instruments, Islamic banks become investment-oriented financial intermediaries and agencies of sustainability of the socioeconomic order, the socio-political order and institutions of preservation of community assets and wellbeing.’ This has hard to understand implications for the nature of money:

The nature of money now turns out to be endogenous. Endogenous money is a systemic instrument that establishes complementarities between socioeconomic, financial, social and institutional possibilities towards sustaining circular causation between money, finance, spending on the good things of life and the real economy. . . . Money cannot have an exchange value of its own, which otherwise would result in a price for money as the rate of interest. Money does not have a market and hence no conceptions of demand and supply linked to such endogenous money in Islam. (Choudhury 2007, p. 34)

Apart from the fact that interest is not the price of money but the price of credit, that is, for borrowing money, it looks like Choudhury only wants to accept money as a means of exchange and a numeraire, not as an asset in its own right. This is the view generally adopted by Muslim authors. It has a distinct Aristotelian twist, as we shall see below. Whether his diffuse picture of an ideal society logically follows from a *tawheed*-based epistemology, or indeed from any epistemology at all, is debatable. It must be said that attempts on the Christian side to base economic analysis on a

specific epistemology anchored in religion have hardly fared better. One who tried was Professor T.P. van der Kooy, who taught economics in the Law Faculty at the VU University of Amsterdam from 1950 to 1969 and sought to base economic analysis on a Calvinist philosophical system developed by others at the VU University.<sup>1</sup> Van der Kooy rejected the distinction between positive and normative analysis, as Choudhury does, but it led nowhere and in the end he had to admit defeat (van der Kooy 1952, 1957). A distinct religion-based epistemology of course is something quite different than an analysis of the consequences for an economy of following Islamic principles with the help of conventional micro- and macroeconomic theory (see, for instance, Choudhury 1986, 1997; Tourani Rad 1989).

Islamic economics is about the rules that should be followed by Muslims. It is normative economics and as such does not require a different epistemology. Islamic economics is first and foremost the application of ethical principles, derived from what is seen as divine law. Sharia is, after all, a system of duties. These duties rest on a few basic principles: *tawheed* and brotherhood, fair remuneration of labour and redistribution of private wealth (Choudhury 1986, ch. 1; Chapra 2000).

- *Tawheed* and brotherhood. *Tawheed* is the oneness of God. It has also been interpreted as the unity of God and his creation, implying 'equality' of all men (Valibeigi 1993, p. 796). *Tawheed* and brotherhood bear on the way people treat each other in the light of their relationship with God, in other words, on social justice. Man as God's vice-regent on earth is charged with the obligation to use His resources in a right way, a principle not unknown in Christianity either.
- Fair remuneration of labour. The remuneration of labour should be commensurate with the character and the amount of the work done. The available resources belong to God and those who appropriate an income that is too high, given this principle, are guilty of excess.
- The right of society to redistribute private wealth. Obligatory alms giving, *zakat*, follows from this principle.

The first two are general principles, but *zakat* is a specific duty. In our discussion of the Islamic economy in this chapter we start with *zakat*, followed by the ban on interest or *riba*, including a comparison with Christian attitudes, and the bans on gambling, *maysir*, and taking unnecessary risk, *gharar*. Then the scope widens and the views of Islam, or at least prominent Muslim scholars, on the economic order are reviewed. Finally, calls for an Islamic economy to be kept apart as far as possible from the non-Islamic one are discussed.

Of course, Muslims should also refrain from consuming haram goods and services. These include alcoholic drinks, pork-related products, gambling and adult entertainment. Among the more strict believers, virtually all entertainment, including the cinema and music, is considered haram (see Maududi 1999, p. 31). No sex, drugs and rock'n'roll for them. This restriction does not require extensive explanation, but it will return in the discussion in the following chapters every now and then.

### 3.2 ZAKAT

Zakat is the third of the five pillars of Sunni Islam, as we saw in Section 2.2. The Arabic word 'zakah' or 'zakat' means 'purity' and 'cleanliness' and the idea is that one purifies one's wealth as well as one's heart by giving away a part of one's wealth to the poor (Benthall 1999, p. 29; Sadeq 2002, p. 13). Zakat comes in two forms: *zakat al-fitr* and *zakat mal*. *Fitr* is the breaking of the fast and *zakat al-fitr* is the requirement for everybody if possible to give something for the needy every year at the end of the fasting month of Ramadan. What is asked is something like 2.2 kg of the local staple food or the equivalent in money. *Zakat mal* is a wealth tax in the form of a levy of, in most cases, 2.5 per cent on a number of assets. It is levied from adult, sane, free Muslims on productive assets that are held for at least one lunar year, above a threshold. Zakat is generally imposed on:

- gold and silver, in any form; not on other metals
- financial assets such as cash, banknotes and stocks
- merchandise for business
- livestock
- income derived from rental business.<sup>2</sup>

Personal needs are not taxable. These include, among other things, clothing, household furniture, utensils, cars, diamonds, pearls and other precious or semi-precious stones. For shares held in a company, zakat is based upon the current market value. Machinery, land, fixtures and fittings, furniture, buildings and so on are exempt from zakat, as only property intended for trade is included, and one is allowed to subtract these from the value of the shares.

There is a fierce discussion on what to include in the range of assets subject to zakat. Many assets did not yet exist in the early days of Islam and it is a moot question whether they should be taxed or not. An additional complication is that even in the days of the rightly-guided Caliphs not all assets were taxed. One hard to understand case was the decision by Caliph

Umar that dates are subject to zakat, but not pomegranates (Kuran 2006, p. 116). As for newer assets, banknotes, for instance, did not exist in the time of the Prophet, and are included on the basis of qiyas, as are bank deposits. Another source of uncertainty is the fact that price ratios have changed over the centuries. In particular, silver prices have fallen relative to gold and a threshold value based on some weight of silver is now way below threshold values based on gold (Sadeq 2002, p. 29).

A literal following of the ahadith concerning zakat leads to all kinds of other inconsistencies and inequities. A not too well-off farmer, for instance, may have to pay a considerable amount of zakat, whereas much richer people who have invested their wealth in cars and other assets that did not exist in the time of the Prophet, such as old masters, pay much less. The Fiqh Academy of the Organization of the Islamic Conference has firmly come out in favour of the traditional view that only items mentioned in the Hadith can be included.<sup>3</sup> In a fatwa issued in its session in Jeddah in November 1985, fixed assets such as buildings, machines and equipment are excluded from zakat (Sadeq 2002, pp. 32–3). This is the line followed in Saudi Arabia, on the grounds that these fixed assets are not items of trade. More liberal currents in contrast are in favour of applying *ijtihad* and *istihsan*, that is, of reinterpreting the rules with an eye to equity. Among those liberal currents, there is lack of unanimity on whether, for instance, salaries should be brought under zakat. Nor do they agree on differentiation of zakat rates, advocated by some who would like to see higher rates for those sources of income that require less exertion of labour and a lower amount of invested capital. Some adaption to modern times was unavoidable. Saudi Arabia, for instance, has fixed the threshold value for assets in terms of gold, ignoring the threshold on silver, and zakat has been imposed on professional income (Sadeq 2002, p. 47). Even those that are against reinterpretation of the Hadith sometimes accept levying zakat on items on which the sunna is silent, in particular banknotes.

The use of zakat is strictly circumscribed. The Quran, 9:60, says:

In fact the sadaqat [zakat] collection is for the poor, the helpless, those employed to administer the funds, those whose hearts need to be won over [to the truth], ransoming the captives, helping the destitute, in the Way of Allah and for the wayfarer. That is a duty enjoined by Allah; and Allah is All-Knowledgeable, Wise.

Still, interpretations differ widely. Jurists disagree over whether zakat should be distributed directly to needy individuals or can also be given to charities or used for welfare projects. Some are convinced that zakat must be spent on the needy in the area where it is raised, unless there is a surplus

left after the needs are met or there is an emergency situation elsewhere (Ramadan 2004, pp. 89, 189). Others, following the salafi reformists Maududi and Qutb, want to include propagation of Islam, Islamic education, activities to establish an Islamic way of life by replacing anti-Islamic or secular systems, or any other struggle in righteous cause (Sadeq 2002, p. 39). Others again argue that zakat proceeds may be used for social welfare programmes and economic development projects, manpower training or education in various scientific and technical fields, on the ground that such programmes will help both the poor who directly participate in them and also others. Even using zakat proceeds for defence is seen as permissible, since an attack on a Muslim country is synonymous to an attack on Islam (*ibid.*). All this opens the way, of course, for financing activities that many would label as terrorist, though the worries of the US government after September 11 do not always seem to have been warranted. The anthropologist Jonathan Benthall, a specialist in this field, at least deems the leading Islamic charities from Britain, Islamic Relief Worldwide, Muslim Aid and Muslim Health, as professional, with transparent money flows (van der Aa 2007).

Zakat may not be used for payments to descendants of Muhammad, to parents, grandparents, children, grandchildren or one's husband or wife. Also excluded are institutions or organizations that do not pass zakat to the rightful recipients, but instead use zakat funds for construction, investment or salaries.

Muslim scholars disagree over whether the poor that qualify for zakat should include non-Muslims. Some state that zakat money may be paid to non-Muslims after the needs of the Muslims have been met, finding no indication in the Quran or sunna that zakat is to be used for Muslims only. Provided they do not fight against Islam and Muslims, non-Muslims qualify. Maududi, by contrast, deems non-Muslims not eligible for receiving zakat, on the basis of an hadith 'To be taken from your rich people and to be distributed to your poor people', where 'your' in his view refers to 'Muslims'. Non-Muslims should receive assistance from general welfare funds (Sadeq 2002, p. 41). These differences are reflected in the policies of charities. Islamic Relief, for instance, extends zakat funds to non-Muslims in Africa, Muslim Aid only supports Muslims (Benthall 1999, p. 31).

The fiqh schools differ on the sums to be given to the poor. According to the Hanafi school, they should be given an amount that brings them up to the minimum taxable income; the Maliki school and most Hanbalis demand an amount sufficient to cover their needs for a year and the Shafii school requires an amount sufficient for the whole of their life. All this does not mean that the poor should be on perpetual welfare, they should rather get an opportunity to rise from their misery and take control of their own

lives; they should become self-sufficient. Some Islamic scholars therefore have advised to provide the poor not only with food and shelter, but also to enable them to buy tools, animals and goods for trade (Ramadan 2004, pp. 192–3).

In most Muslim countries zakat giving is voluntary, but in some countries, including Pakistan (since 1979), Sudan (since 1983), Saudi Arabia, Yemen and Malaysia, it is an obligatory tax. In Pakistan and Saudi Arabia not only individuals but companies are subject to zakat levies (Sadeq 2002, p. 43; Kuran 2006, p. 21). In Indonesia a law enacted in 1999 charged the government with regulating zakat, so that it is no longer a private affair of individual Muslims (Lubis 2004, p. 102). In countries such as Morocco and Oman zakat contributions are completely left to the individual's conscience and Jordan is somewhere in between. There is a zakat directorate under the Ministry of Religious Affairs, but local zakat committees are also allowed to raise and distribute charitable funds (Benthall 1999, p. 29). In Kuwait and Bangladesh the state administers zakat funds, but contributions are voluntary.

State zakat collectors cannot always be trusted to channel the best part of their funds to the poor. Evidence from zakat offices at the level of individual states in Malaysia (Malaysia is a federation) from the 1970s and the 1980s shows that no more than between 11 and 15 per cent went to the poor, with a much larger share set aside for the zakat collectors – in the state of Negeri Sembilan during 1978–82 52 per cent – and to religious education. For Sudan, administrative costs to the tune of 18 per cent have been reported. Whereas zakat in Malaysia and Sudan may be disbursed to all the categories mentioned in the Quran, Pakistan and Saudi Arabia are reported to disburse mainly to the poor and the destitute (Sadeq 2002, pp. 17, 51–2; Kuran 2006, p. 25).

Quite a lot of self-congratulatory noises are made about the institution of zakat, but available evidence suggests that it is neither a fair nor a very helpful tax. It is not fair, because the rich, at least in Pakistan, Saudi Arabia and Malaysia, don't pay much, partly because of evasion and partly because assets such as housing are not taxed. In Malaysia relatively poor rice growers pay disproportionately. It is not very helpful, because the sums brought together are not impressive. In Pakistan zakat tax brought in no more than 0.35 per cent of GDP in 1987–88 and in Saudi Arabia it was even less, 0.04 per cent in the 1970s (Kuran 2006, pp. 21–2). Still, rather overblown claims are being made, to the effect that zakat has other beneficial effects besides alleviating poverty. Qureshi (1991, p. 185) argues that zakat increases what Keynes in Chapter 17 of *The General Theory of Employment, Interest and Money* called the carrying cost of money and thus makes it less attractive to hold deposits (carrying costs are the pecuniary

costs, as distinct from the opportunity costs, involved in holding an asset) (Keynes 1936 [1961], p. 225). This should stimulate wealth holders to invest their money and try and get some return rather than increase their idle balances, thus preventing economic stagnation. It is an echo of Silvio Gesell's idea that people should be made to pay for maintaining the value of their money, in his blueprint by buying stamps to be affixed on banknotes (Gesell 1931). The argument is not convincing. As in the case of inflation, which also acts as a tax on money holdings, people will switch to foreign currency or invest in real estate, without contributing to sustained higher growth. Moreover, with the amounts involved one can hardly expect zakat to have a measurable impact on aggregate spending and unemployment. Furthermore, a lack of spending need not always be a pressing problem. These arguments can also be advanced against the idea that zakat implies a redistribution of goods that should lead to a higher demand for labour-intensive consumption goods (Sadeq 2002, p. 22). Zakat can only play a minor role in addressing poverty. For financing today's social spending levies from a much wider tax base at much higher rates are required than zakat can ever hope to attain.

### 3.3 *RIBA*

#### 3.3.1 The Prohibition of *Riba*

If there is one distinguishing characteristic of the Islamic economy, it is the prohibition of *riba*. This is nothing new. The ban on *riba* was already observed in the medieval Muslim world (Udovitch 1979) and famous scholars such as al-Ghazali took the ban on *riba* for granted (Ghazanfar and Islahi 1990). The literal meaning of *riba* is 'increase' or 'addition' or 'surplus'. In the sharia, *riba* stands for an addition to the principal and, by implication, for a payment for the use of money which has been fixed beforehand. It is a form of excess, of unjustified appropriation of income, and it therefore is at variance with the principle of *tawheed* and brotherhood and with Islamic ideas about income distribution (Choudhury 1986, p. 11).

The prohibition of *riba* is based on a number of verses from the Quran, in particular *Sura* 2:275, 276 and 278, *Sura* 3:130, *Sura* 30:39 and *Sura* 4:161 (see Appendix A). The last two may not include an outright ban on *riba*, they only state that *riba* earnings are not blessed by God, respectively, that *riba* was forbidden for the Jews, but the other verses do. It is not quite clear what the Quran exactly means by the term *riba*, and people have to rely on the *sunna* to find an answer. The first Caliph, Umar, is reported to

have complained that ‘The last [of Quran] that was revealed was the verse on *riba* [2:275–278]; and, behold, the Apostle of God passed away before having explained its meaning to us’ (Meherally 2007).

For those who see the ban on *riba* as the cornerstone of Islamic economics, all forms of interest are forbidden and no discussion is possible on this fundamental tenet (for example, Uzair 1978, p. 4). It may be noted that a Western Muslim such as Tariq Ramadan, who is an outspoken proponent of full participation of Western Muslims in their various national societies, is adamant in defending the ban on *riba* (Ramadan 2004, ch. 8). The relevance of the ban on *riba* for the present-day world is, however, a moot point. One form of *riba* concerned a pre-Islamic Arabic custom which prevailed in transactions of gold and silver. If a debt was not paid on maturity (after one year), the principal was doubled (Qureshi 1991, p. 54). Quran 3:130, which talks about ‘doubling’, probably refers to this custom. The ban on *riba* was aimed, in the view of some commentators, to prevent the debtor being enslaved (Kuran 1995, pp. 156–7; Fazlur Rahman,<sup>4</sup> cited in Haque 1995, p. 35). That would make the ban on *riba* irrelevant for present-day banking and finance, as it would only bear on *riba al-jahiliyya*, the *riba* practised by the Arabs in the pre-Muslim ‘time of ignorance’. *Riba* and interest in these views are different things. Various Muslim scholars, including the great reformer Muhammad Rashid Rida (1865–1935), have accordingly concluded that *riba* manifested itself in Muhammad’s time in very specific forms and that a ban cannot simply be carried over to all forms of interest found today. According to Imad-ad-Dean Ahmad of the Minaret of Freedom Institute of Bethesda, Maryland, *riba* stands for any unjustified increase, and in the Quran specifically concerns consumption loans to people experiencing financial distress (Imad-ad-Dean Ahmad 1996). Others, however, contend that the Quranic injunction refers to business loans, needed for financing long-distance trade (Chapra 2006). Much depends on the way one reads the Quran and the Hadith. If one only looks at the literal statements, one may be inclined to reject interest totally; people who look at the rationale for an injunction may argue that a ban on *riba* is justified when charging interest brings injustice and not when it does not. They may, for instance, consider *riba* on consumer loans as haram and *riba* for productive purposes as halal. Those who see the ban restricted to *riba al-jahiliyya* either conclude that compound interest or that excessively high interest, usury in the connotation it has in common parlance, is forbidden (Talal 2007).

Especially in Egypt, conventional forms of interest have been defended. Already in the mid-1980s Egypt’s highest-ranking judge, Said al-Ashmawy, ruled that the interest charged and paid by commercial banks is quite something else than *riba*. This was after sharia boards of Islamic

banks had come under suspicion of fraud and corruption (Botje 1987). Islamic banks and other financial institutions have such a sharia board or committee made up of religious scholars in order to convince their clientele of the Islamic character of their products (see Section 5.4.5 on sharia boards). Al-Ashmawy's argument that *riba* is not well-defined, as the Prophet had died before he had been able to give a final explanation of the Quran verses on *riba* and furthermore the four orthodox schools of law disagree on the subject, seems to have been unable to make many converts (see Botje 1988). Still, Egyptian religious and secular authorities have been loth to condemn interest outright. Some religious leaders have argued that interest as paid by conventional banks to their depositors can be seen as a share in the profits made by productive investments and, by that token, are fundamentally different from the *riba* that is forbidden by the sharia (El-Gamal 2001a, p. 2). One former Egyptian cabinet minister, Dr 'Abd-Al-Mun'im Al-Nimr, saw the ban on *riba* as a means of protecting debtors, which, in his view, is irrelevant in the case of bank accounts, the bank being the debtor. Egyptian muftis have accordingly issued fatwas authorizing interest-yielding bank deposits (El-Gamal 2000, p. 29). The political situation in Egypt may have played a role, or perhaps the scandals in which dubious firms masquerading as Islamic financial institutions were involved. After a number of pyramid funds had gone bust, one of the leading religious leaders, the mufti of Cairo, issued a fatwa ruling that interest payments provide security to small investors and, therefore, are *halal*, or permitted according to the sharia (Drummond 2000). Quite an uproar was caused by a fatwa issued on 2 December 2002, by the rector of Al-Azhar University, Muhammad Sayid Tantawi, permitting pre-specified fixed-rate bank deposits, in response to a query by the Chairman of the Board of Directors of Arab Banking Corporation and after discussion in the Islamic Research Institute of Al-Azhar.<sup>5</sup> The fatwa sees banks as agents for permissible investment and regards interest paid on bank deposits as profit distributions that are pre-specified by mutual consent (El-Gamal 2003a notes that the fatwa applies not to all bank deposits, but only to investment accounts, see Chapter 4). The leading Muslim organizations in Indonesia have been lukewarm towards banning interest as well.<sup>6</sup> In 1938 the Nahdlatul Ulama stated in its national congress that bank interest benefits the customers and society at large and is therefore *halal* (Lubis 2004, p. 103). The other Indonesian Muslim mass movement, Muhammadiyah, was less sure and tended to accept interest-based banking on the ground of *darura* (necessity), given the lack of sharia-based financial institutions, but in 1993 it had come round to condemning all forms of interest and advocating the founding of Islamic financial institutions (Lubis 2004, p. 104).

Those who see the ban on riba as relevant for the modern world generally distinguish two broad categories, *riba al-nasia* and *riba al-fadl*.

- *Riba al-nasia*, or riba by way of deferment, is produced by delaying completion of an exchange of countervalues and includes interest in the conventional sense of a predetermined payment for a loan, which may be a loan of money or a loan of goods.
- *Riba al-fadl*, or riba by way of excess, refers to an excess or increase paid in a direct exchange of commodities. It looks at first sight a bit like the idea of ‘unequal exchange’, seen by Marxists as characteristic of capitalist society (see Emmanuel 1969). The resemblance, of course, is no more than superficial, as Muslims do not subscribe to the labour theory of value which underlies Marxist analysis. Nonetheless, the strongly anti-capitalist Muslim author Haque (1995) is quite close to it. In his eyes, ‘unequal exchange’ or riba al-fadl is characteristic of capitalist societies.

Many Muslim scholars see riba al-jahiliyya as a form of riba al-nasia, but some consider it a separate category. *Riba al-jahiliyya* is related to transactions in which no increase was stipulated at the time of advancing a loan; however, if the debtor could not pay the principal amount at the time of maturity, the creditor used to offer him two options: either to pay the principal or to increase the amount in exchange for an additional term allowed by the creditor. Those who deem riba al-jahiliyya a separate category see it as the riba condemned in the Quran, whereas the other two forms were dealt with in the sunna. If riba al-jahiliyya is included in riba al-nasia, one of course cannot but conclude that the injunctions in the Quran against riba concern the latter category.

Obviously, then, riba in general is more than the mere phenomenon of a predetermined payment of a sum of money for a loan. The concept of riba covers not only money loans, but also the exchange of goods. It refers to a surplus gain, whether in the form of money or in kind.

From the description given here it is not immediately clear where the dividing line between halal, or permitted, and haram, or forbidden, transactions runs. This, indeed, is a matter for continuing dispute and the various law schools hold different views on the subject.<sup>7</sup> Take the ban on riba al-fadl. This is based on ahadith such as the following:

Ubidat b. al-Simit (Allah be pleased with him) reported Allah’s Messenger (may peace be upon him) as saying: Gold is to be paid for by gold, silver by silver, wheat by wheat, barley by barley, dates by dates, and salt by salt, like for like and equal for equal, payment being made hand to hand. If these classes differ,

then sell as you wish if payment is made hand to hand. (Muslim, book 10, number 3853)

This is interpreted as a ban on exchanging, say, two low-quality dates for one high-quality date, even if it is permitted to sell the low-quality dates for money and use the receipts for buying a high-quality date, according to the Hadith:

Narrated Abu Said Al-Khudri and Abu Huraira: Allah's Apostle appointed somebody as a governor of Khaibar. That governor brought to him an excellent kind of dates (from Khaibar). The Prophet asked, 'Are all the dates of Khaibar like this?' He replied, 'By Allah, no, O Allah's Apostle! But we barter one Sa of this (type of dates) for two Sas of dates of ours and two Sas of it for three of ours.' Allah's Apostle said, 'Do not do so (as that is a kind of usury) but sell the mixed dates (of inferior quality) for money, and then buy good dates with that money'. (Bukhari, vol. 3, book 34, no. 405; see also Muslim, book 10, number 3875)

It is not quite clear what the rationale for the ban on *riba al-fadl* is. Possibly, it was meant to protect people against sharp traders (Talal 2007). Whatever the case, the question that immediately arises is: must the list be seen as an exhaustive account or not? Hanafis, with their liberal application of *qiyas* (analogy), generalize the ban to all goods that are measurable by weight or volume. Zahiris, by contrast, reject all forms of *qiyas* and restrict the ban on *riba al-fadl* to the six commodities mentioned in the Hadith. The curious thing is that, as a result of their dogmatic rigour, they end up with a more liberal view on *riba al-fadl* than less strict schools of law.

Only the slightest form of *qiyas* has to be applied in order to extend the ban on *riba al-fadl* to the exchange of money against claims on money. This would imply that money and claims on money can only be traded if those claims are traded at par, effectively banning conventional interest again. It may be different if the claims on money are backed by real goods, because the claims on money can in that case be interpreted as claims on goods.

It may be noted that *riba al-fadl* does not seem to make a transaction null and void. It is argued by some Muslim jurists that the implementation of the prohibition of *riba al-fadl* is the responsibility of individual Muslims (Usmani 2000, para. 107). In general, the verdict on a contract tainted by *riba* often seems to be defective, and if sharia courts find that *riba* was involved in a contract, the transgressor has to donate the amount involved to the poor. This also applies to *riba al-nasia*.

One interesting question concerning loans is whether if a predetermined interest payment is not allowed, that also precludes giving and receiving an inflation compensation. Generally, Muslim scholars think it does.

Indexation has found little favour with them, on the grounds that rules of *riba* or any other divine rule cannot be relaxed for man-made problems like inflation. What is needed is an effective check on inflation through rational macroeconomic policies and not an acceptance of inflation (Obaidullah 2005, p. 28). Others, however, see a place for inflation compensation. A.L.M. Abdul Gafoor (1996, ch. 2, 2000), for instance, regards inflation compensation as a separate component of the cost of borrowing, quite distinct from interest. In his view, the interest charged by conventional banks can be split up in six components, namely services costs, overhead cost, a risk premium, profit, inflation compensation and interest proper. Only the last category, which banks pass on to depositors, is subject to the ban on *riba*. Islamic banks would, in Mr Gafoor's view, perfectly well obey the *sharia* if they charged their clients a fee which covered the first five categories and left interest out. Depositors would not receive interest, but the value of their balances would be guaranteed, the real value, that is, they would receive an inflation compensation.

Mr Gafoor's ideas appear to be largely ignored in the world of Islamic finance. Still, one authoritative Islamic organization, the Islamic Fiqh Academy of the Organization of the Islamic Conference, has moved just a few steps in his direction. It draws a distinction between foreseen and unforeseen inflation. A loan contains a gift element, because the provider of the loan could have invested the money in other, more profitable, ways. After all, according to Maududi (1999, p. 167), the profound objective of the ban on *riba* was to replace the stinginess and selfishness of the capitalist mentality with generosity and a cooperative spirit. If there is foreseen inflation, the gift element simply is larger and it does not give the loan provider the right to demand compensation. If, however, inflation is unforeseen, the loan provider may lose more in real terms than was his intention. The Academy advises to resort to arbitration in such cases. If that should be impossible, losses above the, admittedly arbitrary, limit of 33 per cent should be compensated (El Gamal 2000, pp. 32–3).

A question on a more theoretical plane is whether the Islamic rejection of interest on loans precludes a recognition of a time value of money. Many Muslim scholars, following Maududi (1999, pp. 175–7), amongst others, are convinced that the whole concept of a time value of money or time preference is devoid of sense. There is no unanimity on the subject though. El-Gamal (2002, pp. 3–4) argues that not all forms of interest fall in the category of forbidden *riba* and that not all *riba* is interest. *Riba* and interest are not the same thing. In Chapter 4 we shall discuss mark-up and leasing contracts that involve an increase in the purchase price, and El-Gamal regards such an increase as a fully justified compensation to the trader or the financier for the opportunity cost of providing credit (cf. the Scholastic

idea of *lucrum cessans* in Section 3.3.3 below). Whether we denote this compensation as interest or not is immaterial. The point is that, as we have already seen in *Sura 2:275*, trade is permitted but *riba* is not. El-Gamal (2000, p. 12) shows that the traditional jurists of the various schools of law saw sales in which the price is increased in case of deferment as permitted, whereas an increase in the amount of debt was seen as *riba*, and thus as not permitted. Credit sales can therefore be used as a form of finance, but interest-bearing loans not. Why this is so, only God knows (El-Gamal 2000, p. 13). The notion of a time value of money is thus fully accepted, according to El-Gamal. So, even if in many cases the fees or mark-ups that sellers and financiers demand look suspiciously close to conventional interest, there is one requirement that most Islamic scholars emphasize can never be disregarded, and that is that all financial transactions should be asset-backed, unless done at par. Whether the conditions of a financial transaction smack of interest is in the last analysis less important than this coupling of a financial transaction to a real transaction.

Part of the condemnation of *riba* can be found in the Hadith. If the authority of the Quran is unassailable, the authority of a hadith is dependent on a reliable chain of transmitters. Fazlur Rahman saw contradictions between the different ahadith condemning *riba*, which led him to the conclusion that they are unlikely to be authentic (Pal 1999, p. 53). This strengthened his conviction that the ban on *riba* refers exclusively to *riba al-jahiliyya*, as described in the Quran, with its exorbitant increase in the capital sum when the term of payment of a debt is extended. This did his name no good among the more conservative ulama in Pakistan.

### 3.3.2 Secular Arguments for the Prohibition of *Riba*

The injunctions against *riba* in the Quran and the sunna were given without a justification. Muslims simply have to follow the commands of God, whether they understand the rationale of those demands or not. Nevertheless, Muslim scholars have tried to give a secular justification for the ban, showing why it should be beneficial for mankind. Some argue that money in itself is not a factor of production and that a loan of money which does not go hand in hand with at least some entrepreneurial risk taking should not bring a reward. Money, or capital, can only be seen as a factor of production when combined with entrepreneurship (for example, Uzair 1978, pp. 14–21; Maududi 1999, p. 170). We shall return to this argument in Section 3.3.3.

Some justifications look a bit far-fetched. Choudhury (1986, p. 11) follows a Kalecki-like reasoning, arguing that capitalists reinvest their income. Capital accumulation makes the rate of profit fall, but interest

rates will increase and in order to maintain profits, the capitalist will lower wages or dismiss workers. Riba thus leads to exploitation and unemployment. This reasoning smacks of Marxist business cycle analysis and is far from compelling. For one thing, it is not made clear why the interest rate should increase when the rate of profit falls.

A common justification of the ban on riba is that interest means a transfer of wealth from the poor to the rich, turns people away from productive enterprise or makes people selfish and stone-hearted (Siddiqi, quoted by Kuran 2006, p. 8). One would be hard put to detect such effects in, say, widows and orphans living from the interest on government bonds. Some Muslim scholars, among whom Mahmoud A. El-Gamal, consequently make short shrift of the alleged danger of exploitation (El-Gamal 2001a). After all, that would imply that the US government is exploited by investors in treasury bills or that banks are exploited by holders of savings accounts. This does not mean that he wants to throw the ban on riba overboard. He rather looks for another rationale. His approach marries microeconomic theory to the ideas of the Maliki scholar Ibn Rushd, or Averroes (1126–98), who, in this case, leaned to Hanafi views, which means that he generalized the ban on riba al-fadl. The ban on riba al-fadl sees to it that partners in a transaction collect information about the market valuation of goods. This prevents trade taking place at non-equilibrium prices, which would happen under imperfect information, and leads to Pareto-optimality. Goods in this situation are exchanged against each other at a ratio that equals both the ratio of the marginal utilities and the ratio of market prices. If the outcome is an unacceptable distribution of income, that should be taken care of by *ex post* reallocations of wealth, in particular by zakat. With riba al-fadl there is an informational argument that can be used to justify its banning. With riba al-nasia there is an additional argument, namely that the dimension of time adds another source of inefficiency in the form of dynamic inconsistency. A ban on riba al-nasia provides a precommitment mechanism in financial contracts that effectively deals with this dynamic inconsistency. El-Gamal argues that people do not always make rational choices. There are, in particular, anomalies in the discounting of expected future costs and benefits. El-Gamal attacks the problem with the help of a three-period model in which investments yield a profit in the third period. Investments are partly financed by loans. Now economic agents will be tempted to take one-period loans rather than two-period loans, as short-term loans carry lower interest rates. The danger is that economic agents deviate in period two from the plans they made in period one, presumably jeopardizing the financing of the project in the process. If finance is provided in the form of a participation instead of a loan, agents are not free to, say, suddenly increase consumption in period two over and above what was planned in period one, at least not

without the agreement of the partners. This should, in El-Gamal's eyes, go a long way to prevent dynamic inconsistency and, with it, loss of efficiency. Financial instruments based on participation provide a form of precommitment and therefore are not only preferable over interest-paying loans but also over halal forms of loans.

The argument looks a bit far-fetched, even if it is presented in the language of modern economics. It should make clear, though, to what lengths Muslim economists working in the Western world and fully acquainted with modern economic theory go to link economic analysis with the precepts of the Quran and the sunna.

### 3.3.3 Digression: Parallels in Medieval Christianity

The condemnation of interest has not been confined to Islam. Based on passages from the Bible, the Christian Church at various times took a strong stand against demanding and paying interest. The term used for interest was *usura*, which is a technical term that includes 'normal' interest and what is commonly seen as exorbitant rates of interest, or usury, but also excessive profits (van Straaten 2002, p. 9). In the Old Testament, or Tenach, it was forbidden to demand interest on loans, but not entirely, as interest could be charged on loans to foreigners, and the ban sometimes was restricted to loans to the poor (Exodus 22:24; Leviticus 25:35–36; Deuteronomy 23:20–21, see Appendix C). Money was not borrowed for productive purposes, but out of dire necessity, and the ban on interest was most probably intended to prevent people profiting from a deplorable situation of the poor (van Straaten 2002, p. 13). In the New Testament the negative attitude is less absolute. In the parable of the talents (Matthew 25:14–30; Luke 19:11–27), paying interest is apparently not frowned upon, and though other passages are perhaps less positive, they do not seem to contain an outright condemnation (see Luke 6:27–38).

Whereas Leviticus 25:36 and Deuteronomy 23:20 forbid demanding interest from one's countrymen, older translations have 'brothers' instead of countrymen, and Christians were inclined to set great store by the universal brotherhood of man. This led to a wholesale rejection of interest by the Church. One of the first to speak out against interest was the holy Clemens of Alexandria (†220). The Council of Nicea (325) forbade interest payments among the clergy. The First Council of Carthago (345) disapproved of interest payments by laymen, even if it did not go so far as to forbid them. The Second Lateran Council (1139) excommunicated 'usurers' and the Third Lateran Council (1179) denied them Christian burial. Pope Eugene III in 1148 condemned mortgage loans as indirect usury. The Fourth Lateran Council (1215) berated Christians who did

business with Jewish usurers and the Second Council of Lyon (1274) added foreign usurers. The Council of Vienne (1311–12) extended the threat of excommunication to authorities who permitted usury or protected usurers. Those who let a house to usurers could be excommunicated as well. It furthermore declared all secular legislation in favour of usury null and void. The last encyclical against usury, promulgated by Pope Benedict XIV, dates from 1745.<sup>8</sup> The French bishops issued a decree on 12 October 1789, during the Revolution, repealing the ban on interest but it took until 1838 before the Vatican followed suit, in a pastoral letter to confessors (see on the attitude of the Church Beutels 1990; Gelpi and Julien-Labruyère 2000; Le Goff 1979; O'Brien 2001; van Straaten 2002; Wood 2002).

Medieval Scholastics, like present-day Muslims, marshalled not only theological but also secular arguments to the defence of a ban on interest, or rather usury. St Thomas Aquinas (1225–74) argued that interest is a price paid for the use of money while money, seen from the point of view of the individual agent, is consumed, used up, when it is used, in the same way as goods such as wine. Money cannot be used without decreasing the existing stock, unlike durables such as houses, land or horses. To demand interest for the use of money means that a payment is demanded for something that in the case of money does not exist, namely a use distinct from consumption (Aquinas 1965, Question LXXVIII). This would be an injustice, because it would amount to asking for double payment: first for the use and then for the return of the good in equal measure. This is, in the eyes of the Scholastics, fundamentally different from, say, letting a house. According to O'Brien (2001, pp. 97ff), Aquinas saw a loan contract, a *mutuum*, as a sale, because ownership passed. What matters in sales is the fixing of just prices, and in case of fungible goods, of which money is the prime example, the just price is nothing else but the return of fungibles of the same value as those lent. The amount to be returned thus is simply the amount of money borrowed.

The argument draws heavily on Aristotle, who in his *Politika* (book I, ch. 10; Aristotle 1992, pp. 85–7) argues that money has been developed first and foremost as a means of exchange and that, consequently, it should be used for making purchases and not for lending and receiving a reward for that lending. Lending money and receiving a reward for lending goes, in Aristotle's view, against nature. The Greek term for interest, *tokos*, also means offspring. But unlike nature – cattle, fields – money has no offspring, it does not produce anything, it is barren. Money does not beget money. Money is nothing more than a convention and conventions, unlike natural things, cannot produce things. His reasoning seems to have been fed by disdain for the daily activities of common people, first of all merchants; an attitude far from unique among the upper classes at the time (Engen 2004).

Another explanation, not necessarily at odds with the earlier one, is that Aristotle's main concern was maintaining a well-ordered stationary state, where people, or rather heads of households, should involve themselves only up to a modest degree in acquisitive activities and have no use for money making as an end in itself (Gordon 1993). It may all look less than compelling in our eyes, but Aristotle was intensively studied and was seen as an unassailable authority by thirteenth- to fifteenth-century theologians, including Thomas Aquinas. Thomas's teacher Albertus Magnus (c. 1200–80) was so steeped in his writings that he was nicknamed 'Aristotle's ape' (O'Brien 2001, p. 13). Aquinas fully adopted Aristotle's reasoning and saw money as sterile in itself. True, a borrower can use the money borrowed in some venture and make a profit, but such a result was seen by Aquinas and the other Scholastics as the reward for the labour applied by the borrower. The delay in the repayment of the loan could not be used as a reason for demanding interest either, because that would amount to a sale of time, and time cannot be owned.

The medieval view on interest is evident in the first part of Dante's *Divina Commedia*, *Hell*, which appeared around 1314. In Canto XVII Dante spots the Usurers, predominantly Florentine bankers, on the burning sand of Circle VII, Ring iii, lumped together with the Sodomites. One commentator observes that the two groups are classed together because the latter make sterile the natural instincts which result in fertility, whereas the former make fertile that which by its nature is sterile (Dante 1955, pp. 174–9). This is pure Aristotle. The pernicious effects of associating oneself with interest were somewhat later literally painted in bright colours by Quinten Metsys (1465 or 1466–1530) in his *The moneylender and his wife* (1514, Louvre, Paris, see [www.louvre.fr](http://www.louvre.fr)) and in a caricatural painting of two moneylenders and their clients (Galleria Doria Pamphilj, Rome, see [www.bridgemanartondemand.com](http://www.bridgemanartondemand.com)). Marinus van Reymerswaele (c. 1490–1567) followed with quite a number of similar paintings. Some present-day manifestations of a negative attitude to the phenomenon of interest are JAK Banken in Sweden, a bank that provides interest-free loans but requires its clients or participants to hold funds for long periods on interest-free accounts (they in fact give up liquidity in one period for the privilege of not paying interest in another period), and action groups and NGOs such as the Dutch *Stro* social trade organization that support local initiatives for interest-free borrowing and investment (see Anielski 2003 and [www.strohalm.nl](http://www.strohalm.nl)). Another example was the poet Ezra Pound, already mentioned in Chapter 1, who in his Canto 45 carries on about 'usura, sin against nature'.

El-Gamal (2000, n. 3) may argue that the notion that money is sterile and does not grow by itself is part of the traditional doctrine of the Catholic Church and is alien to Islam, but it cannot be denied that the

Scholastics, including St Thomas, leaned heavily on such Islamic scholars as Al-Ghazali. Al-Ghazali, like Aristotle, argued that money is meant to express the value of goods in exchange and not for earning additional money (Hosseini 1995, p. 540). Those Islamic scholars in their turn were heavily influenced again by Aristotle (Versteegh 2008).

The ban on usury did not mean that all interest was forbidden. The Scholastics accepted various justifications for demanding and paying interest, the so-called extrinsic titles, extrinsic because they were based on circumstances outside the loan itself. These extrinsic titles were the following:

- *Lucrum cessans*, the gain foregone by lending. Acceptance of *lucrum cessans* means that the notion of opportunity cost entered the discussion (Beutels 1990, p. 320; Schumpeter 1967, pp. 103–4). *Lucrum cessans* figures for the first time in a letter from Pope Alexander III, written in 1176; it was only gradually accepted and it took until the fifteenth century before theologians accepted it universally.
- *Damnum emergens*, a loss incurred because someone else was using one's goods and the lender had to do in the meantime with inferior ones or had to borrow money himself. This title had been clearly laid down by Aquinas and had already been recognized by Albertus Magnus. Loss as a result of late repayment is also included.
- *Periculum sortis*, the danger or risk of loss, justifying a recompense for default risk. The acceptability of this title was still hotly debated in the fifteenth century.

There was furthermore a possibility to write contracts specifying a penalty for late payment, *poena conventionalis*, which met with no objections. The needs of the commercial and financial community in Europe saw to it that fictitious late payments became an accepted, though disingenuous, way of circumventing the ban on usury.

Interest paid on account of the extrinsic titles was seen as something different than usury. This interest was 'interesse', or what is between, difference. It was meant to compensate the lender for any deterioration in his condition between the moment the loan was made and the time of the repayment (O'Brien 2001, p. 100; Wood 2002, p. 181). Of course, the extrinsic titles justifying the payment of interest could hardly fail to undermine the ban on usury. The introduction of the notion of opportunity cost under the title of *lucrum cessans* can even be seen as lethal for such a ban.

Rivalry between the Order of the Dominicans, to which the leading Scholastics belonged, and the Order of the Franciscans seems to have played a role in the struggle about the ban on usury. Starting in 1462 in

Perugia, more than 200 so-called *Montes Pietatis* (mounts of compassion, or charitable pawnshops) had sprung up that lent money to the needy at 5 per cent, in order to prevent them falling into the clutches of usurers, who charged a multiple. The Franciscans urged city governments to set up such *montes pietatis* (Wood 2002, p. 203). Against Dominican opposition, the Fifth Lateran Council (1515–16) sanctioned this exception to the ban on usury (van Straaten 2002, p. 47). The Church perhaps had no choice but to agree to what had become accepted practice. It was not all-powerful. Already in 1345, the city government of Florence had decided that the church courts had no jurisdiction over its citizens. The pre-monte *pietatis* pawnbrokers did get fined at those times, but the fines were for all practical purposes licence fees (Wood 2002, p. 183).

In the fifteenth century a number of theologians, in particular from Paris and Tübingen, came to see the intentions of the lender as the proper measure of usury. If the lender did not intend to oppress the borrower, interest could not be labelled usury. The German theologian Johannes Eck (1486–1543), supported by the Fugger banking family from Augsburg, defended a 5 per cent interest rate as fully acceptable if the loan was for a bona fide business opportunity (Jones 2004). According to Eck, a fixed annual return was a guarantee for the creditor that his capital would remain intact and functioned as a kind of insurance against uncertain profit disbursements (van Straaten 2002, pp. 48–9). In fact, a fixed-rate contract could be seen as a combination of three contracts, a *contractus trinius*:

1. A partnership contract, stipulating profit sharing.
2. The sale of uncertain profit disbursements at a fixed price.
3. An insurance contract protecting the investor against any loss on the principal sum (Henning 2000).

Church law had never made any objection to any of those different contracts and, therefore, Eck reasoned, the combination should be acceptable as well. His views did not go down too well with the Church, but nevertheless deposits that paid 5 per cent soon became common in a number of German states.

The Reformation finally put an end to the ban on interest. True, Luther, who often crossed swords with Eck, was still dead set against interest, not only in the guise of usura but also as interesse, and indeed hostile to the world of banking and commerce in general (Tawney 1960, pp. 95–6; see also Luther's injunctions against usury in Kerridge 2002<sup>9</sup>). He grudgingly tolerated one exception, with a lot of ifs and buts: buying an annuity (Sneller 1968). His associate Melancthon adopted a more liberal attitude and accepted the extrinsic titles (Jones 2004). The breakthrough came with

John Calvin, who argued that Deuteronomy does not ban interest per se, but only exorbitantly high interest rates, or usury in the present-day connotation. One Hebrew word for interest, *nesech*, means 'bite', and was used in the sense of 'putting the bite on the poor', but another word that also is translated as interest, *tarbit*, means 'to take legitimate increase' (Jones 2004). More importantly, Calvin argued that the injunctions of the Old Testament are not always relevant for modern societies, even the rulings of the Gospels were designed for other kinds of societies than ours. And then, of course, St Paul maintained in his Letter to the Romans, Chapter 3, that the 'New Covenant' had replaced Mosaic law, so that the Church did not have to follow Deuteronomic rules (Lewis and Algaoud 2001, pp. 204–5). Calvin also made short shrift of Aristotle's argument that money does not beget money, arguing that houses do not beget anything either, but that nobody objects when someone lets his house in return for a rent (though Aristotelians will not have been impressed, as houses are not normally used up by a tenant). Calvin, however, was careful to point out that this should not be taken as a charter to charge interest at the highest rate allowed by the law of the land. There were, in Calvin's view, all kinds of limitations to charging interest. Loans should be made available to the poor and needy without charge and the borrower must reap as much advantage as the lender (see letters by Calvin,<sup>10</sup> reprinted in Kerridge 2002).<sup>11</sup> In Calvin's Geneva the government took harsh measures against those who exceeded the interest ceiling it imposed and also, for that matter, against those that borrowed in order to purchase luxury goods (Valeri 1997). The important thing, however, is that he accepted that commerce in modern urban communities could not flourish without credit (Tawney 1960, ch. 2, section 3). A factor that most probably influenced Calvin and in general helped to weaken the aversion to interest was a shift that took place in society from consumption loans to production loans, where 'fairness' or fear of exploitation is less of an issue (Lewis and Algaoud 2001, p. 206).

Calvin's orthodox Calvinist followers were inclined to adopt his negative views on consumption loans. In the Dutch Republic, for instance, moneylenders came under fire from leading Calvinist clergy in the seventeenth century, which even led to acrimonious conflicts with the provincial governments (van Straaten 2002, pp. 64–6). Eventually, the orthodox Calvinists had to back down when the provincial governments of Gelderland and Holland in 1658 decided that church assemblies should accept that it was the secular authorities that regulated interest ceilings and that it was inappropriate for the Church to brand licensed moneylenders who charged interest rates not exceeding such ceilings as usurers. The provincial government of Utrecht followed in 1664 (van Asselt 2007, pp. 65ff). In the Roman Catholic Church resistance against the interest phenomenon

lingered on until 1838, when the Vatican more or less surreptitiously said farewell to it in the pastoral letter to confessors mentioned above (Beutels 1990, p. 325). Still, given the acceptance of the extrinsic titles, even in the thirteenth century the attitude of the Church was less negative to interest than those of present-day Muslims who equate interest with *riba*.

### 3.4. *GHARAR AND MAYSIR*

#### 3.4.1 The Prohibition of *Gharar* and *Maysir*

Commercial activities are permitted under Islam, but they are subject to the ban on *riba*. They are also subject to another restriction: the ban on *gharar* and *maysir*. *Gharar* is risk, uncertainty, and *maysir* is gambling or speculation.

The ban on *gharar* implies that commercial partners should know exactly the countervalue that is offered in a transaction. The word ‘*gharar*’ in the Arabic language means risk. It also has the connotation of deception and delusion. Of course, risk can never be totally avoided, certainly not by entrepreneurs, and no productive or commercial activities would be possible without a certain degree of risk and uncertainty. Only conditions of excessive risk have to be avoided (Obaidullah 2005, p. 29). The ban on *gharar* stands for transparency and fairness. In order to avoid *gharar* the parties to a contract must:

- Make sure that both the subject and prices of the sale exist, and that parties are able to deliver.
- Specify the characteristics and the amounts of the countervalues.
- Define the quantity, quality and date of future delivery, if any.

The prohibition of *gharar* is found in ahadith forbidding as *gharar* the sale of such things as ‘the birds in the sky or the fish in the water’, ‘the catch of the diver’, the ‘unborn calf in its mother’s womb’ (El-Gamal 2001b, p. 2). These are all cases where the object of the transaction is uncertain. One may not buy tomorrow’s catch of a diver, but one may hire a diver for a certain number of hours tomorrow. Also selling goods without specifying the price, such as selling at the ‘going price’, is haram, as is selling goods without allowing the buyer to properly examine the goods (Al-Ameen Al-Dhareer 1997). Gambling, *maysir*, is banned in the Quran (2:219, 5:90, 91), see Appendix B. Speculation is seen as a case of *maysir*.

The ban on *gharar* and *maysir*, though less well-known than the ban on *riba*, has consequences that are hardly less far-reaching. There are

many contracts that do not stipulate the exact nature, date or value of what is received in exchange. This is especially the case with insurance and on financial markets. Hard and fast rules are difficult to discern, as it is not a priori clear when there is a case of *gharar*. Risk and uncertainty can hardly ever be fully excluded. If we follow Schumpeter and see the entrepreneur as the creator of new combinations (*'neue Kombinationen'*), as an innovator, risk and uncertainty, especially uncertainty in the sense of Frank H. Knight, are part and parcel of entrepreneurial activities. *Gharar* and *maysir*, therefore, do not cover each and every manifestation of risk and uncertainty, but only cases that can reasonably be avoided. But where to draw the line? Not surprisingly, interpretations of exactly under what circumstances the bans on *gharar* and *maysir* apply vary. Hanbalis, for instance, have allowed obligations from a contract to arise before the sale price is precisely known. Also, sales concluded at market prices are for the most part seen as valid even when at the time of offer and acceptance the exact market price is not known (Deutsche Bank 2007). But does the ban on *gharar* also mean that one may not sell agricultural products before they are harvested or picked? After all, it is not certain what the harvest will look like and the buyer is unable to examine the goods at the time of purchase. Sure enough, the different law schools have come up with diverging rulings (see for details Saleh 1986, ch. 3). But in general, futures, forwards and other derivatives are seen as *gharar*, as there is no certainty that the object of the sale will exist at the time the trade is to be executed (El-Gamal 2000, p. 8). We shall see, though, that some exceptions are made and that Islamic banks do not hesitate to try and stretch the limits of what is deemed acceptable by sharia boards.

There seems to be a consensus among Muslim scholars that *gharar* and *maysir* make a contract null and void. A distinction between null and void, on the one hand, and defective or voidable, on the other hand, is, however, not always made in Islamic law (Lewis and Algaoud 2001, p. 197).

### 3.4.2 Secular Arguments for the Prohibition of *Gharar* and *Maysir*

As with *riba*, commentators have tried to find a secular rationale for the ban on *gharar* and *maysir*. Muslim jurists see the ban on *gharar* as a means to prevent people taking advantage of naivete on the part of their counterparties, or, in the language of economics, asymmetric information (Saleh 1986, p. 49; Hassan 2002, p. 290). The weak should be protected against exploitation by the strong. There is a hadith which has Muhammad saying: 'Do not go forward to meet the caravan [to buy from it on the way before it reaches the town]. . . . A town dweller should not sell the goods for the desert dweller' (Bukhari, vol. 3, book 34, no. 360). In other

words, the smart should be prevented from tricking people who do not yet possess full price information. Muslim jurists treat the ban on gharar as an injunction to maintain commutative justice. Like Aristotle, as interpreted by Thomas Aquinas, they tend to translate commutative justice into the idea of *iustum pretium*, the just price, seen as the competitive market price (Hassan 2002).<sup>12</sup> Before entering into a contract, both parties should have full knowledge of relevant facts, including the market price.

As with *riba*, El-Gamal tries to make sense of the ban on gharar with the help of modern economic concepts, in the process shifting the emphasis away from protection of the weak (El-Gamal 2001b). The ban on gharar can, in his view, best be approached as a prohibition of trading in risk. What falls under the ban is a question of cost–benefit analysis. Trading in risk generally is inefficient compared with other forms of risk sharing, because it does not lead to a correct pricing of risk. From this it follows that not all risks should be avoided. Three types of risk that may be implicitly traded in a contract can be distinguished:

- Ambiguity in the contract language. This may lead to uncertainty regarding the nature of the object of sale or regarding the price. An example would be: I sell you the item hidden in my sleeve, or I sell at this or that price deferred until Mr X returns from abroad, without specifying when this return might happen.
- The object of the sale may be known, but the delivery may be doubtful. This would be the case with the birds in the sky or the fish in the water mentioned in the Hadith.
- The object of the sale may itself contain risk or uncertainty, for example, the sale of an as yet unborn calf.

According to El-Gamal, the first category is not very interesting. Removing ambiguity in the contract language is the obvious solution. This would prevent costly legal disputes and would hardly have negative effects. The other two categories are more interesting, and here cost–benefit analysis gives an explanation of why some forms of gharar are permissible according to Muslim scholars. There are two prominent exceptions to the prohibition. The first are formed by *bai'salam* contracts, or sales with the price paid in advance and delivery deferred to a future date. The future existence of the object of sale, such as a harvest, is uncertain, but agriculture would suffer greatly if this form of buyer's credit were not allowed. The other case is the phenomenon of *istisna*, which is the commission to manufacture or build an object, with part of the price paid in advance. This is especially important in the building industry. *Istisna* is permissible, according to Islamic jurisprudence (*fiqh*), because of a custom that prevailed at

the time of the Prophet resembling this phenomenon, following a qiyas reasoning. *Istisna* has also been declared *halal* because of the necessities of business and because of equity (Saleh 1986, p. 61). El-Gamal tries to give an economic justification for this state of affairs by showing that risk trading is in most cases negative for economic efficiency, in the sense of reducing utility. It is doubtful whether that explains the prohibition of *gharar*, though it may explain the exceptions.

As for the ban on *maysir*, there is again an idea of commutative justice that is invoked to justify it. Gambling is seen by Muslim jurists as a zero-sum game. If one party gains, it goes at the expense of the other party. It does not contribute to an increase in welfare (Tag El-Din et al. 2007).

### 3.5 THE ECONOMIC ORDER

A pithy description of the difference between capitalist, socialist and Islamic economies was given by Mahmud Ahmad (1999, p. 43): capitalism accepts both profit and interest, socialism rejects them both and Islam accepts the profit motive but rejects interest. It is true that the Quran is far from negative on market activities. The Quran in Chapter or *Sura* 2:275 explicitly states that commercial activities are allowed (see Appendix A). Indeed, Muhammad's first wife, Khadijah, was a trader.

Generally, Muslim scholars share Ahmad's view. They see entrepreneurship as a positive force as long as it does not degenerate into preponderantly speculative activities (Valibeigi 1993). Still, as in Christianity, views differ widely. One of the early proponents of Islamic economics, Anwar Iqbal Qureshi, was very much in favour of capitalism, but a later one, Haque, takes him to task for referring to texts from the Quran in the defending of capitalism that, in his view, have nothing to do with the subject (Haque 1995, p. 52). For Qureshi, profit is a positive phenomenon, even if it accrues to a capitalist who did not have to exert himself to earn it, as in the case of landowners earning a rent. Haque, by contrast, is very critical of capitalism and would favour a large role for the state in the economy. Profits are suspect and in his view the injunctions in the Quran against *riba* are meant to cover a much wider range of activities where unjustified increases or surpluses are involved than is usually thought to be the case. People such as Haque subscribe to what Valibeigi (1993, p. 796) called the 'populist' interpretation of *tawheed*, emphasizing the equality of all men. For them, state ownership is the primary form of ownership. Another proponent of this approach was Banisadr, the president of Iran in 1980–81. A Muslim equivalent to the Austrian School is not lacking either. The Minaret of Freedom Institute that we already met in Section

2.4 shows great admiration for the work of Murray Rothbard (1926–95), a representative of the Austrian school who even by Austrian standards went a bit over the top in his glorification of the market mechanism (see Imad-ad-Dean Ahmad n.d., 1995). Still, the most widely accepted view seems to be that private ownership is generally a good thing, but that it should not be used to exploit other people (for example, Maududi 1963). Everything belongs in the last analysis to God and man should manage his possessions as God’s steward or *khalifah*. Ownership is never absolute, there are no rights without obligations, in particular the obligation of social justice.

### 3.6 DREAMS OF A SEPARATE MUSLIM ECONOMY

Some currents in Islam, including political literalist salafism, want to separate Muslims to a large extent from the rest of the global economy. Influential Muslim economists such as M.A. Choudhury, for instance, have spoken out in favour of a separate group of Muslim countries setting up an Islamic World Trade Organization and freeing themselves from what they call ‘the yoke of Western dominance and manipulation’ in international economic relations. These countries would mainly trade with each other, ‘in a spirit of godliness and following the precepts of the sharia, with rules and institutions not imposed from above but developed in ongoing consultations’. This would bring ‘felicitous orders of balance, growth, goodness, purpose and distributive equity’, leading to ‘collective self-reliant development, complementarity and growth’ (Choudhury 1996, pp. 18–19). Even Western technology and science should not be imitated, as they are ‘inherently socially alienating’.

Another manifestation of the drive for a separate Muslim economy can be found in the Islamic Mint, which has its seat in Malaysia.<sup>13</sup> The Islamic Mint officially launched the Islamic gold dinar just after the attack on the Twin Towers, namely on 7 November 2001. This dinar should, together with a silver dirham, help the Muslim world return to the days of the Caliphate. In the view of the Islamic Mint, fiduciary money is not acceptable as a currency for paying religious tax, *zakat*, or for dowries. Fiduciary money, or paper money as they call it, is a mere promise to pay, as it has no intrinsic value. *Zakat* and dowries require real payments, not promises to pay, in their interpretation of Islamic law as distilled from the Hadith. Furthermore, dinars and dirhams should replace paper money, in particular the US dollar, as a medium of exchange. This is because it is, again in their view, forbidden for Muslims to entrust wealth to non-Muslims, and what else is accepting US dollars, mere promises

to pay, than entrusting wealth to non-Muslims? Nor are Muslims in their interpretation of sharia generally allowed to take a non-Muslim as a partner outside dar al-Islam, the territory of Islam, where Islamic law prevails, as they might cheat or use a Muslim's wealth in forbidden transactions (Islamic Mint n.d.). Within dar al-Islam these restrictions are less binding, presumably because non-Muslims can be kept under strict supervision there.<sup>14</sup>

In the same vein, a British-based organization, Al-Khilafah Publications, runs a website [www.khilafah.com](http://www.khilafah.com) which blames capitalist economic policies for all economic ills in the Muslim world, though the siphoning off of the wealth of Muslims to Swiss bank accounts by corrupt governments plays a role as well, in their view. The solution touted is simply to restore the Caliphate.

### 3.7 CONCLUSIONS

Muslims who regard not only the Quran but also the sunna as a source whose injunctions and exhortations should be followed to the letter, both in matters of worship and in matters of muamalat, in social relationships, want to see the bans on gharar, maysir and riba rigorously maintained. However, it is always a question of interpretation which present-day phenomena would fall under such a ban. Interpretations differ widely, the more so as there is also the additional question of whether the relevant ahadith can really be regarded as authentic. But even if they are not that strict and feel not attracted to any form of salafism, many Muslims, including those in Western countries, feel uncomfortable with paying and receiving interest and with conventional insurance (which involves, in their view, gharar and maysir, see Section 6.2).

For the rest, a great majority of Muslim scholars are in favour of an economy with private enterprise, but as in most other religions and much of secular thought this is no licence for unrestricted profit seeking. There are currents, though, that would prefer to set up an Islamic economy largely apart from the rest of the world, where the practices of the Golden Age of the Caliphate can be reintroduced and one can live according to the Islamic ideals without any danger of getting tainted with non-Islamic stains. This dreamworld of the political literalist salafists in particular is one where non-Muslims, be they angelic or not, would fear to tread – as would many Muslims, probably. After all, golden age or not, only the first Caliph, Abu Bakr, died a natural death, the other three were assassinated. It was a time of great military successes, but also of internecine strife and discord (Waardenburg 2008).

## NOTES

1. The 'Wijsbegeerte der Wetsidee', literally Philosophy of the Law-Idea but usually called Calvinist or Reformational Philosophy. It was mainly developed by Professor Herman Dooyeweerd (1915–86). Note that the VU University was staunchly Calvinist during the first 80 years or so after its founding in 1880. The 'Wijsbegeerte der Wetsidee' did not really catch on, outside a small band of enthusiasts; see van Deursen (2005).
2. [www.islam.tc/alhilaal/site/zakat.html](http://www.islam.tc/alhilaal/site/zakat.html), September 2006.
3. The Islamic Fiqh Academy is an international body of Muslim jurists sponsored by the 46 nation Organization of the Islamic Conference.
4. Fazlur Rahman (1919–88) was a highly respected scholar of Islam who taught in the UK, Canada and the USA, interrupted by a short and unsuccessful stint as head of the Central Institute of Islamic Research, which was set up by the Pakistani government in order to implement Islam into daily life. Rahman was a critical thinker who, following Schacht, distrusted the reliability of ahadith, among others those on *riba*. He further held non-traditional views on the nature of revelation. He was branded a *kafir* or apostate by aggressive traditionalists, including Maududi, which forced him to resign from the Institute and leave the country (Pal 1999, pp. 6–7, 53).
5. The fatwa can be found in Netzer (2004), which further analyses the character of the relationship between Al-Azhar and the Egyptian government, in the light of the latter's hostility towards the Muslim Brotherhood. The fatwa is also reproduced in El-Gamal (2003a), which gives the arguments used in the discussion on the fatwa.
6. The Indonesian Ulemas Council (MUI) Edict Commission announced on 16 December 2003 that it was seriously considering to prohibit Muslims from using conventional financial institutions once sharia-compliant institutions were operating in their area (Wijaksana and Junaidi 2003). The Council's pronouncements certainly carry weight, as representatives of Indonesia's two Islamic mass organizations, Nahdlatul Ulama (NU) and Muhammadiyah, play prominent roles there, but these appeared to be less than enthusiastic. Interestingly, NU owns Nusumma Bank and Muhammadiyah manages Bank Persyarikatan, both of which are engaged in conventional banking. Muhammadiyah Chairman Ahmad Syafii Maarif called the views of the MUI a nice piece of *ijtihad*, but did not want to attach too much weight to it. In his view, bank interest is different from *riba* as long as there is no element of exploitation involved (Wahyuni 2003).
7. For a thorough description of the various views, see Saleh (1986).
8. English and other translations of the encyclical are easily found through a Google search.
9. M. Luther, *Grosser Sermon vom Wucher*, 1519, 1. Teil, in *Alle Bücher und Schriften*, vol. 1, pp. 195–7, Jena 1555; M. Luther, *An die Pfarrherrn wider den Wucher zu predigen Vermanung*, 1540, 7. Teil, in *Alle Bücher und Schriften*, vol. 7, pp. 397–9, Jena 1555–8.
10. J. Calvin, *Commentarii in Libros Mosis necum in Librum Josue*, Amsterdam, 1567; J. Calvin, *Epistolae et Responsa*, Geneva, 1575.
11. Similar ideas had earlier been developed by Heinrich Bullinger (1504–75), the successor to the Protestant reformer Zwingli in Zürich (Baker 1974).
12. Hassan (2002, p. 296) notes that the Muslims jurists were acquainted with Aristotle's ideas from his *Nichomachean Ethics* and had a similar approach, but need not consciously have followed him.
13. According to the Defamation League, officers of the Islamic Mint (who hail from England, Spain, Switzerland, Malaysia and Germany) are members of the Murabitun movement – a tiny, Western offshoot of Islam's Sufi movement, founded by a Scottish convert in the 1960s. The sect is staunchly anti-Al Qaeda and anti-Taliban and seeks to enlist Muslims worldwide in an effort to overturn world finance in favour of a 'Quranic' gold and silver system ([www.adl.org/internet/e\\_currency.asp](http://www.adl.org/internet/e_currency.asp), 2006).
14. The idea of a gold dinar also holds attractions for people who have little inclination to separate Muslims from the rest of the world, but who, in the vein of the Austrian School, harbour a deep distrust of managed money (see Imad-ad-Dean Ahmad 1998).