occasional clashes) of Islam and the West, starting with the end of the Islamic golden age. In the later Middle Ages, while Islamic culture and civilization still thrived elsewhere (in North Africa and Spain, for example), the birthplaces of Islam and of the early Islamic empires had entered a long period of stagnation. In later centuries, with a few exceptions, the Islamic world continued to stagnate, while European powers forged ahead. A well-known chain of historical events – the Renaissance, the Reformation, the Enlightenment, the Industrial Revolution, Imperialism – created an unprecedented economic, political, cultural and intellectual gap between the Islamic world and the West. Characteristically, the Ottoman empire, the last great Islamic empire, once feared by the Christian West, was considered, for at least its last 200 years, 'the sick man of Europe', an ever-weakening entity susceptible to all forms of encroachments by foreign powers.

Of particular interest to us are the political, economic and cultural impacts of the Western ascendency on the Islamic world throughout the colonial – or 'modern' – era, generally dated from Napoleon's 1798 Egyptian campaign. Until then, most of the Islamic world had lived in relative isolation and kept to its traditional ways. While certain Islamic societies had proven quite dynamic, others had remained stagnant for generations. In those communities, there was a deep-seated suspicion of innovation (bidaa). Yet in a changing world, the habit of condemning absolutely every practice that did not go back to the time of the Prophet could not be sustained. Innovations would be analyzed on the basis of their intrinsic merits. In the confrontation with a strong and assertive Europe bent on exporting its ideas and institutions, certain scholars were more inclined than others to adopt alien ideas and customs. Hence the disagreements between those who favoured taqlid (imitation) and those who advocated islah (reform) or tajdid (renewal).[13]

By the late nineteenth century, most countries followed a path of Westernization and secularization that led them to adopt, under foreign tutelage, Western models in politics, economics, law, and education. Muslims were divided. While some did not see a necessary contradiction between Islam and Westernization, a number of political and religious movements emerged throughout the Islamic world, calling for a return to Islamic values and traditions. There was no clear consensus, insofar as some wanted a return to the past while others called for an update of Islamic doctrine. Islamic modernists shared with traditionalist Islamist groups the belief that the ills of society were caused by the betrayal of Islamic ideals. While they shared with secularists the embrace of reason, science and progress, what set Islamic modernists apart was their belief that political liberalization and intellectual reawakening could be, indeed had to be, rooted in a return to Islam. The Wahhabis of Saudi Arabia, the Mahdists of the Sudan, the Sanussis of Libya and other 'fundamentalist' movements that emerged in the eighteenth and nineteenth centuries, drew their rhetoric and their ideals from the early Islamic Age. The 'new' ideology, seeking to blur the lines between religion and politics, has been characterized by Olivier Carré as a 'deviant orthodoxy'.[14]

Another characteristic of many such fundamentalist movements was their anti-Western character, which worked in perfect symbiosis with the anti-Islamic bias of certain Westerners, justifying and reinforcing stereotypes. A whole tradition of Orientalist writers posited axioms that later came to shape common perceptions of Islam.[15] Writer Ernest Renan proclaimed the Muslim to be 'incapable of learning anything or of opening himself to a new idea'.[16] And Lord Cromer, who ruled Egypt in the late nineteenth century, argued that 'Islam's gradual decay cannot be arrested by any modern palliatives however skillfully they are applied'.[17]

Among social scientists, there is a venerable tradition, going back at least to Max Weber, that looks at Islam as a closed system whose essence is inhospitable to development and modernity. Yahya Sadowski observed:

> When the consensus of social scientists held that democracy and development depended upon the actions of strong, assertive social groups, Orientalists held that such associations were absent in Islam. When the consensus evolved and social scientists thought a quiescent, undemanding society was essential to progress, the neo-Orientalists portrayed Islam as beaming with pushy, anarchic solidarities. Middle Eastern Muslims, it seems, were doomed to be eternally out of step with intellectual fashion.[18]

There were, nonetheless, from the nineteenth century, significant attempts to modernize Islamic doctrine. Perhaps the most influential movement was the Salafiyya, founded in Egypt in 1883 by the pan-Islamic forerunner Jamal al-Din Al-Afghani (1839–97), a Persian whose influence was felt throughout the Islamic world. Through their journal *al-Manar*, Al-Afghani and his disciples, the Egyptian Muhammad Abduh (1849–1905) and the Syrian Rashid Rida (1865–1935), sought to bring about political, legal, and intellectual reform.[19] The movement encapsulated the complexity of the phenomenon. Edward Mortimer saw in Al-Afghani 'an example of three types of Muslim response to the West: the defensive call to arms, the eager attempt to learn the secret of Western strength, and the internalization of Western secular modes of thought'.[20] In sum, modernity – undertaking a radical reinterpretation of Islam to suit modern conditions – is not easy to dissociate from a quest for authenticity. And fundamentalism – if defined as the effort to return to the fundamentals of the religion – is not necessarily the same as literalism.

2.2 Islamic Economics

Commerce is central to the Islamic tradition. The Prophet Mohammed was himself a merchant. Born in the Banu (sons of) Hashim clan of the Quraysh tribe, Mecca's leading traders, he was orphaned in childhood and raised by his uncle, Abu Talib, who taught him the caravan trade. In his twenties, he became the commercial agent of a rich widow whom he later married. It should therefore come as no surprise that in the early Islamic literature, merchants were glorified, or that commercial profit is sometimes referred to as 'God's bounty'. Whereas it took Christianity centuries before it stopped regarding business as a degrading occupation,[21] Islam from its inception explicitly legitimized private property, business enterprise and profit. As long as the merchant fulfils his religious duties, he is rewarded spiritually as well as materially (2:198, 73:20).[22] Unlike the Jewish and the Christian Sabbaths, Friday is not a full day of rest: before and after the religious gathering, Muslims are expected to carry on their worldly activities (62:9–10).[23] Another illustration of the close connection between commerce and religion is that the Islamic religion was spread in many parts of the world (such as Africa and the Far East) by proselytizing merchants

In Mohammed's day, the economic system was quite simple. Mecca, at that time Western Arabia's wealthiest city, depended heavily on trade, but from a regional perspective it was somewhat backward and inconsequential. The continuous spread of Islam soon brought the region's lucrative trade routes, previously controlled by Byzantium and Sassanid Persia, under Islamic control. Muawiyah and his Umeyyad successors expanded the empire from their new capital, Damascus, into Europe and to the borders of India and China, inaugurating a new era of prosperity. The Abbassid caliphate, based in Baghdad, established links between the Mediterranean basin and the Indian Ocean, creating a single trading system that brought about significant changes in agriculture and crafts, and the emergence of great cities.[24]

As the economy became increasingly complex, a number of previously unknown questions – about administering an empire, regulating trade, taxation, etc. – had to be addressed. Institutional innovation occurred, for example with the creation of hisbah, an office in charge of supervising markets, providing municipal services, and settling petty disputes.[25]

The Islamic literature on such subjects as contract law grew to account for every possible eventuality. As for more theoretical issues dealing with economics, they were largely ignored by the fuqaha of the classical age.[26] There were however a few thinkers who dealt with economic issues, the most famous of whom is Ibn Khaldun (1332–1406). Best known for his pioneering work in history and sociology, he also wrote about supply and demand, capital formation, trade cycles, and the theory of value. Still, Ibn Khaldun, usually considered to be the greatest economist of Islam, was writing in the period immediately preceding the great transformation of the world economy, on the eve of the era of major discoveries, which was to be followed by the rise of capitalism and the industrial revolution. More importantly for our purpose, banks and other modern-style financial institutions had not yet come into existence. When they did, Islamic scholars had to struggle to reconcile a scholarly and legal tradition rooted in the medieval age with the exigencies of the modern world.

Modernists managed to extend their influence with various degrees of success throughout the Islamic world. Most constitutions and legal codes that were written in subsequent decades would usually invoke the Shariah, although in practice references to Islam were limited (typically stating that the state religion would be Islam, that the head of state would be a Muslim, and that the Shariah would be a source of law). Most areas of the law (with certain exceptions, such as family law) were inspired directly or indirectly by Western models. For example, Egypt under Mohammed Ali was directly inspired by France's Napoleonic code. (By later using Egypt as a model, other Islamic countries were indirectly influenced by French ideas.) In addition, with the importation of Western models, the role of the ulema was reduced, and that of elected representatives enhanced. Thus even where the Shariah may have been 'the principal source of all legislation', elected representatives had wide discretion to use other sources of legislation as well.[27]

As the colonial era came to an end, newly independent states came to reassess their economic policies. The 1950s and 1960s saw the advent of economic nationalism, with its emphasis on the role of the state as an engine of growth and development.[28] Neither this statism nor the later liberalization would be significantly challenged on strictly religious grounds. Indeed, in economics as in politics, Islam does not provide an explicit blueprint. Two strands of Islam could be used to justify one or the other set of policies. Liberals played up Islam's accent on property rights and the glorification of commercial profit to advocate laissez-faire. Socialists emphasized the Koran's focus on justice (adl) and compassion towards the needy to justify state intervention as well as redistributive policies.[29]

But although the process of economic decision-making was significantly secularized, references to Islam were seldom absent. Thus Nasserite Egypt had founded the Islamic Congress (in conjunction with Saudi Arabia and Pakistan)[30] and created the Supreme Council of Islamic Affairs which published *Minbar al-Islam* (The Pulpit of Islam). And in pursuing controversial policies on matters such as nationalization, land reform or family planning, Islamic symbols and references were occasionally used, and the government was careful to obtain approving fatwas.[31]

But since Ibn Khaldun the Islamic world had not really produced any prominent economist.[32] The ideological debates of the modern era had been framed according to Western norms. In the liberal era, Muslims who had studied Western-style economics (and related fields) tried to transpose that knowledge to the Islamic world. With decolonization and the nascent trend towards a return to Islam, religious scholars attempted to rethink economics and the social sciences in the light of their religious training, with the goal of creating an 'authentic' or at least indigenous brand of economics.[33] Rather than simply asserting claims based on divine revelations, and which human beings cannot refute, Islamic economists have gone to great lengths since the 1970s to buttress their case with logic, scientific theory and empirical evidence.[34] Rodney Wilson observed that '[t]here has been more written on Islamic economics in the last two decades than in the previous fourteen hundred years'.[35] Yet in the words of Chibli Mallat:

> Many of the works tend to dabble in generalities and to err in a lack of rigour which prevents the emergence of a serious and systematic literature. The recent 'fad' of 'Islamic economics' has impressed the production with an urgency that has kept the literature produced so far to a superficial and repetitive standard.[36]

It is usually agreed that the most original work is that of Mohammed Baqer as-Sadr, whose book *Iktissaduna* ('our economy') is a far-reaching critique of both capitalism and Marxism, and an attempt to develop an Islamic approach to economics.

For Baqer as-Sadr, 'Islamic economics is not a science (ilm)', but simply a doctrine (madhab). In other words, it is not designed to explain why economic events occur, but to shows the path to follow. It is principally based on the idea of justice, which is by essence a matter of 'ethical appreciation'. It is subordinated to a totality ultimately determined by religion. The three basic principles of the Islamic system are 'multifold property', 'limited economic freedom', and 'social justice'. As for dealing with scarcity and wealth creation, Baqer as-Sadr focuses on distribution, 'before and after production'. A distribution system must be established based on the moral principle of 'general insurance and social solidarity' and taking into account labour, need, and Islam's original view of property.[37] While it could be easily criticized, the work of Baqer as-Sadr was original enough to warrant serious attention. And although critical of capitalist and socialist ideologies, it incorporated elements of both, showing that Islam was not incompatible with modern economics.

With the newfound wealth of oil-producing countries and the rise of Islamic militancy, the need to promote further thinking on economic matters gained new urgency. The proliferation of research institutes, and the encouragement of an 'ijtihad' designed to update Islamic beliefs, resulted in countless attempts to define a system that would be at once internally consistent, faithful to Islamic principles, and adapted to the contemporary world. A number of fiqh academies sprouted throughout the Islamic world, with the purpose of providing such authoritative opinions. Unable to speak in a single voice, modern Islamists have settled for majority-based decisions. Thus, in a new twist to the old doctrine of ijmaa (consensus), scholars have been engaging in group or collective ijtihad. Gathering in convocations, scholars deliberate collectively and decide questions by a majority vote.

In 1976, the First Islamic Conference on Islamic Economics was held in Mecca. For the first time in Islamic history, a high-level conference dealt exclusively with economic matters. Concrete steps were taken to survey the field and promote Islamic economics as an academic discipline. King Abdul Aziz University established the International Center for Research in Islamic Economics (ICRIE) in 1979 to conduct and support theoretical and applied research in various sub-fields.[38] Such research institutes proliferated throughout the eighties and nineties, and more universities expanded their teaching of Islamic economics.[39] Starting with Pakistan in 1977, a growing number of countries sought to Islamicize their economic systems. Islam would typically be presented as offering a 'third way' between capitalism and socialism that would be not only different, but also superior to, and no less efficient than, the two others. In a few instances – as in Libya in the 1970s and 1980s where Moammar Qaddafi's 'Green Book' presented an idiosyncratic brand of radical socialism – the system proposed was closer to the socialist end of the continuum.[40] But as later sections will show, since the late 1980s, the 'third way' reflected the global neo-liberal trend, and was in most Islamic countries far closer to the capitalist end of the continuum.

2.3 Adapting to Changing Circumstances

As already mentioned, no belief system that has flourished over a long period of time and in a variety of places could have done so without some measure of adaptability. Even a scholar with the unimpeachable Islamic credentials of Mohammed Baqer as-Sadr noted that the texts of the Koran and the Sunna 'do not manifest – generally – their legal or conceptual content in a clear precise manner'.[41] In drawing up the economic rules, more effort – more ijtihad – is needed. And if we consider the institutions created by the Iranian revolution – the most significant Islamic revolution in modern times – a substantial amount of innovation has taken place.

It should be noted at first that Islamic commandments are not as unbending as they would superficially appear. Traditional Islamic injunctions are not framed as simple dichotomies, but situated along a continuum, thus allowing significant flexibility. In the early Islamic community, an action (either for the community as a whole, or for every single member of it) could be regarded as obligatory (wajib), meritorious (mustahabb), morally neutral (mubah), reprehensible (makruh), or forbidden (haram). Also, most injunctions contain dispensations and exceptions, thus showing considerable flexibility and pragmatism. On the subject of fasting during Ramadan, the sick and the travellers could postpone their fasting, and those for whom it would cause hardship could dispense with it, compensating instead with a good deed such as feeding a poor person (2:184–5).[42]

As Islam expanded, it was brought into contact with different cultures and this made it necessary for Islamic jurisprudence to produce legislation on problems for which there were no clear legal precedents to follow. The principles of Islamic jurisprudence (usul el fiqh) provide for a set of elaborate rules to interpret the Shariah. But the existence of such complex rules did not preclude adaptive mechanisms. The principle of *talfiq* ('patching') would for example authorize judges to choose an interpretation from schools of jurisprudence other than their own if it seemed to fit the particular circumstances of the case.

More generally, three principles allow for departures from existing norms: local custom (urf), the public interest (maslaha), and necessity (darura). The Shariah can thus be accommodated to societal developments, and allow for innovation, exceptions and loopholes – provided they are properly justified.

We already saw how in administering justice during the Umeyyad era, the governors took into account the existing customs and laws of newly conquered territories, and how the cosmopolitanism of the Abbassid era resulted in considerable diversity. With the weakening of Arab influence in later centuries, syncretism was unavoidable. To put it differently, the farther removed in time and space from early Islam and its birthplace, the stronger the likely influence of indigenous customs.

And as Islam encountered new challenges, especially following its nineteenth-century encounters with capitalism and the West, the concept of *maslaha*, translated as the general good or public interest, was frequently invoked. Based on that classical principle, a jurist confronted with rival interpretations of a passage from the Koran or the Hadith can choose the one he deems most conducive to human welfare. Islamic modernists such as Muhammad Abduh and Rashid Rida made maslaha the key principle for deciding the law where the Koran and the Hadith gave no clear guidance. The principle of talfiq, combined with independent ijtihad, was extended to allow a systematic comparison of all classical schools of laws and to reach a synthesis that would combine their best features. Some fuqaha have argued that the general interest could even override a revealed text.[43] So regardless of how far they have been willing to go, Muslim thinkers have had wide latitude to reason independently from first principles, and a modern Muslim nation could thus enact 'a system of just laws appropriate to the situation in which its past history has placed it'.[44]

A related concept is that of *darura*, or overriding necessity. Otherwise questionable innovations could be justified by the notion, tacitly accepted by all fiqh schools, that 'necessity permits the forbidden' (al-darura tubih al-mahzurat). In its dietary injunctions for example, the Koran specifically authorizes transgressions caused by necessity (2:173).[45] On various occasions, the Koran has disavowed any divine intent to cause hardship (2:286).[46] The doctrine originally related to individual behaviour. For example, a person who would otherwise starve could be allowed to eat pork. A version of the doctrine holds that a mere 'need' (haja), if it affects many, may be treated like a dire necessity affecting only one.[47] In Iran, the scope of darura was considerably expanded. It has been invoked to waive the primary rulings of Islam if the very existence of the state was threatened, or, in the words of the Ayatollah Khomeini, in instances where inaction would lead to 'wickedness and corruption'.[48]

This has happened frequently in Iran since the Islamic revolution. The landmark 'temporary cultivation agricultural land' bill, transferring ownership of properties from their legal owners to those who had seized them following the revolution, was justified on the grounds of 'zarura' (Persian transliteration of darura). The bill acknowledged that the government would be dispossessing those who had legal title to the land, but this was justified because the alternative was even less satisfactory. In the debate, necessity itself (the impracticality of removing farmers from the land they occupied) was often conflated with criteria such as fairness and justice and with political considerations such as retribution against the *ancien régime*.[49]

More generally, frequent departures from doctrine have occurred since the revolution, and considerable interpretive leeway was allowed to political leaders. On private property issues, the Iranian constitution requires property to meet three conditions: that ownership must 'not go beyond the bounds of Islamic law', that the property itself 'should contribute to the economic growth and progress of the country', and that the property must not 'harm society'. The crucial matter is one of interpretation as to what 'contributes to economic growth and progress' or to 'what harms society'. On such issues, considerable latitude was left to the Majlis (Parliament), which remains in a position to confiscate property arbitrarily.[50]

In a global economy, the overriding necessity of 'the markets' often prevail over tradition and doctrine. In Saudi Arabia for example, Islamic courts had until recent years tended to side with defaulting borrowers against creditor banks. So Saudi banks, invoking the credibility of the country in international financial markets, obtained that the government revive and expand an independent secular court to hear financial cases. Subsequently, Saudi Arabia used this reputation for fair play to borrow heavily on international markets.[51]

In financial matters, darura has been invoked to justify interest on loans, on the grounds that Muslims had to be able to compete with other peoples who were not bound by the same strictures.[52] Keeping interest-bearing balances in foreign banks could also be justified since such were the norms and practices of the international economy. Similarly, the 'necessity' of economic development has been invoked in the Egyptian fatwas authorizing interest.[53] Typically however, those fatwas invoking darura add that certain types of unlawful profit should be 'purified', that is, used for religiously meritorious purposes, that Muslims should work toward finding an Islamically acceptable alternative, and that when this is accomplished, the raison d'être for granting a dispensation will be extinguished.

2.4 Reconciling Homo Islamicus and Homo economicus

The most important difference between Homo Islamicus and Homo Economicus is the assumption of altruism. As with other pre-capitalist systems, Islam is preoccupied with the welfare of a community where every individual behaves altruistically and according to religious norms.

One of the most significant intellectual developments of the modern era was the new thinking that accompanied and inspired capitalism and the industrial revolution, and came to constitute the basic proposition of the 'science' of political economy in the eighteenth and nineteenth centuries – and later of the discipline of economics. At a time when the Christian ethic emphasized the pursuit of private virtue and the merits of selfless behaviour, a number of thinkers turned the logic on its head: acknowledging the 'dark side' of human nature, they argued in favour of 'pitting greed against greed', of 'turning private vices into public virtues' and of letting 'interests' rather than 'passions' rule.[54] In dealing with the age-old issue of scarcity, this intellectual movement stressed the role of selfish and rational individuals. The central proposition of free market economics is that by pursuing their own self-interest, people confer countless benefits on one another. In the famous formulation of Adam Smith (1723–90), 'It is not from the benevolence of the butcher, the brewer, or the baker, that we can expect our dinner, but from their regard to their own interest'.[55]

For its critics, the major flaw of Islamic economics is the assumption of altruism. In the words of Timur Kuran:

> The primary role of the [behavioral norms of Islam] is to make the individual member of Islamic society, homo islamicus, just, socially responsible, and altruistic. Unlike the incorrigibly selfish and acquisitive homo economicus of neoclassical economics, homo islamicus voluntarily foregoes temptations of immediate gain when by doing so he can protect and promote the interests of his fellows.[56]

The core problem of political economy, that of scarcity in a world of self-interested actors, is abolished by assumption since it is solved by the diffusion of selfless behaviour. Richards and Waterbury write: ‘The Islamist position is that harmony and social order will be achieved by the promotion of individual virtue – by individuals’ altering their behavior to conform with Divine Revelation’.[57] Insofar as God has created everything in the right amounts to meet human needs, scarcity is an unnatural condition caused by greed and avarice. Under normal circumstances, altruism, sobriety and virtue are expected, all the more so since the human being is God’s ‘Khalifah’, or vicegerent on earth (2:30)[58] and the resources at his disposal are only a temporary trust (57:7).[59]

In other words, what is ‘economically correct’ is not ‘Islamically correct’, and vice versa. Where one approach sees man as inherently selfish, the other considers him altruistic and virtuous. For economists, Islam does not have a realistic view of human behaviour; for Islamists, economics is founded on the principle of individual self-interest and as such, it glorifies greed and is immoral.

In reality however, the gap between Homo Economicus and Homo Islamicus has proved easy to bridge. For one thing, there is an original area of convergence in that, in some respects, ‘Homo Islamicus is a modern incarnation of “the Protestant ethic”: an entrepreneur who works hard for material gain and is spiritually pure will be rewarded here on earth in the form of shared profits and social recognition’.[60] In certain Islamic communities, sanctification through hard work is at the core of religion. In Senegal for example, this has been a defining characteristic of the two-million strong Mouride brotherhood. Some of the injunctions of that community are reminiscent of Calvinism as described by Max Weber: ‘Let us reject jihad [holy war] and wage jihad against our souls’, and ‘Work as if you were never going to die, and pray as if you were going to die tomorrow’.[61]

As for modern Islamic economics, distinctions should be drawn between early and later writings on the one hand, and between abstract, theological treatises and more pragmatic, policy-oriented writings on the other hand. The well-reasoned critique by Timur Kuran refers primarily to writings of the 1976–81 period.[62] These were the early years of modern Islamic economics, when economic Islam was mostly theoretical (the Pakistani and Iranian experiments had barely started). The confident tone of the literature owes as much to the untried nature of the solutions proposed as to the euphoric mood of the years following the oil boom, when a New International Economic Order seemed within reach.[63] As the abstract views collided with a harsh reality, Islamic economics became more pragmatic. Subsequent writings on Islamic economics, while not very original, have generally shed their utopian expectations and built bridges to conventional economics. As the case studies in Chapter 6 show, experiments in Islamic economics were influenced more by ‘situational factors’ than by ideology proper. One recent textbook in Islamic economics offers the following comparison of capitalism and the Islamic economic system:

– under capitalism, human beings are selfish; under the Islamic economic system, human beings are selfish as well as altruistic;

– under capitalism, materialism is the supreme value; under the Islamic economic system, materialism should be controlled;

– capitalism favours absolute private ownership; the Islamic economic system favours private ownership within a moral framework.[64]

In sum, far from being inherently contradictory and irreconcilable, Islamic and conventional economics differ primarily to the extent that the former adds an ethical and social dimension that the latter usually lacks. Another example of the convergence is the fact that rather than some heavenly ideal, it is *falah*, best translated as 'well-being', which is increasingly at the centre of Islamic economics.[65] By one definition, 'Islamic economics aims at the study of human falah achieved by organizing the resources of the earth on the basis of cooperation and participation.'[66] Although incorporating moral as well as material well-being, falah refers to the welfare of the community. This new focus, combined with the justifications of darura and maslaha, could pave the way for further convergence between Homo Islamicus and Homo Economicus.

This more pragmatic brand of Islamic economics is not fundamentally different from 'Keynesian' approaches (which in a broad sense include socio-economics, institutionalism and other approaches seeking to alleviate the excesses of the market through state intervention), or from attempts by Christian, Jewish or even secular thinkers to inject an ethical dimension to free-market economics by tempering the unbridled pursuit of self-interest with certain social and moral values. Paradoxically, at a time when unfettered free markets have triumphed, attempts at 'balance' (between state and market, between individual rights and social obligations) have been increasingly common.[67]

Contemporary debates on political economy can be situated on a continuum where the two extremes are a pure free market and absolute government control. Most ethical and religious systems reject this polarization and invoke a 'third way' or a 'middle ground'. History has shown that such a 'middle ground' can accommodate a range of opinions, and that such 'middle ground' can shift at different times and in different places. The Catholic Church has historically been able to accommodate both left-wing 'liberation theology' and right-wing conservatives. In recent years, with the triumph of the free-market ideology, many religious thinkers have seen no contradiction between religious teachings and the defence of the free market. Catholic theologian Michael Novak has launched a strong moral defence of capitalism, noting that, 'like prudence in Aristotelian thought, self-interest in democratic capitalist thought has an inferior reputation among moralists'. Arguing that 'self-interest' is not synonymous with greed or acquisitiveness, he proposed a definition that would encompass 'religious and moral interests, artistic and scientific interests, and interests in peace and justice', as well as concern for the well-being of one's family, friends and country.[68]

Islamic economic thinking has evolved along a similar tack. Whereas in the sixties, many Islamic intellectuals emphasized the compatibility of Islam with socialism and, for some, even with Marxism, many influential economists today emphasize the affinities between Islam and the free-market ideology. Since dubious intentions could combine to produce beneficial results – welfare and especially progress toward meeting the needs of the poor[69] – the system could be morally justifiable, and indeed perhaps morally superior to well-meaning but ineffectual policies.[70] It is revealing that the first major attempt at full Islamization of an economy – in Pakistan under President Zia in 1977 – was part of a neo-liberal economic package. Even more striking, in the Sudan of 1992–3, Islamists have openly and unapologetically embraced the most extreme form of neo-liberalism, under the stewardship of Abdul Rahim Hamdi, a Minister of Finance (and Islamic banker) who was influenced by the ideas of Milton Friedman. He defended free-market rules on the grounds that 'this is how an Islamic economy should function'. He even argued that '[t]he population accepts these hardships because it supports Islam and us'.[71]

In sum, the 'Homo Economicus' vs. 'Homo Islamicus' contrast is now largely irrelevant. Both represent, if not a utopia (literally meaning 'no place') at least an ideal.[72] Both are normative rather than descriptive. Homo Islamicus states what people should strive towards, as opposed to how people are likely to behave (the 'ought' as opposed to the 'is').[73] Homo Economicus similarly represents an idealized free market, one that works only under certain assumptions. As noted by Alan Richards and John Waterbury, 'It is well to remember that policymaking practice *never* conforms to rigorous theory.'[74] Much to the dismay of fundamentalists of all stripes, the 'real economy', though it may be inspired by a given ideology, is also likely to stray from that ideology.

In fact, insofar as the economic profession can be regarded as a learned class devoted to the defence of the free-market system,[75] one can see obvious parallels between the guardians of the dogma in both Islam and economics: intolerance toward dissident or 'incorrect' views, territoriality, focus on arcane and sterile debates, etc. Reading Paul Krugman's diatribes against the encroachments of those who are not 'trained economists' or Robert Barro's or Milton Friedman's denunciations of the sins committed by 'politicians' against the free market, one recognizes a tone the Western press usually associates with 'ayatollahs'.[76] One can even see religious overtones in 'economic fundamentalism'.[77] Rodney Wilson wrote about the preoccupation of economists with 'pure' equilibrium:

> The economic order is … permanent, and should reflect the divine order … [S]ome of the language and symbolism – perfect markets,

> the concept of equilibrium, efficiency in transactions which implies perfect knowledge – all perhaps unconsciously, could be viewed as striving for some heavenly ideal.[78]

And Bernard Maris remarked that abstract economics possesses 'the same essence as theology insofar as both are based on compilation and gloss, commentary and the deepening of commentary'.[79] Just as those who inhabit a highly formalized world of perfect competition, perfect information and perfect rationality seek to eliminate imperfections (such as the existence of a public sector, which in most countries accounts for nearly half of the Gross Domestic Product), so Islamic purists seek to eliminate selfish motives in a world dominated by altruism and virtue. Just as one can find absurd prescriptions in the writings of religious fundamentalists, so one can find equally absurd policy prescriptions made by economic fundamentalists.[80]

2.5 Reconciling Islam and Finance

The Koran states that despite their superficial resemblance, profits from commerce are fundamentally different from profits from money-lending (2:275).[81] Unlike Christians who have long denigrated all business endeavours, Muslims have traditionally looked favourably at commerce, while being suspicious towards finance. As Chapters 3 and 12 show, the reconciliation between Christianity and finance, and for that matter between Christianity and business in general, was long-drawn and fraught with theological and philosophical disputes.

In Islam, although riba would occasionally be interpreted not as interest, but as usury (or excessive interest), strict definitions have typically prevailed. But as its economy grew more complex, the Islamic world was able to find proper substitutes, justifications, or subterfuges. In the early years of Islam, jurists devised an impressive array of contracts designed to circumvent riba, the most important ones being profit-and-loss sharing contracts (mudaraba or qirad).[82] Some of these contracts were in fact so clever as to be considered *hiyal* (sing.: *hila*), meaning ruses or wiles; that is, lawful means used, knowingly and voluntarily, to reach an unlawful objective. Provided that certain formalities were used, interest, albeit by a different name, could be charged and paid. Certain schools of jurisprudence – in particular the Hanafis and Shafiis – took a tolerant view of such hiyal,[83] and entire treatises were written, detailing how Muslims could use such contrivances while staying on the right side of the Shariah. It was thus a form of casuistry (looking at a specific 'case' to prove that the general rule of behaviour does not apply). One of those 'hiyal', the 'mohatra contract', is mentioned in Blaise Pascal's eighth 'Lettre Provinciale' (1656) as representative of the casuistic reasoning of Jesuits.[84]

The mohatra refers to the ancient double sale also known as ina or mukhatara, where a borrower and a lender arrange to sell and then resell between them a trivial object, once for cash and once for a greater sum on credit, with the net result being a loan with interest.[85] There is disagreement among scholars as to how common such devices were. Maxime Rodinson has found them to be very common, while others argue that he overstated the case.[86] Then, of course, there was the possibility of circumventing riba by dealing with non-Muslim (mostly Jewish) money-lenders, a common practice since the Abbassid era.

Modern finance entered the Islamic world alongside Western colonial expansion.[87] Foreign banks financed trade and development, and in due course Islamic governments, strapped for cash, had become debtors, therefore paying interest to foreign creditors. The Ottoman empire since 1840 had been issuing interest-bearing Treasury Bonds,[88] but it is in Egypt that foreign bankers played a crucial role.[89] Egypt's role in legitimizing modern finance cannot be overemphasized. It was the first Islamic country to possess indigenously controlled banks. The National Bank of Egypt was created in 1898 with mixed capital (50 per cent was in Egyptian hands). In 1920, Banque Misr was established, the first ever to be formed exclusively with local capital. Egypt's thriving stock-market made it a favourite among early twentieth-century 'emerging' markets. (At one point in the highly unusual context of the period following the end of World War II, Egypt had the third largest stock market in the world.[90]) Egypt's legal code, which was French-inspired, allowed interest not exceeding seven per cent, and served as a model for many Arab codes. Perhaps most importantly, it is in Egypt that interest was legitimated by religious authorities in 1904. In a famous if controversial fatwa, mufti Sheikh Muhammad Abduh, a leading figure of Islamic reform, cautiously legitimated interest generated either by savings bank accounts or by insurance policies.[91]

The riba controversy was temporarily ignored but not put to rest. Many legal codes adopted by Islamic countries observed an 'eloquent silence' – to use Maxime Rodinson's formulation – on the issue of interest-bearing loans. Overall, interest was tolerated, although it was not uncommon for devout Muslims to refuse interest on their savings. The world of finance took a new turn with the end of colonialism. Newly independent states established national monetary authorities and central banks, and issued local currencies. Control over the credit system and thus over interest rates was perceived as a crucial part of development and economic policy, especially where banks had been nationalized (in countries such as Egypt, Syria, Iraq, Algeria, South Yemen, Libya, and the Sudan). In short, until recent attempts at 'Islamicizing' economic systems, all countries, regardless of ideological leanings, learned to live with interest and with modern finance. Custom, necessity and the public interest helped overcome the age-old suspicion towards debt and practices such as insurance.[92] With the advent of Islamic finance, the prevailing consensus among Islamic scholars was that dealing with conventional banks was acceptable if Islamic institutions were not accessible to them. As for the issue of Muslims or Islamic institutions benefiting from interest, opinions and practices have varied. Some Islamic institutions have steadfastly refused to receive interest, whereas others, including the Islamic Development Bank and the Faisal Islamic Bank of Egypte (FIBE), have always placed their excess funds in interest-bearing accounts, usually overseas.[93] Three theological arguments have typically been invoked to justify receiving interest. One was the overriding necessity argument: given the developmental needs for Muslims, taking interest was justified. Another was based on the old distinction between 'Dar Al Harb' (literally the 'realm of war'), that is, non-Muslim countries, and the realm of Islam ('Dar Al Islam'). It would then be permissible to profit from interest in dealings with Dar Al Harb, especially since this would strengthen the relative position of Dar Al Islam. A third, more frequent position was that income from interest could be accepted, but that it should be 'purified', that is, earmarked for charitable purposes.

Islamic revivalism has to some extent led, along with the Islamicization of economic systems (in Pakistan, Iran and the Sudan), to a re-examination of riba and gharar. But as Chapter 6 shows, even those countries that have 'eliminated interest' have developed interest-like mechanisms, and still have significant components of their economies operating on the basis of conventional interest. The transformation of modern finance that has taken place since the 1980s has also reopened the debate about the acceptability of new financial instruments. But rather than a wholesale rejection, the trend has been towards a new ijtihad designed to separate those products that are acceptable from those that are not, and to create financial instruments adapted to the needs of Islamic societies.[94]

Notes

1. Aziz Al-Azmeh, *Islam and Modernities*, London: Verso 1993, p. 12.
2. At one extreme end of the spectrum, some have gone so far as to argue that only the Meccan part of the Koran was binding. See William E. Shepard, 'Islam and Ideology: Towards a Typology', *International Journal of Middle East Studies* 19 (1987), p. 312.
3. See Nicholas Heer (ed.), *Islamic Law and Jurisprudence*, University of Washington Press 1990; Wael B. Hallaq, *A History of Islamic Legal Theories: An Introduction to Sunni Usul Al Fiqh*, Cambridge University Press 1997; C. G. Weeramantry, *Islamic Jurisprudence: An International Perspective*, New York: St. Martin's Press 1988.
4. Henri Laoust, *Les Schismes dans l'Islam*, Paris: Payot 1965.
5. Philip K. Hitti, *Syria: A Short History*, New York: Macmillan 1959, p. 115.
6. Albert Hourani, *A History of the Arab Peoples*, Harvard University Press 1991, p. 66.
7. Hourani, p. 161.
8. Wael B. Hallaq, 'Was the Gate of Ijtihad ever closed?', *International Journal of Middle East Studies* 16 (1984), pp. 1–33.

9. Joseph Schacht, *An Introduction to Islamic Law*, Oxford University Press 1964, p. 70.
10. Edward Mortimer, *Faith and Power: The Politics of Islam*, New York: Random House 1982, p. 37.
11. Olivier Carré, *L'Islam laïque ou le retour à la Grande Tradition*, Paris: Armand Colin 1993.
12. Bernard Lewis, *Islam and the West*, Oxford University Press 1993, p. 13.
13. John O. Voll, 'Renewal and Reform in Islamic History: *Tajdid* and *Islah*', in John L. Esposito (ed.), *Voices of Resurgent Islam*, Oxford University Press 1983, pp. 32–47.
14. Carré, 1993.
15. Edward Said, *Orientalism*, New York: Random House 1979.
16. Albert Hourani, *Europe and the Middle East*, University of California Press 1980, p. 10.
17. John O. Voll, *Islam: Continuity and Change in the Modern World*, Boulder, Colo.: Westview Press 1982, p. 33.
18. Yahya Sadowski, 'The New Orientalism and the Democracy Debate', in Joel Beinin and Joe Stork, *Political Islam: Essays from Middle East Report*, University of California Press 1997, p. 43.
19. Malcolm Kerr, *Islamic Reform: the Political and Legal Theories of Muhammad Abduh and Rashid Rida*, University of California Press 1966.
20. Mortimer, p. 115.
21. Max Weber, *The Protestant Ethic and the Spirit of Capitalism*, Englewood Cliffs, N.J.: Prentice Hall 1980.
22. Koran 2:198 'It is no sin for you that you seek the bounty of your Lord. So when you press on from Arafat, remember Allah near the Holy Monument, and remember Him as He has guided you, though before that you were certainly of the erring ones'. (Reference to commercial activities in Mecca during Pilgrimage.)

    73:20 'Thy Lord knows indeed that thou passes in prayer nearly two-thirds of the night and [sometimes] half of it, and [sometimes] a third of it, as do a party of those with thee. And Allah measures the night and the day. He knows that [all of] you are not able to do it, so He has turned to you [mercifully]; so read of the Koran that which is easy [for you], keep up prayer and pay the poor-rate and offer to Allah a goodly gift. And whatever of good you send on before hand for yourselves, you will find it with Allah – that is best and greatest in reward. And ask forgiveness of Allah. Surely Allah is forgiving, merciful'.
23. Koran 62:9 'O you who believe, when the call is sounded for prayer on Friday, hasten to the remembrance of Allah and leave off traffic. That is better for you, if you know'.

    62:10 'But when the prayer is ended, disperse abroad in the land and seek Allah's grace, and remember Allah much, that you may be successful'.
24. Ira M. Lapidus, *Muslim Cities in the Later Middle Ages*, Harvard University Press 1967.
25. Muhammad Akram Khan, *An Introduction to Islamic Economics*, Islamabad: International Institute of Islamic Thought and Institute for Policy Studies 1994, p. 83.
26. Chibli Mallat, *The renewal of Islamic law: Muhammad Baqer as-Sadr: Najaf and the Shi'i International*, Cambridge University Press 1993, p. 111.
27. William E. Shepard, 'Muhammad Sa'id Al-Ashmawi and the Application of the Shari'a in Egypt', *International Journal of Middle East Studies* 28 (1996), pp. 39–58.
28. Myron Weiner and Samuel P. Huntington (eds), *Understanding Political Development*, Boston: Little, Brown and Company 1987.

29. Timur Kuran, 'Economic Justice in Contemporary Islamic Thought', *International Journal of Middle East Studies* 21:2, May 1989, pp. 171–91.
30. In those years competition between pan-Arabism and pan-Islamic usually pitted Egypt against Saudi Arabia (see Chapter 5), although there were periods of *rapprochement* between the two countries.
31. John L. Esposito (ed.), *Voices of Resurgent Islam*, Oxford University Press 1983, p. 9.
32. Khalid M. Ishaque, 'The Islamic Approach to Economic Development', in John L. Esposito (ed.), *Voices of Resurgent Islam*, Oxford University Press 1983, pp. 268-76.
33. See Chapter 5.
34. Timur Kuran, 'The Economic System in Contemporary Islamic Thought: Interpretation and Assessment', *International Journal of Middle East Studies* 18 (1986), p. 135.
35. Rodney Wilson, *Economics, Ethics and Religion: Jewish, Christian and Muslim Economic Thought*, New York University Press 1997, p. 115.
36. Mallat, p. 111.
37. Mallat, pp. 117–20.
38. Traute Wohlers-Scharf, *Arab and Islamic Banks: New Business Partners for Developing Countries*, Paris: OECD 1983, p. 91.
39. Khan, p. 30.
40. John L. Esposito, *The Islamic Threat: Myth or Reality?*, Oxford University Press 1992, p. 80.
41. Mallat, p. 125.
42. Koran 2:184 'But whoever among you is sick or on a journey, [he shall fast] a like number of other days. And those who find it extremely hard may effect redemption by feeding a poor man. So whoever does good spontaneously, it is better for him; and that you fast is better for you if you know'.

    2:185 'The month of Ramadan is that in which the Koran was revealed, a guidance to men and clear proofs of the guidance and the Criterion. So whoever of you is present in the month, he shall fast therein, and whoever is sick or on a journey, [he shall fast] a [like] number of other days. Allah desires ease for you, and He desires not hardship for you, and [He desires] that you should complete the number and that you should exalt the greatness of Allah for having guided you and that you may give thanks'.
43. Carré, p. 15.
44. Mortimer, p. 244.
45. Koran 2:173 'Allah has forbidden you only what dies of itself, and blood, and the flesh of swine, and that over which any other name than that of Allah has been invoked. Then whoever is driven by necessity, not desiring, nor exceeding the limit, no sin is upon him. Surely Allah is forgiving, merciful'.
46. Koran 2:286 'Allah imposes not on any soul a duty beyond its scope. For it is that which it earns [of good] and against it that which it works [of evil]. Our Lord, punish us not if we forget or make a mistake. Our Lord, do not lay on us a burden as Thou didst lay on those before us. Our Lord, Impose not on us afflictions which we have not the strength to bear. And pardon us! And grant us protection! And have mercy on us! Thou art our Patron, so grant us victory over the disbelieving people'.
47. Frank E. Vogel and Samuel L. Hayes III, *Islamic Law and Finance: Religion, Risk, and Return*, The Hague: Kluwer Law International 1998, p. 38.
48. Shaul Bakhash, 'The Politics of Land, Law, and Social Justice in Iran', *Middle East Journal*, Vol. 43, No. 2, Spring 1989, p. 196.
49. Bakhash, 1989.
50. Jahangir Amuzegar, *Iran's Economy Under the Islamic Republic*, London: I. B.

Tauris 1993, pp. 21–8.
51. Kiren Aziz Chaudhry, *The Price of Wealth: Economies and Institutions in the Middle East*, Cornell University Press 1997, p. 37.
52. Mortimer, p. 245.
53. Michel Galloux, *Finance islamique et pouvoir politique: le cas de l'Egypte moderne*, Paris: Presses Universitaires de France 1997, p. 43.
54. Albert Hirschman, *The Passions and the Interests: Political Arguments for Capitalism Before Its Triumph*, Princeton University Press 1977.
55. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, University of Chicago Press 1977.
56. Kuran 1986, p. 136.
57. Alan Richards and John Waterbury, *A Political Economy of the Middle East*, Boulder, Colo.: Westview Press 1996, p. 354.
58. Koran 2:30 'And when thy Lord said to the angels, I am going to place a ruler in the earth, they said: Wilt thou place in it such as make mischief in it and shed blood? And we celebrate Thy praise and extol Thy holiness. He said: Surely I know what you know not'.
59. Koran 57:7 'Believe in Allah and His Messenger and spend of that whereof He has made you heirs. So those of you who believe and spend – for them is a great reward'.
60. Karen Pfeifer, 'Is there an Islamic Economics?' in Joel Beinin and Joe Stork, *Political Islam: Essays from Middle East Report*, University of California Press 1997, p. 163.
61. Sophie Bava and Danielle Bleitrach, 'Islam et pouvoir au Sénégal: Les mourides entre utopie et capitalisme', *Le Monde diplomatique*, November 1995.
62. Kuran 1986, pp. 135–64.
63. See Chapter 5.
64. Khan, p. 26.
65. Khan, pp. 34–44.
66. Khan, p. 33.
67. See Ellen Frankel Paul, Fred D. Miller, Jr, and Jeffrey Paul (eds), *Ethics and Economics*, London: Basil Blackwell 1985; Amitai Etzioni, *The Moral Dimension: Towards a New Economics*, New York: Free Press 1988.
68. Michael Novak, *The Spirit of Democratic Capitalism*, Lanham Md.: Madison Books 1991.
69. Michael Novak, *The Catholic Ethic and the Spirit of Capitalism*, New York: Free Press 1993; Richard John Neuhaus, *Doing Well and Doing Good*, New York: Doubleday 1993.
70. See for example, Muhammad Akram Khan, *An Introduction to Islamic Economics*, Islamabad: International Institute of Islamic Thought and Institute of Policy Studies 1994, pp. 33–90.
71. Judith Miller, *God Has Ninety-Nine Names: A Reporter's Journey through a Militant Middle East*, New York: Simon and Schuster 1996, p. 144.
72. *Utopia* is also the title of the famous book by Thomas More (1516), about an imaginary island that represented moral, political and social perfection.
73. Mohammed N. Siddiqi, *Muslim Economic Thinking*, Leicester: The Islamic Foundation 1981, p. 69.
74. Richards and Waterbury, p. 356.
75. Peter E. Earl, 'A Behavioral Theory of Economists' Behavior', in Alfred S. Eichner, *Why Economics is not yet a science*, Armonk, N.Y.: M. E. Sharpe 1983.
76. Paul Krugman, *Peddling Prosperity: Economic Sense and Nonsense in the Age of Diminished Expectations*, New York: W. W. Norton 1994; Robert J. Barro, *Markets and Choices in A Free Society*, MIT Press 1996; and Milton Friedman, *Capitalism and*

Freedom, University of Chicago Press 1963; see also the exchange between James K. Galbraith and Paul Krugman, 'Who's the Real Economist?' in *Slate*, 7 and 11 November 1996.
77. George Soros, *The Crisis of Global Capitalism*, New York: Public Affairs 1998.
78. Wilson, p. 45.
79. Bernard Maris, *Des Economistes au-dessus de tout soupçon, ou la grande mascarade des prédictions*, Paris: Albin Michel 1990, p. 57.
80. Ibrahim Warde, 'La vie, la mort, le marché', *Le Monde diplomatique*, June 1998.
81. See Chapter 3.
82. Abraham Udovitch, *Partnership and Profit in Medieval Islam*, Princeton University Press 1970.
83. Nabil A. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law: Riba, gharar and Islamic banking*, Cambridge University Press 1986.
84. Blaise Pascal, *Les Provinciales ou Les Lettres écrites par Louis de Montalte à un provincial de ses amis et aux RR. PP. Jésuites sur le sujet de la morale et de la politique de ces Pères*, Paris: Gallimard Folio 1987, p. 131.
85. Vogel and Hayes, p. 39.
86. Maxime Rodinson, *Islam and Capitalism*, London: Penguin, p. 48, and Galloux, p. 18.
87. Charles Issawi (ed.), *The Economic History of the Middle East 1800–1914*, University of Chicago Press 1966, pp. 10–11.
88. Historians however disagree on the amount of interest charged. Estimates vary between eight and twelve per cent. Rodinson, p. 144.
89. David Landes, *Bankers and Pashas: International Finance and Economic Imperialism in Egypt*, Harvard University Press 1958.
90. *Worth*, December 1996–January 1997.
91. Chibli Mallat, 'The debate on riba and interest in twentieth century Egypt', in Chibli Mallat (ed.), *Islamic Law and Finance*, London: Graham and Trotman 1988, pp. 69–88.
92. Mortimer, p. 238.
93. Elias Kazarian, *Islamic Versus Traditional Banking: Financial Innovation in Egypt*, Boulder: Westview Press 1993, p. 225.
94. Vogel and Hayes, pp. 235–95.

3

RIBA, GHARAR, AND THE MORAL ECONOMY OF ISLAM IN HISTORICAL AND COMPARATIVE PERSPECTIVE

Most definitions reduce Islamic banking to 'interest-free' banking. While the injunctions against riba are indeed the cornerstone of Islamic finance, debates persist as to the exact significance of the word. Since the early days of Islam, the majority of scholars have adopted a restrictive definition: any form of interest constitutes riba. The debate is nonetheless still lively. A few voices – including those of prominent figures such as the Egyptian mufti, Muhammad Sayyed Atiyya Tantawi, now Shaikh of Al-Azhar, one of Islam's oldest and most prestigious learning centres – have rejected that definition and argued that Islam tolerates a reasonable rate of interest. This chapter starts with the riba debate, its origin and significance. It later discusses gharar, a lesser known yet – in the contemporary world of finance – equally significant prohibition, the moral economy of Islam, a broader approach focusing on the spirit, as opposed to the letter of Islam, and the religious vs secular approaches to these issues. The final section places the money and religion debate in comparative and historical perspective.

3.1 Riba

The controversy over riba shows no sign of abating. Some have condemned attempts to even discuss the matter. One scholar wrote:

> If Quranic theories come into conflict with the modern scientific theories, I find no reason to trouble my conscience. I firmly believe that the sciences of today may become the mythology of tomorrow and what Quran has said, we may not understand it today, but it is likely to become quite clear to us tomorrow.[1]

At the other end of the spectrum, a few have dismissed the 'entire medieval notion of riba as an obsolete idea'.[2]

The riba debate has been approached from many angles. One set of discussions contrasts 'interest', a moderate, economically justified remuneration of capital, with 'usury', an excessive, sometimes extortionary rate. A few scholars have argued that only the latter constitutes riba. The majority of Islamic scholars still consider that any increase in the amount of money returned by a borrower constitutes riba and is therefore prohibited.

Another angle is the requirements of the modern economy. In recent decades, darura (necessity) and maslaha (the general interest), as well as existing practices and customs have been repeatedly invoked by Islamic modernists.[3] In the words of Fazlur Rahman:

> As long as our society has not been reconstructed on the Islamic pattern, it would be suicidal for the economic welfare of the society and the financial system of the country and would also be contrary to the spirit and intentions of the Quran and Sunna to abolish bank-interest.[4]

By the same token, some have raised the issue of the inflationary nature of the contemporary economy. The prohibition of riba would then apply to real interest (that is, the interest rate minus the rate of inflation) as opposed to nominal interest. Otherwise, the absence of interest in an inflationary period would amount to negative real interest, which would penalize lenders and subsidize borrowers.[5]

In the same vein, some have argued that the concept of riba had been misunderstood, misinterpreted and misapplied. Mohammed Said al-Ashmawi makes three arguments to show that a sweeping prohibition against interest is unwarranted: first, in his view, the riba referred to in the Koran was the riba al-jahiliyya (see below), which refers to the common pre-Islamic practice of doubling the principal[6] in exchange for more time, and which resulted in the enslavement of the borrower if in the end he could not pay; second, riba – based on a widely quoted Hadith – specifies six commodities, and should apply only to these six, and not to modern currency;[7] third, a distinction should be drawn between economically useful loans, such as those taken by businesses and institutions for the purpose of investing and making profit, and exploitative loans such as those made to poor individuals to help them meet immediate basic needs.[8]

In contrast, certain scholars have claimed that a modern economy could bypass riba altogether by devising appropriate mechanisms.[9]

Rather than resolving the issue, a number of fatwas have perpetuated the controversy. In 1904, in a context of rapid economic change, Egypt's mufti, the reformer Muhammad Abduh, issued, by request of the government, a controversial fatwa on the Egyptian Savings Fund (Sanduq al-Tawfeer) created by the Postal Administration. In exchange for cash deposits, the Egyptian Savings Fund had issued savings 'certificates' which yielded depositors a fixed and predetermined rate of return on their money. The Savings Fund used such deposits for various small investments. The fatwa adopted, albeit carefully, a tolerant view of fixed and predetermined rates.[10] Ambivalence and hedging have since characterized such decisions. As was observed by Chibli Mallat:

> Egyptian muftis writing in the 20th century acknowledge that they are treading a delicate path and are dealing with powerful economic actors and institutions that have strong supporters in new, as well as in established, commercial sectors. Because a fatwa that unilaterally condemned interest-bearing transactions would be totally ineffective, most muftis have taken care to formulate their opinions in language that is either cautious or ambiguous.[11]

Despite attempts at 'balance', disagreements have not subsided. In 1986, the Fiqh (jurisprudence) Academy of the Islamic Conference supported the restrictive interpretation of early jurists, condemning all interest-bearing transactions as void.[12] But in 1989, while an economic and rhetorical debate between Islamic financial institutions and conventional banks was raging (in the wake of the collapse of Islamic Money Management Companies [IMMCs]),[13] the mufti of the Egyptian Republic, Muhammad Sayyed Atiyya Tantawi, issued what he considers his most important fatwa, one legitimizing 'capitalization certificates' (shahadat al-istithmar), which are interest-bearing government bonds underwritten by Egyptian banks. To justify his position, he cited jurists as well as bankers and secular experts. He argued 'that the determination of the profit in advance is for the sake of the owner of the capital (that is deposited) and is done to prevent a dispute between him and the bank.'[14] In addition, since the certificates are issued in connection with the state's financing of the development plan in order to encourage the population to increase its level of savings, the certificates legally are not loans, but deposits. Despite the traditional pre-eminence of Egyptian Grand Muftis within the Islamic – especially Sunni – world, many leading figures therein remained unconvinced. Thus a decision of the Federal Shariat Court of Pakistan dismissed that fatwa in 1992 as the 'solitary opinion of Shaikh Tantawi of Egypt'.[15]

On other occasions, Tantawi launched frontal attacks against Islamic banks, accusing them of hypocrisy and of misleadingly using the word Islam in their appellation. In a 1995 speech, he criticized Western-style banks which established 'Islamic' subsidiaries to meet the growing demand for such services. He said that there was little difference between Western-style banks which offer fixed interest rates, and Islamic banks in which depositors share the risk of investing in projects, for Islam simply requires financial transactions to be marked by 'clarity and justice'. Even more provocatively, he argued that 'banks which set fixed interest are closer to Islam because they make clear people's entitlement'.[16]

Tantawi's successor as mufti, Sheikh Nasr Farid Wassel, took the same position, declaring: 'I will give you a final and decisive fatwa: so long as the banks invest the money in halal, then the transaction is halal.' He called for an end to the controversy about bank interest, adding that 'there is no such thing as an Islamic and non-Islamic bank'.[17]

Egypt is in a singular position in the Islamic world. On the one hand, it played a pioneering role in Islamic finance and hosts some of the best-known Islamic institutions. Also, most of its conventional banks offer Islamic products. Yet the country's top religious establishment has legitimated moderate interest and in effect considers Islamic institutions superfluous and questionable. The Egyptian fatwas had a paradoxical impact on Islamic finance, insofar as they added legitimacy to more pragmatic approaches, but the intellectual debate on riba is still raging. It is all the more inconclusive that unassailable, factual elements about the origin of riba are scarce.

It is generally agreed that Mohammed's view evolved from exhortation against riba in his 'Mecca period' to outright prohibition in his 'Medina period'. The Koran declares that those who disregard the prohibition of riba are at war with God and his Prophet. That prohibition is explicitly mentioned in four different revelations of the Koran (2:275–81, 3:129–30, 4:161 and 30:39), expressing the following ideas: despite the apparent similarity of profits from trade and profits from riba, only profits from trade are allowed; when lending money, Muslims are asked to take only the principal and forgo even that sum if the borrower is unable to repay; riba deprives wealth of God's blessings; riba is equated with wrongful appropriation of property belonging to others; Muslims should stay away from it for the sake of their own welfare.[18] But the Koran does not elaborate further. A few of Mohammed's companions even expressed frustration at the vagueness of the definition.

The Hadith however is more specific, distinguishing two types of riba: riba al-fadl, which is produced by the unlawful excess of one of the countervalues, and riba al-nasia, which is produced by delaying completion of the exchange of the countervalues. Early Islamic scholars also mentioned a third type of riba, riba al-jahiliyya (or pre-Islamic riba), which occurs when the lender gives the borrower at maturity date a choice between settling the debt or doubling it.

So, what exactly is riba? Literally, it means increase. Based on that definition, there is in riba both more and less than meets the eye. Riba is not necessarily about interest rates as such, and it certainly is not exclusively about interest rates. It really refers to any unlawful gain derived from the quantitative inequality of the countervalues. Interest or usury (i.e., reimbursing more than the principal advanced) would then be only one form of riba.

Different explanations have been advanced as to why riba is condemned. A few had to do with expediency but most were related to economic/ethical norms. Historian Philip Hitti has, for example, suggested that Mohammed's injunctions against usury were aimed at the Jews of Medina: he badly needed their financial support when they were keen on charging interest on these loans.[19] Yet the very persistence of the prohibition, well beyond Mohammed's life, suggests concerns beyond mere expediency.

Islamic scholars have insisted that the prohibition of riba is not an isolated religious injunction but 'an integral part of the Islamic economic order with its overall ethos, goals and values'.[20] One needs therefore to look at the 'moral economy' of a 'pre-modern' economic system, where transactions involved various forms of barter and exchange, often completed over time. From such a perspective, one can find striking parallels between early Islam and contemporaneous ethical and religious systems. Following a discussion of gharar, we will dwell on the moral economy of Islam and on those parallels.

3.2 Gharar

With only a few exceptions, the vast majority of the writings on Islamic finance simply ignore gharar.[21] Although the word itself is not mentioned in the Koran, etymologically related words, meaning deception or delusion, are.[22] It is however in a number of Hadiths that gharar is condemned. As in the case of riba, the prohibition is unequivocal though the concept itself is somewhat vague. It should be noted however that certain schools of fiqh tolerate gharar in case of need (haja) and when it cannot be averted except with great difficulty.[23]

The word gharar means deception or delusion but also connotes peril, risk or hazard. In its financial interpretation, it is usually translated as 'uncertainty, risk or speculation'. As explained by Maxime Rodinson:

> Any gain that may result from chance, from undetermined causes, is here prohibited. Thus, it would be wrong to get a workman to skin an animal by promising to give him half the skin as reward, or to get him to grind some grain by promising him the bran separated out by the grinding process, and so on. It is impossible to know for certain whether the skin may not be damaged and lose its value in the course of the work, or to know how much bran will be produced.[24]

Importantly however, gharar should not be used interchangeably with the broad concept of risk. Gharar is prohibited yet it would be nonsensical to prohibit risk. Islam does not even advocate the avoidance of risk. Indeed, incurring commercial risk is approved, even encouraged, provided it is equitably shared. More accurately, gharar refers to aleatory transactions, that is, transactions conditioned on uncertain events. Three passages in the Koran prohibit Maysir,[25] which is usually meant to include all games of chance (2:219, 5:90 and 5:91).[26] In every instance, the prohibition is associated with that against wine drinking. The primary reason for condemning Maysir is that it causes enmity and distracts the faithful from worship.

The Hadith goes much further, extending the concept to commercial transactions involving uncertainty. Among the most significant hadiths are the following:

> – 'The Messenger of God forbade the "sale of the pebble' ["hasah": sale of an object chosen or determined by the throwing of a pebble], and the sale of gharar'.
>
> – 'Do not buy fish in the sea, for it is gharar'.
>
> – 'The Messenger of God forbade the [sale of] the covering [copulation] of the stallion'.
>
> – 'The Prophet forbade sale of what is in the wombs, sale of the contents of the udders, sale of a slave when he is runaway, ... and [sale of the] "stroke of the diver" ["darbat al-gha'is": sale in advance of a diver's dive]'.
>
> – 'Whoever buys foodstuffs, let him not sell them until he has possession of them'.
>
> – 'He who purchases food shall not sell it until he weighs it'.
>
> – '[T]he Prophet forbade the sale of grapes until they become black, and the sale of grain until it is strong'.[27]

Based on these Hadiths, Frank Vogel has arranged the prohibitions in a spectrum according to the degree of risk involved: pure speculation, uncertain outcome, unknowable future benefit, and inexactitude. He concluded that:

> [A] possible interpretation of the gharar hadiths is that they bar only risks affecting the existence of the object as to which the parties transact, rather than just its price. In the hadiths, such risks arise either 1) because of the parties' lack of knowledge (jahl, ignorance) about that object; 2) because the object does not now exist; or 3) because the object evades the parties' control. Therefore the scholars might use one of these three characteristics to identify transactions infected by the type of risk condemned as gharar.[28]

3.3 Contemporary Interpretations: Religious and Secular Experts

At a time of revolutionary changes in international finance, it was inevitable that literal, scholastic and legalistic interpretations of the Shariah would clash with pragmatic ones focusing on the spirit of Islam, and likely to invoke maslaha (the general interest) and darura (overriding necessity). Where traditionalists are likely to defer to fiqh scholars, modernists will seek the advice of secular experts. In reality, the world of finance has grown so complicated that secular experts must be called upon to explain certain instruments and practices, leaving it to Shariah Boards and Islamic financiers to decide whether certain products and practices conform to the spirit of Islam.

In that regard, the 1989 Tantawi fatwa broke new ground. Chibli Mallat explains how the mufti based his decision 'on the basis of the Koran and Hadith, the obligation of wise men to search for the truth, the principle of ijtihad, the virtue of avoiding fanaticism, and *the importance of expertise to unravel arcane subjects'* (my emphasis). Tantawi cited the Koran's injunction to 'ask the ahl al-dhikr if you do not know' (21:7), with ahl al-dhikr defined as 'the people of expertise and experience in all science and art'. The mufti further added, 'in medicine you ask physicians, in fiqh the fuqaha, and in economics you ask economists'.[29]

In what Mallat emphasized was a 'significant and unusual move', the mufti conceded he could not answer questions that fell beyond his area of expertise – he specifically wrote that expertise in the Shariah does not imply familiarity with arcane financial matters – without consulting experts on banking: '[S]cientific trust requires (the mufti) not to issue a fatwa in such matters before asking those who are knowledgeable and possess expertise in these matters, because ruling on an issue requires (the mufti) to fully understand it (literally: ruling on a matter is part of imagining it)'.[30] Accordingly, Tantawi sent detailed questions to the Chairman of the board of Egypt's Ahli Bank, and inserted in his fatwa lengthy quotes from secular specialists. Not only were the opinions of secular experts a factor in the fatwa, but the mufti promised that in the future such consultations would occur to unravel financial matters.[31]

As already noted, the Tantawi fatwa was controversial in the Islamic world. Considering that modern economic and financial orthodoxy has turned old axioms on their heads, we can appreciate the range of controversy among scholars – and better understand the diversity of Islamic finance. Examples of the clash between secular financial orthodoxy and traditional Islamic injunctions on finance abound. On the topic of speculation, the early Islamic tradition roundly and unambiguously condemned gharar. Yet in recent centuries, new approaches towards risk have emerged: by relying on the past and using probabilities and other quantitative techniques, risk could be measured and to some extent tamed.[32] In areas such as insurance or financial derivatives, risk management has become crucial. So, rather than a wholesale condemnation of aleatory transactions, a more subtle and sophisticated approach to risk is called for in the light of recent intellectual advances.[33]

Put differently, rather than avoiding risk, financiers must learn to control it. But the danger of over-reliance on secular experts is that of falling into the trap of 'market fundamentalism'.[34] Economics textbooks usually explain that speculators play a 'positive and necessary' role in the economy. The benefits of debt and the advantages of using 'OPM' (other people's money) are highly touted. Finance professors have routinely justified egregious behaviour[35] and glorified dubious characters such as 'junk bond king' Michael Milken.[36] There is even an Orwellian tinge to the language of finance. Thus 'hedge funds', whose purpose as suggested by their name is theoretically to mitigate risk, have become instruments of the riskiest form of speculation.[37]

Nor is there a credible consensus among secular experts. To be sure, the dominant economic orthodoxy assumes that a minimally regulated finance is good for the general welfare, and that the financial economy is a reasonably accurate reflection of the underlying real economy.[38] Yet other scholars have noted the disconnection between the financial economy and the real economy. Susan Strange for example has described it as the erratic, volatile world of 'casino capitalism', that bears little resemblance to the textbook universe of finance.[39] The international financial crisis of 1998 has shown that the leading experts of secular finance – Myron Scholes and Robert Merton who won the Nobel Prize in economics in 1997 for their contribution to the pricing of options and yet whose Long-Term Capital Management hedge fund collapsed the following year – can get it wrong.[40]

One could therefore see how, by relying on the rationalizations of certain experts, virtually any financial transaction could be justified. One manifestation of the range of disagreement is the 'fatwa wars', which can only intensify as finance gains in complexity. Financial institutions are likely to step up the competition for scholars ready to justify whatever suit the institutions' preferences.[41]

3.4 The Moral Economy of Islam

Joan Robinson identified the three pre-requisites for an economic system as being 'a set of rules, an ideology to justify them, and a conscience in the individual which makes him strive to carry them out'.[42] The ethical dimension is all too often forgotten, though it exists, as we shall see later, in any society.[43] This section explores the moral economy, or ethical framework, of Islam.

Hard work and participation in economically creative activity is obligatory for every Muslim (62:10).[44] The importance of productivity has been justified as follows:

> Economic activity is not to be confined to earning or producing enough to meet one's personal needs only. Muslims are expected to produce more because they cannot participate in the process of purification through providing security to others (zakat or alms tax) unless they produce more than what they themselves consume. The most recommended use of fairly earned wealth is to apply it to procuring of all means to fulfill a Muslim's covenant with Allah.[45]

The broad ethical/economic system emphasizes fairness and productivity, honesty in trade and fair competition (17:35; 26:181–3),[46] the prohibition of hoarding wealth and worshipping it (104:2–4),[47] and the protection of human beings from their own folly and extravagance. Such a system, although rooted in an ancient tradition, is not, at least in its broad outlines, far removed from many contemporary approaches to ethical business practices.

As for the ethical/economic justification for the prohibition of riba, it is three-pronged: riba is unfair, it is exploitative, and it is unproductive. Under a traditional interest-based relation between borrower and lender, the borrower alone either incurs the losses or reaps disproportionately high benefits. Conversely, the lender makes money irrespective of the outcome of the business venture. Islam prefers that the risk of loss be shared equitably between the two. In other words, rather than collecting a 'fixed, predetermined' compensation in the form of interest, lenders should be entitled to a share from any profits from a venture they have helped to finance. The broader argument is that any profit should be morally and economically justified. Hence the injunctions against aleatory contracts and gharar where gain is the result of chance, or undetermined causes. As in other religions, riba was also seen as exploitative, since it tended to favour the rich, who were guaranteed a return, at the expense of the vulnerable who assumed all the risk.

Significantly, the issue of fairness is not unrelated to issues of productivity and efficiency. Earning a profit is legitimate when one is engaged in an economic venture and thereby contributes to the economy. By certain accounts, Meccan merchants in the days of the Prophet routinely engaged (usually in-between arrivals and departures of caravans) in interest-based lending, speculation and aleatory transactions.[48] This would account for the sharp distinction drawn in the Koran between profit from trade and profit from riba. While the former benefited the community and enhanced welfare, the latter diverted resources towards non-productive uses and contributed to illiquidity and scarcity.[49] The modern-day equivalent of that debate contrasts the real, productive economy with the financial, speculative one. Some Islamic economists have also argued that an interest-based economy was inherently inflationary and caused unemployment and poverty because the creation of money was not linked to productive investment.[50]

3.5 A Historical and Comparative Approach

There are striking similarities between the spirit and often the letter of all Abrahamic religions on economic matters. All three emphasize justice through just wages and just prices, criticize speculation and wasteful consumption, and advocate moral behaviour in commerce. This section considers primarily the attitudes towards interest. While injunctions were often identical in the pre-capitalist world, changes in the Western world, in particular since the sixteenth century, have led to new intellectual and theological attitudes. After the idea of a moderate, legally capped interest to replace the previous ban on usury gained ground, there was a movement to eliminate such ceilings and let 'the market' determine interest rates.

Moral qualms about money were common in the pre-capitalist world. In ancient Mesopotamia, the Hamurabi code (1800 BC) placed limits on interest rates and banned compound interest (interest on the interest). Aristotle provided the most influential argument about the 'barrenness' of money: it should be a means of exchange and should not be allowed to multiply. The Romans allowed interest but regulated interest rates.[51]

The scholastic tradition among Christian theologians made the Aristotelian case that money was a 'sterile commodity'. The long-standing rule was *pecunia pecuniam non parit,* or money does not make money. The canon (which was not necessarily shared by the classical scholars of Islam) also considered the 'pricing of time' illegitimate, since 'time belongs to God'. Unlike the farmer or the craftsman who actually produced something, money-lenders did not.[52]

Judaism, Christianity and Islam considered that the lender, by definition, possessed a store of capital that exceeded his requirements, while the borrower lacked the resources to satisfy his immediate needs. It would thus be unfair and even immoral for a needy borrower both to repay the capital and to increase the lender's wealth still further by paying him interest, especially since the additional amount must be taken from the fruit of the borrower's industry. All three religions preached that the prosperous had a duty to assist the needy, if not by gifts, at least through interest-free loans.[53]

Importantly however, if those religions were very similar, they were not identical. The Jewish tradition generally prohibited interest (Leviticus 25:36).[54] A loophole however allowed interest for money lent to non-Jews (Deuteronomy 19:19-20).[55]

The Christian gospels do not mention interest specifically, though they repeatedly denigrate moneymaking and economic pursuits.[56] As is the case with Judaism and Islam, the Christian tradition recommends that lenders forgive parts of their loans to the poor (Luke 6:34–5).[57] Later Christian tradition provided for something called 'antidora', a spontaneous and unforced gift of the borrower to the lender to thank him for his loan. Unlike conventional interest, it was not obligatory, pre-determined and fixed, but voluntary and in an amount left to the discretion of the borrower.[58]

In Christianity as in Islam, there is also the principle of purification of ill-gotten gains. It was common in the Christian Middle Ages for money-lenders to lighten their guilt 'by including in their will a token bequest to a charity and calling it restitution of any "ill-gotten" money'.[59] Money lenders were sinners, but they were not beyond salvation: 'Indispensable but malodorous, they were deliberate public sinners, likened to prostitutes, and hence tolerated on earth but earmarked for hell unless they repented, and made full restitution of their accursed gains'.[60] Historian Jacques Le Goff draws interesting connections between the invention of the concept of purgatory in the second half of the twelfth century, and money-lending. In his words, 'the birth of purgatory is also the dawn of banking'.[61]

Economic transformations created new financial needs and typically resulted in an intensification of the debates over usury.[62] 'The more frequent practices contrary to doctrine become', wrote Maxime Rodinson,

> the more the ideological authorities (if they want to retain, on the one hand, some influence over society, and, on the other, some degree of coherence in their intellectual system) are led to theorize with finesse and subtlety, to allow for cases, exceptions, degrees of guilt and of innocence, means of atoning more or less fully for one's offences, and to work out a graduated scale of penalties and tolerances. It therefore seems quite in order that, in mediaeval Christian society as in Muslim society, it was at the very moment when capitalistic practices implying the need for interest were developing with the greatest vigor that the theologians and religious lawyers took the greatest trouble to theorize about the prohibition of interest, justifying it, explaining it and allowing for cases and exceptions.[63]

Similarly, Abraham Udovitch noted: 'The frequent, copious, and vehement reiteration of the prohibition against usury in medieval Islamic religious writings has been interpreted by some scholars as indirect testimony to its equally frequent violation in practice'.[64]

In medieval Europe, the ban on usury had been repeatedly reaffirmed. The Council of Reims (1069) and the Second Lateran Council (1139) condemned usury. The Third Lateran Council (1179) excommunicated usurers, and the Fourth Lateran Council (1215) permitted Jews to practise it. The Council of Lyon (1274) reiterated the condemnation and marked the first official recognition of salvation by purgatory. The arguments of the scholastics and other canonists remained virtually unchallenged throughout the thirteenth and fourteenth centuries. Like the Third Council of Lateran, the Second Council of Lyons in 1274 proclaimed that Christians who received interest would be excommunicated.[65] In 1311 the Council of Vienna declared that secular legislation that did not prohibit interest was invalid, and that anyone who asserted otherwise was a heretic who would be punished accordingly. In the fifteenth and sixteenth centuries, increasing attention was devoted to the question of the licitness of new financial institutions and practices.[66]

It was only in 1515 that the Church, at the Lateran Council, legitimated interest on secured loans. Although it still took a long time before the idea was fully accepted, new and increasingly subtle approaches to money-lending (often inspired by the Islamic hiyal) had been gaining ground. There were a number of ways of circumventing prohibitions on usury, which in its canon law definition meant 'whatever is added to the principal'.[67] One was the traditional 'free and loving loan' (*mutuum gratis et amore*), a loan with a built-in, concealed interest.[68] Perhaps the most significant invention in that respect was the 'letter of exchange'.[69] As a first step, the idea of a small interest for certain purposes was accepted. The Jesuits for example approved of commercial credit.[70]

A counter-theory of usury appeared with the Protestant Reformation. The reformers, no longer bound by canon law, engaged in significant innovation on matters of political economy and money. Martin Luther (1483–1546) urged Christians to participate fully in the world and challenge Church teachings. John Calvin (1509–64) argued that religious fulfilment came from hard work and not merely from prayer and spiritual contemplation. In his famous 'Letter on Usury' (1545), Calvin stated that usury is licit, but 'not everywhere, nor always, nor in all goods, nor from all'. He used the golden rule as a guide: usury is sinful only if it hurts one's neighbour, and charity and natural equity alone can decide in what particular cases a charge for a loan does hurt a neighbour since each believer is guided by his own conscience. For example, lending to the poor in order to achieve a profit is wicked, but in lending to the rich, a modest profit is acceptable. The ministers of the gospel could lend to merchants, but in such a way that their profit was not certain.[71]

The Calvinist bankers in Geneva were thus free to develop their financial interests without any feelings of guilt, provided they observed the Christian teaching on justice to the poor, and that they were totally honest in their dealings.[72] In time, some of Calvin's followers sought to eliminate some of the 'exceptions' that Calvin had provided for. In 1630 Calvinist classicist Claude Saumaise (1588–1653) took the defence of usurers who lent to the poor. In his view, the money-lender performs a highly useful service, as does anyone who provides a means for meeting a great public need. His views, as summarized by John Noonan, are:

> If it is licit to make money with things bought with money, why is it not licit to make money from money? Everyone makes his living from someone else; why should not the usurer? The seller of bread is not required to ask if he sells it to a poor man or a rich man. Why should the moneylender have to make a distinction?

Saumaise also defended high interest charges, which he saw as beneficial in stimulating the borrowers to repay more quickly. In his view, it is negligence, inertia and prodigality that are the real enemies of the poor, not the usurer.[73]

Such views become common, especially in England, with the advent of industrialization and the triumph of the capitalist ideology. In letters written in 1787 'in defence of usury', Jeremy Bentham made the case for the

'the liberty of making one's own terms in money bargains'.[74] He noted the mischief of anti-usurious laws, principally 'that of precluding so many people, altogether, from the getting the money they stand in need of, to answer their respective exigencies', and 'the distress it would produce, were the liberty of borrowing denied to every body'.[75] Bentham objected in particular to the differentiation made between money-lending and other forms of commerce:

> Why a man who takes as much as he can get, be it six, or seven, or eight, or ten per cent for the use of a sum of money, should be called usurer, should be loaded with an opprobrious name, any more than if he had bought an house with it, and made a proportionable profit by the house, is more than I can see.[76]

In sum, the history of ideas in relation to money had gone through three stages. In the first one, usury was generally forbidden. In the second one, a small rate of interest, regulated by the state, was permitted. In the theological debate, a new emphasis was placed on those passages of the gospels that stressed the need for wealth to fructify. Thus the parable of the talents stresses the need to be productive (Matthew, 25:14–30). In another parable, a nobleman calls 10 of his servants before a long journey, giving them a pound each saying, 'Trade with this while I'm away.' Upon his return, the servants who used the funds their master had provided to make additional money were praised, whereas the servant who merely returned the money without gain was condemned (Luke, 19:22–6).

Catholic countries were somewhat slower in formally endorsing this view. Thus in France, interest-based loans were only formally legalized in October 1789 (and later incorporated in the Napoleonic civil code).[77] The Egyptian code (as well as other codes in the Islamic world that were influenced by it), inspired by the French code, also adopted the view that interest was legal provided it was limited by law. In the third stage, the prevailing view was that existing ceilings were too low and that they should either be significantly increased or removed altogether. In line with the free-market ideology, it was argued that it was up to the market to determine interest rates. Nowadays, and especially with the deregulation movement of the 1980s, while most countries still have laws on the books against usurious rates and against extortionary lending, it is a Benthamite logic that prevails, as usury ceilings have been allowed to rise significantly or to be overridden under most circumstances.

Despite this evolution, misgivings about finance and about the 'unearned' quality of financial profits have not subsided. There is a considerable literature on predatory and unproductive finance, ranging from critiques of rentier economies and parasitic groups, to the pernicious effects of debt, to scathing portraits of the misdeeds of financiers.[78] In the United States, despite the dominance of the free-market ideology, there is a long history of suspicion of banks and financiers. At the time of the controversy over the chartering of the Bank of the United States, Thomas Jefferson had argued that it was only 'the speculators, the creditors, and the wealthy bank stockholders who benefited from a public debt' and that 'the bankers had no stake in general prosperity or public well-being except insofar as they generated tax revenues to pay the interest charges that enriched them'.[79] At times of economic hardship – for example in the 1890s and 1930s – bankers and financiers were the designated culprits.[80] During the Great Depression, bank robbers became folk heroes. In recent years 'paper entrepreneurs' were attacked for shuffling assets without creating value,[81] just as 'Wall Street' (in the 1990s, announcements of layoffs would invariably boost a company's stock) was criticized for having interests that were antithetical to those of 'Main Street'.[82]

Notes

1. Anwar Iqbal Qureshi, *Islam and the Theory of Interest*, Lahore: Ashraf 1974, p. 4.
2. Ziaul Haque, *RIBA: The Moral Economy of Usury, Interest, and Profit*, Selangor, Malaysia: Ikraq 1995.
3. Edward Mortimer, *Faith and Power: The Politics of Islam*, New York: Random House 1982, p. 245.
4. Fazlur Rahman, 'Riba and Interest', *Islamic Studies: Journal of the Ccntral Institute of Islamic Research*, Karachi, Vol. 3, No. 1. 1964, p. 42.
5. See Baldwin and Wilson, 'Islamic Finance in Principle and Practice, with special reference to Turkey', in Chibli Mallat (ed.), *Islamic Law and Finance*, London: Graham and Trotman 1988.
6. Hence the Koranic verse 3:129 'O you who believe, devour not riba, doubling and redoubling and keep your duty to Allah, that you may be successful.'
7. The Hadith, in its abbreviated form: The Prophet said: '[Exchange] gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt, measure for measure and hand-to-hand. If the [exchanged] articles belong to different genera, the exchange is without restraint provided it takes place in a hand-to-hand transaction.' Nabil A. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law: Riba, gharar and Islamic banking*, Cambridge University Press 1986.
8. William E. Shepard, 'Muhammad Sa'id Al-Ashmawi and the Application of the Shari'a in Egypt', *International Journal of Middle East Studies* 28 (1996), p. 46.
9. Chibli Mallat, *The renewal of Islamic law: Muhammad Baqer as-Sadr, Najaf and the Shi'i International*, Cambridge University Press 1993, pp. 162–84.
10. Chibli Mallat, 'The debate on riba and interest in twentieth century Egypt', in Chibli Mallat (ed.), *Islamic Law and Finance*, London: Graham and Trotman 1988, pp. 69–88.
11. Ibid.
12. Fuad Al-Omar and Mohammed Abdel-Had, *Islamic Banking: Theory, Practice and Challenges*, London: Zed Books 1996, p. 8.
13. See Chapter 4.
14. Chibli Mallat, 'Tantawi on banking', in Muhammad Khalid Masud, Brinkley Messick and David S. Powers (eds), *Islamic Legal Interpretation: Muftis and their Fatwas*, Harvard University Press 1996, pp.286–96.
15. Ibid.

16. Reuters, 30 May 1995.
17. Agence France-Presse, 22 August 1997.
18. Koran 2:275 'Those who swallow riba cannot rise except as he arises whom the devil prostrates by [his] touch. This is because they say, Trading is only like riba. And Allah has allowed trading and forbidden riba. To whomsoever then the admonition has come from his Lord, and he desists, he shall have what has already passed. And his affair is in the hands of Allah. And whoever returns [to it] – these are the companions of the Fire: therein they will abide'.

    2:276 'Allah will blot out riba, and He causes charity to prosper. And Allah loves not any ungrateful sinner'.

    2:277 'Those who believe and do good deeds and keep up prayer and pay the poor-rate – their reward is with their Lord; and they have no fear, nor shall they grieve'.

    2:278 'O you who believe, keep your duty to Allah and relinquish what remains [due] from riba, if you are believers'.

    2:279 'But if you do [it] not, then be apprised of war from Allah and His Messenger; and if you repent, then you shall have your capital. Wrong not, and you shall not be wronged'.

    2:280 'And if [the debtor] is in straitness, let there be postponement till [he is in] ease. And that you remit [it] as alms is better for you, if you only knew'.

    2:281 'And guard yourselves against a day in which you will be returned to Allah. Then every soul will be paid in full what it has earned, and they will not be wronged'.

    3:129–30 'O you who believe, devour not riba, doubling and redoubling and keep your duty to Allah, that you may be successful. And guard yourselves against the fire which has been prepared for the disbelievers'.

    4:161 'And for their taking riba – though indeed they were forbidden it – and their devouring the property of people falsely. And We have prepared for the disbelievers from among them a painful chastisement'.

    30:39 'And whatever you lay out at riba, so that it may increase in the property of men, it increases not with Allah; and whatever you give in charity, desiring Allah's pleasure – these will get manifold'.
19. Philip Hitti, *Islam: A Way of Life*, Oxford University Press 1970, p. 23.
20. Al-Omar and Abdel-Haq, *Islamic Banking: Theory, Practice and Challenges*, London: Zed Books 1996, p. 9.
21. Among the notable exceptions are Nabil Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law*, Cambridge University Press 1986 (a second edition was published by Kluwer Law International in 1992); and Frank E. Vogel and Samuel L. Hayes III, *Islamic Law and Finance: Religion, Risk and Return*, The Hague: Kluwer Law International 1998.
22. Koran 31:33 'Let not this world's life deceive you, nor let the great deceiver (the devil) deceive you about Allah'.
23. Saleh, p. 53.
24. Maxime Rodinson, *Islam and Capitalism*, London: Penguin 1978, p. 16.
25. A game of chance played by Arabs. The derivation is either from yusr (facility or ease, i.e., ease with which wealth could be attained) or from yasara (dividing anything into parts or portions).
26. Koran 2:219 'They ask thee about intoxicants and game of chance. Say: In both of them is a great sin and [some] advantage for men, and their sin is greater than their advantage. And they ask thee as to what they should spend. Say: What you can spare. Thus does Allah make clear to you the messages that you may ponder'.

    5:90 'O you who believe, intoxicants and games of chance and [sacrificing to] stones set up and [dividing by] arrows are only an uncleanliness, the devil's work; so shun it that you may succeed'.

5:91 'The devil desires only to create enmity and hatred among you by means of intoxicants and games of chance, and to keep you back from remembrance of Allah and from prayer. Will you then keep back?'

27. Vogel and Hayes, pp. 87–8.
28. Vogel and Hayes, pp. 89–90.
29. Mallat, 'Tantawi on banking', pp. 286–96.
30. Ibid.
31. Ibid.
32. Peter L. Bernstein, *Against the Gods: The Remarkable Story of Risk*, New York: Wiley 1997.
33. See Chapter 2.
34. See Chapter 2.
35. Benjamin J. Stein, *License to Steal: The Untold Story of Michael Milken and the Conspiracy to Bilk the Nation*, New York: Simon and Schuster 1992.
36. Ibrahim Warde, 'Michael Milken, ange et martyr', *Le Monde diplomatique*, August 1993.
37. Ibrahim Warde, 'La grande kermesse de l'économie financière', *Le Monde diplomatique*, June 1993.
38. Ibrahim Warde, 'La tyrannie de l'économiquement correct', *Le Monde diplomatique*, May 1995.
39. Susan Strange, *Casino Capitalism*, Oxford: Basil Blackwell 1986.
40. Ibrahim Warde, 'Le système bancaire dans la tourmente' and 'LTCM, un fonds au-dessus de tout soupçon', *Le Monde diplomatique*, November 1998.
41. Michel Gallois, *Finance islamique et pouvoir politique: le cas de l'Egypte moderne*, Paris: Presses universitaires de France 1997.
42. Joan Robinson, *Economic Philosophy*, London: C. A. Watts 1962, p. 13.
43. James C. Scott, *The Moral Economy of the Peasant: Rebellion and Subsistence in Southeast Asia*, Yale University Press 1976.
44. Koran 62:10 'But when the prayer is ended, disperse abroad in the land and seek Allah's grace, and remember Allah much, so that you may be successful'.
45. Khalid M. Ishaque, 'The Islamic Approach to Economic Development', in John L. Esposito, *Voices of Resurgent Islam*, Oxford University Press 1983, p. 271.
46. Koran 17:35 'And give full measure when you measure out, and weigh with a true balance. This is fair and better in the end'.

    26:181–3 'Give full measure and be not of those who diminish. And weigh with a true balance. And wrong not men of their dues, and act not corruptly on earth making mischief'.
47. Koran 104:2–4: 'Woe to who amasses wealth and counts it. He thinks that his wealth will make him abide. Nay, he will certainly be hurled into the crushing disaster'.
48. Henry Lammens, *La Mecque à la veille de l'Hégire*, Beirut: Imprimerie catholique 1924.
49. Traute Wohlers-Scharf, *Arab and Islamic Banks: New Business Partners for Developing Countries*, Paris: OECD 1983, p. 75.
50. Ahmed Abdel Aziz El-Nagar, *One Hundred Questions & One Hundred Answers Concerning Islamic Banks*, Cairo: International Association of Islamic Banks 1980, p. 8.
51. Hamid Algabid, *Les banques islamiques*, Paris: Economica 1990, pp. 48–50.
52. John Noonan, *The Scholastic Analysis of Usury*, Harvard University Press 1957.
53. J. Pierre V. Benoit, *United States Interest Rates and the Interest Rate Dilemma for the Developing World*, Quorum Books 1986, pp. 34–55.

54. Leviticus 25:36 ‘You shall not charge your brother interest on a loan, either by deducting it in advance from the capital sum, or by adding it on repayment’.
55. Deuteronomy 19:19 ‘Do not charge your brother interest, whether on money or food or anything else that may earn interest’.
    19:20 ‘You may charge a foreigner interest, but not a brother Israelite, so that the Lord your God may bless you in everything you put your hand to in the land you are entering to possess’.
56. Luke 16:13 ‘No servant can be the slave of two masters; for either he will hate the first and love the second, or he will be devoted to the first and think nothing of the second. You cannot serve both God and Money’.
    Luke 18:22 ‘Sell everything you have and distribute to the poor, and you will have riches in heaven’.
    Luke 18:24–5 ‘How hard it is for the wealthy to enter the kingdom of God! It is easier for a camel to go through the eye of a needle than for a rich man to enter the kingdom of God’.
57. Luke 6:34–5 ‘And if you lend only where you expect to be repaid, what credit is that to you? Even sinners lend to each other to be repaid in full. But you must love your enemies and do good; and lend without expecting any return; and you will have a rich reward’.
58. Bartolomé Clavero, *La Grâce du don: anthropologie catholique de l’économie moderne*, Paris: Albin Michel 1997.
59. Robert Lopez in *The Dawn of Modern Banking*, Center of Medieval and Renaissance Studies, University of California, Los Angeles, Yale University Press 1979, p. 7.
60. Ibid.
61. Jacques Le Goff, ‘The Usurer and Purgatory’, in *The Dawn of Modern Banking*, Center of Medieval and Renaissance Studies, University of California, Los Angeles, Yale University Press 1979, p. 52.
62. Robert Heilbroner, *The Making of Economic Society*, Englewood Cliffs, N.J.: Prentice Hall 1993, pp. 35–49.
63. Rodinson, p. 48.
64. Abraham L. Udovitch, ‘Bankers without Banks: Commerce, Banking, and Society in the Islamic World of the Middle Ages’, in *The Dawn of Modern Banking*, Center of Medieval and Renaissance Studies, University of California, Los Angeles, Yale University Press 1979, p. 257.
65. Center of Medieval and Renaissance Studies, University of California, Los Angeles, *The Dawn of Modern Banking*, Yale University Press 1979, pp. 291–9.
66. Benoit, p. 47.
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4

THE EVOLUTION OF MODERN ISLAMIC FINANCE

Following a few pioneering experiments, modern Islamic finance started in earnest in the 1970s. Largely driven by the oil boom, it was bound to be transformed by the collapse of oil prices in the 1980s, and more generally by changes in the global political and economic system. Many of the assumptions underlying the aggiornamento of the 1970s became somewhat obsolete, and a new aggiornamento has since been taking shape. This chapter traces the evolution of modern Islamic banking and finance. The following chapter will delve in greater detail into the connection between these developments and broader political and economic changes.

4.1 Precursors

A few pilot experiences preceded the formal start of Islamic banking. In the Indian subcontinent, loan cooperatives, influenced by European mutual loan experiments[1] and infused with religious and ethical ideals, were started from the 1940s.[2] At least one (short-lived) experiment took place in Pakistan in the late 1950s, when rural landlords created an interest-free credit network.[3] In Malaysia, the Muslim Pilgrims Savings Corporation was set up in 1963 to help people save for performing their religious pilgrimage (haj). It later evolved into the Pilgrims Management and Fund Board, or the Tabung Haji as it is now popularly known – an Islamic savings bank of sorts which invested the savings of prospective pilgrims in accordance with the Shariah.[4]

The highest profile experiment was conducted in Egypt between 1963 and 1967, in Mit Ghamr in the Nile Delta. The founder, Dr Ahmed al-Najjar (who would later become Secretary of the IAIB [International Association of Islamic Banks]), had been educated in West Germany and greatly influenced by the mutual savings schemes he discovered there. With capital supplied by West German banks, he obtained the support of the Egyptian government. At its peak, the bank had nine branches in operation, 250,000 depositors and close to two million Egyptian pounds in deposits. Although its charter made no reference to Islam or the Shariah, the bank neither paid nor charged interest. It earned profits by engaging in trade and industry directly or in partnership with others, and to a lesser extent by financing business on a profit-sharing basis.[5] The circumstances of its closure are somewhat obscure. By certain accounts the bank had encountered severe financial problems. Others suggest that the bank was commercially successful but was closed for political reasons, which ranged from fear of Islamic fundamentalism to disagreements over how the bank should be regulated.[6]

In 1971, as part of its policy of coopting Islamic groups in its fight against leftist elements, the Egyptian government created the Nasser Social Bank. The official goals were to 'broaden the base of social solidarity among citizens' and 'provide aid to needy citizens'. As with the previous experiment, there was no direct reference to religion, but the bank's operations were based on mudaraba (profit-and-loss sharing) and the collection and distribution of zakat (almsgiving).[7]

Finally, a few experiments involving Islamic money management took place around the same period. In Egypt, Abd Al-Latif Al-Sharif, who at one time had to flee to Saudi Arabia to avoid Nasser's persecution of the Muslim Brothers, founded the Al-Sharif company in the sixties.[8] The company would gain notoriety in the 1980s as one of the leading Islamic Money Management institutions.

4.2 The First Aggiornamento

Since the late 1940s, theoretical works, written mostly by Pakistani scholars, had addressed the feasibility of a financial system that would conform with the Shariah. But it took a number of political and economic developments, more specifically the advent of pan-Islamism and the rise in oil prices, before such ideas were put in practice.[9] The aggiornamento of Islamic doctrine on banking matters occurred under the auspices of the Organization of the Islamic Conference (OIC), then largely dominated by Saudi Arabia. Most accounts suggest that the turning point occurred when, in the early seventies, King Faisal of Saudi Arabia was sold on the idea of the creation of a pan-Islamic bank. These were heady days for oil-producing countries, many of which having already moved to take control over their economic destiny by progressively nationalizing the 'commanding heights' of their economies, including oil industries and financial institutions.[10] The quadrupling of oil prices in 1973–4 marked a watershed, leading many to believe it had ushered in if not a New International Economic Order (NIEO), at the very least a new era in North–South relations.[11] Under those circumstances, an Islamic banking system held the promise of more control over the Islamic world's political and economic destiny. It was also assumed that idle funds that had stayed away from the conventional (or interest-based) banking system would flock to a system devised according to Islamic precepts.

As the issue moved to the forefront of the Islamic agenda, the challenge was to devise a system that would be at once consistent with religious precepts and viable in a modern economy. Hence an unprecedented 'ijtihad' that built on earlier attempts to redefine financial concepts and practices. At the Third Islamic Conference, held in Jeddah in 1972,[12] a comprehensive plan to reform the monetary and financial systems according to Islamic ethics was presented to the foreign ministers of participating countries.

The 1974 OIC summit in Lahore voted to create the inter-governmental Islamic Development Bank (IDB), which was to become the cornerstone of the Islamic banking system. In addition to injecting funds into the regions where they were most needed and providing fee-based financial services and profit-sharing financial assistance to member countries – in the spirit of the NIEO and of Southern solidarity – the new institution was to promote, through direct participation, training and advice, the creation of additional Islamic institutions. It would also manage the income from interest received from non-Muslim countries, as well as from zakat funds, finance reciprocal trade and serve as a clearing house for international payments between Muslim countries. Forty-four countries were founding members of the bank, the largest shareholders being Saudi Arabia (25%), Libya (16%), the United Arab Emirates (14%) and Kuwait (13%).

The Dubai Islamic Bank, created in 1975, is considered to be the first modern, non-governmental, Islamic bank. Before the decade was over, similar banks sprouted throughout the Islamic world: the Kuwait Finance House (1977), the Faisal Islamic Bank of Egypt (1977), the Islamic Bank of Sudan (1977), the Jordan Islamic Bank for Finance and Investment (1978), the Bahrain Islamic Bank (1978), and the International Islamic Bank for Investment and Development in Egypt (1980). In addition, a handful of international investment banks were created, such as the Islamic Investment Company in Nassau (1977), the Islamic Investment Company of the Gulf in Sharjah (1978), the Shariah Investment Services in Geneva (1980) and the Bahrain Islamic Investment Bank in Manama (1980).[13] Those developments would not have been possible without the influence of a handful of pioneers, chief among them Prince Mohammed al-Faisal al-Saud (a son of King Faisal), whose role as entrepreneur, lobbyist and proselytizer will be further discussed in the following pages. Another early pioneer was Sheikh Saleh Kamel, a self-made Saudi businessman and founder of the Dallah Al-Baraka group. According to Clement M. Henry, 'Each was a determined and principled innovator, noted for his piety as well as his entrepreneurship.'[14]

The paradigm of modern Islamic banking was established in those years. Since riba was defined as interest, Islamic banking became synonymous with interest-free banking. The prevailing belief was that interest-based banking would be primarily replaced by profit-and-loss sharing (PLS) schemes. Many questions however were left unresolved, for example whether banks could invest in bonds or debentures, earn interest on their balances with conventional banks, or be involved in commodity trading and similar operations that could involve uncertainty or speculation. Nor was the question of the dealings between Islamic and non-Islamic institutions fully addressed. Yet the oil bonanza as well as the novelty of the concept allowed considerable latitude for experimentation. Funds were plentiful for the handful of Islamic institutions which were in a position to share a monopoly on the small but growing niche of clients looking for Islamically correct investments. Many depositors did not seek any remuneration, thus providing banks with the cheapest possible funding.

Despite the early enthusiasm, the initial evolution of Islamic finance led to disappointment in many quarters. Banks concentrated on trading, leasing and a variety of mark-up schemes. Profit-and-loss sharing arrangements – which were to be the main financial instruments – proved far more complicated to put together. They also did not generate great enthusiasm among depositors, who were fearful of losing their savings.[15] Nor did most banks make the extra effort necessary to expand and promote such products, preferring instead to concentrate on those mirroring conventional products. Perhaps the most common criticism was that interest-free banking was really an exercise in semantics. To many critics, Islamic banks were in reality quite similar to conventional banks since something resembling interest, albeit under a different name, was in the end paid to most depositors and charged to most borrowers. It should be remembered that the seventies were a decade of high inflation worldwide.

In their own defence, Islamic financiers argued that the system was still in its infancy. Governments, and most significantly private-sector pioneers, invested a lot of effort and money to help fine-tune Islamic banking concepts and practices. The creation in 1977 of the International Association of Islamic Banks (presided by Prince Mohammed) provided an additional coordination and advice mechanism for the new banks. Among the IAIB's first initiatives was the publication of the *Handbook of Islamic Banking*.[16] Written in Arabic by leading Islamic scholars, and financed by the Prince, this 'scientific and practical encyclopedia for Islamic bankers' was designed to become the definitive reference for Islamic institutions.

Conceptual and practical issues were to be further clarified under the auspices of the IAIB and other pan-Islamic organizations. At the meeting of the Governors of Central Banks and Monetary Authorities of the Islamic Conference held in Riyad in 1980, Prince Mohammed presented a progress report on Islamic banking. On the same occasion the Islamic Investment Company submitted proposals for Model Islamic Banks and a Model Law for the Establishment, Organization, Regulation and Control of Islamic Banks. Countries were invited to adapt such guidelines to their individual requirements.[17]

The period saw the proliferation of research institutes dedicated to Islamic economics and finance.[18] One example was the Saleh Kamel Center for Islamic Commercial Research created in 1979 at the Al-Azhar University. Funded by the founder of the Dallah Al-Baraka group, its goals were:

> [T]o favor comparative research on Islamic and Western thought in economics, management, and accounting; advise Islamic financial institutions; organize training sessions for their executives, as well as conferences and symposia; publish the Review of Islamic commercial studies; and revive the cultural heritage of Islam, through the translation and publication of ancient works.[19]

In 1979, Pakistan became the first country to embark on a full Islamicization of its banking sector.[20] The following years saw a number of important developments. One was the rapid expansion of transnational networks. The most significant one was the 'Prince Mohammed group', comprised of Islamic banks and investment companies promoted by the Saudi prince. The group included national Islamic banks which provided finance to the general public at local level as well as internationally oriented Islamic investment and holding companies. In addition to the Islamic Investment Company in the Bahamas (with its wholly owned subsidiaries, the Islamic Investment Company of the Gulf and a service company, the Sharia Investment Services company in Geneva), Prince Mohammed set up in 1981 the most ambitious Islamic project ever, Dar Al-Maal Al-Islami (the DMI Group), with a targeted capitalization of $1 billion.[21]

DMI was a potent mix of finance, politics and religion. The founding members – a who's who of Islamic political and religious leaders – signed the 'appeal of the Islamic Umma'. Shareholders belonged to 16 countries: seven countries were represented by their rulers; the others by prominent business, political and religious leaders. The list included 10 Saudi princes, two Kuwaiti princes, the Emir of Bahrain, the Emir of Abu Dhabi (and leader of the United Arab Emirates) Sheikh Zayed Bin Sultan al-Nahyan, Guinean President Ahmed Sekou Toure, Pakistani leader Zia ul-Haq and even the exiled King Fuad II of Egypt (who signed the manifesto from his residence in Monaco). The Sudanese signatories were the President Jaafar al-Nimeiri, the Prime Minister Sadeq al-Mahdi, and Hassan al-Turabi, president of the National Islamic Front. Egyptian signatories included, in addition to the former king, Ibrahim Kamel, a pioneer of Islamic banking, and Omar Abdul-Rahman.[22] DMI was registered as a trust under the laws of the Bahamas and managed by an 18-member board. Its wholly owned operating company, DMI S.A. was registered in Geneva. A six-member Religious Supervision Board was to ensure that operations were conducted in accordance with the Shariah.

The very name of the group evokes the golden age of Islam, since Dar Al-Maal Al-Islami was the organization in charge of public finance and almsgiving. As for being headquartered in non-Islamic tax and regulatory havens, the internal information bulletin of the group explained that it was 'for reasons of neutrality and political security'. The bulletin added that 'given the Islamic nature of the enterprise and the desire to promote unity inside the Islamic umma', the founders hoped that 'in the nearest possible future, a company would be created within the legal framework of an Islamic state, whose headquarters would be in Mecca, thus emphasizing its pan-Islamic character.' The statement also said that 'this transformation should not affect the economic interests of the DMI shareholders'.[23]

From the outset, DMI had ambitious expansion plans: financing development and setting up a worldwide network of subsidiary Islamic banks, investment and insurance companies in the 'Umma West' (Africa), the 'Umma Center' (the Persian Gulf, North Africa and Turkey), the 'Umma East' (Pakistan, Bangladesh, Malaysia) and even outside the Islamic world, in the Americas, Europe and the Far East.[24] With such political and financial firepower, backed up by religious credentials, the group was in a position to enter most markets it targeted, often on favourable terms.

The early eighties also saw further 'full Islamicizations' of banking systems (the Sudan and Iran in 1983). Another interesting development was the decision by Danish authorities to authorize the creation of the Islamic Bank International, which would operate according to the Islamic Shariah without any special concessions or exceptions granted. This marked a breakthrough insofar as it showed the compatibility of Islamic banks with conventional banking frameworks, including in countries with small Islamic populations and tenuous relations with the Islamic world.

4.3 The Changing Context of Islamic Finance

The first aggiornamento was associated with the politics and economics of the 1970s – primarily the oil boom and the rise of pan-Islamism. In the words of Kiren Aziz Chaudhry, 'The capital flows of the 1970s reshaped the domestic institutions and economies of each constituent country: whole classes rose, fell, or migrated; finance, property rights, law, and economy were changed beyond recognition'.[25] In the Middle East, a new regional economy took shape, characterized by a sharp increase in trade, aid, labour migration and capital movements. Modern Islamic banking had been a creature of that era. But the price of oil peaked in 1981 and after a steady decrease, collapsed in 1986. The political and economic context of the mid-eighties was thus quite different from that of the previous decade, and it challenged many of the assumptions of the first aggiornamento.

At the same time, other factors gave Islamic finance a second wind. In November 1985, the Islamic Fiqh Academy, meeting in Jeddah, made an appeal to all Islamic countries to facilitate the creation of Islamic banks. It also decided to forbid Muslims from using a conventional bank if an Islamic bank was available in their area.[26] Needless to say, neither injunction had immediate results. At the very least however, it marked a further commitment by the Islamic community to the cause of Islamic finance, and made outright governmental opposition to Islamic finance difficult.

The collapse of oil prices caused sharp decreases in the revenues of oil-rich states, with attendant economic, political, social and religious consequences throughout the Islamic world: cancellation of contracts, reduction of subsidies and public expenditures, drop in foreign workers' remittances, political and social unrest, and growing Islamic militancy. Other major political economic and financial changes were taking place in the world at large – the winding down of the cold war, the spread of neo-liberal ideology and deregulation and privatization policies, and the transformation of finance[27] – which in due course profoundly affected the Islamic world.

These developments did not hinder the growth of Islamic financial institutions. In fact, countries that experienced financial difficulties welcomed the major Islamic groups. In Turkey for example, the creation of the 'Special Finance Houses' (Islamic banks) occurred in 1983 under a temporary military dictatorship which paradoxically 'supported secularism with a zeal reminiscent of Muslim "fundamentalism"'.[28] But since the country was in the midst of a financial crisis, its secular leaders courted Islamic banking groups, granting them unprecedented privileges. In those years, Turkey also obtained substantial aid from other Arab and Islamic sources, particularly the Islamic Development Bank (IDB). The decree that established the Special Finance Houses gave them rights and privileges that were not available to their conventional competitors. It reserved to the Prime Ministry the right 'at all times' to supervise them. After the Al-Baraka and Faisal groups opened their banks, a special law specifically exempted them from the provisions of the existing banking legislation. The new institutions were required to keep as reserves with the Central Bank only 10 per cent of their current accounts and a mere one per cent of their much larger participation accounts (in contrast to the 10 to 15 per cent reserve requirement to which conventional banks were subjected). The 'Special Finance Houses' were also authorized to deal in commodities and were exempted from the lending limits and deposit insurance requirements to which other commercial banks were subjected. And despite a 1984 ban on television advertising for banks (in the wake of the brokerage houses crisis) they were given permission to advertise on state television. According to a Turkish journalist, all these privileges amounted to a new 'form of capitulation'.[29]

In sum, because of the financial crunch experienced by governments, the bargaining power of Islamic bankers grew and they were able to keep on expanding. Yet with the dramatic economic transformations, many of the assumptions, indeed the founding principles, underlying the 'ijtihad' of the first aggiornamento crumbled. In particular, the world of international finance, which had not changed much in the fifties, sixties and seventies, underwent a veritable revolution in the eighties, and one that has accelerated since.[30] The *Handbook of Islamic Banking* thus left out a wide range of financing techniques and instruments, and adopted what in hindsight appears as an unduly restrictive position on many products that later gained great currency. For example, the *Handbook* stated that transactions involving financial derivatives such as futures and options were forbidden,[31] as were purchases of government bonds and fixed-return securities.[32] Also, Islamic banks could not purchase stocks or commodities for short periods of time solely to make a profit. (Such transactions also had to be aimed at promoting investment.[33])

A new aggiornamento was therefore needed to deal with the changing position of Islamic finance within the international political economy and the new world of finance. Islamic finance grew more decentralized, diverse and pragmatic. As the following section shows, new forms of Islamic finance came into existence outside of the networks created by the first aggiornamento.

4.4 New Forms of Islamic Finance

In the 1980s, the pioneers of the aggiornamento lost their near-monopoly on Islamic finance. Egypt, for example, saw the proliferation of *sharikat tawzif al-amwal al-islamiyya* or 'Islamic Money Management Companies' (IMMCs). With the exception of the Al-Sharif group mentioned earlier, these companies appeared in the early 1980s. Unrelated to existing Islamic banks, they came to dominate Egyptian finance, and even the country's economics and politics throughout the 1985–8 period.[34]

The emergence of IMMCs was the result of a combination of factors: the loopholes in the infitah (open-door) policies, the growth of labour remittances, the rigidities of the banking system, the drop in government revenues, and of course the rise of Islamism. The policy of infitah, inaugurated in the early 1970s by Anwar Sadat and pursued under the Mubarak regime, had introduced significant changes, but it did not do away with some of the essential characteristics of pre-infitah policies. '*Infitah* has often been misrepresented,' wrote Yahya Sadowski,

> by its advocates and its opponents, as marking a change from a state-directed to a free-market economy in Egypt. It unquestionably led to important changes in economic structure, but fostered only limited liberalization. It legalized a wide range of imports, but kept tariff barriers high. It promoted private banking, but kept interest rate regulations intact. It left most price controls in place and expanded consumer subsidies. It created a more liberal economy, but one whose basic features were still clearly *dirigiste*.[35]

The integration of Egypt within the regional economy (in addition to the massive aid received from the United States following the Camp David Agreements) transformed Egypt's financial situation. Migrant workers, who needed to repatriate their hard currency, found few outlets for their savings. Credit and interest rates were tightly regulated, and cumbersome and outdated rules and regulations still prevailed. As a result, interest rates offered by banks did not even compensate for inflation, and most of the available credit went to finance short-term trading, established businesses or collateralized transactions. Clearly, the official banking system was unable to cope with the demands of the new economy.

A parallel financial sector was quick to emerge. It started with the black market for foreign exchange. Currency traders suddenly became among the richest businessmen in the country. The government tolerated this black market, 'viewing it as a safety valve that lubricated the wheels of trade and encouraged the flow of dollars into Egypt'.[36] As foreign exchange restrictions were partially lifted, many such dealers evolved into full-service financial institutions. Rather than offering traditional savings accounts, they purported to manage the public's money. And rather than offering traditional loans, they engaged in profit-and-loss sharing arrangements, as well as a variety of mark-up schemes. To their depositors, they issued 'investment certificates'.[37] Since 'dividends' paid under musharaka, mudaraba or murabaha were not technically interest, they were not subject to the government regulations controlling interest rates. And since these companies were not really banks, they were not subjected to costly and stifling regulations or to reserve requirements. They were not even bound by law to disclose financial statements, hold annual meetings or keep detailed records of transactions. Neither were the IMMCs subjected to any coordinated religious supervision (although most employed religious figures and used their fatwas to justify their practices).

Islamic Money Management Companies drew huge deposits by offering attractive dividends, typically 25 per cent, more than double what official banks offered, and became the preferred channel for the remittances of Egyptians working abroad. In a typical 'euphoric episode',[38] Egyptians accustomed to negative interest rates and unresponsive banks experienced something unprecedented: their savings were rapidly increasing in value; to boot, the companies were offering an unprecedented level of service. Religion was a strong selling point. Vigorous marketing campaigns warned against the ills of 'usurious interest', and associated their success with their religious orientation.

Although the companies made heavy use of religious language and symbolism, they do not seem to have had significant ties to political organizations. There were a few exceptions, such as the Al-Sharif group, which had long-standing ties to the Muslim Brothers.[39] Still, the possible political implications of an alliance with anti-governmental groups did not escape the government.[40]

Obviously, given the large number of such firms – about 200 at their peak – generalizations are hazardous: some were serious about their religious character, while others used it primarily as a marketing ploy. Some made legitimate and 'productive' investments while others were essentially speculative ventures. A few were from the start fraudulent operations.[41] The best-known and largest IMMC was Al-Rayyan (named after one of Islam's heavenly gates), which was fronted by a religious figure, but in reality controlled by the Abdul-Fattah brothers. Its early income had come from money changing, black-market currency trading as well as a few high profile commercial and industrial ventures, but it increasingly engaged in financial speculation. Such a mix of activities was typical of most Islamic Money Management Companies: the visible investments were in the productive sectors of the Egyptian economy (manufacturing, tourism, etc.), but the hidden ones involved speculation – primarily in gold, foreign currency and commodity markets. In addition, it looked like many deposits found their way into bank accounts abroad.

By 1985, the role of the IMMCs in the economy became critical. The government was then in the middle of a fiscal crisis, the official economy was in a recession, and the official banks were experiencing a shortage of funds. So, on the one hand, their role seemed salutary: they mitigated the effects of the economic crisis, providing the much-needed basic services that the official banking sector was unable to offer. On the other hand, the government realized that the Islamic Money Management Companies were a time-bomb waiting to explode. Central Bank governor, Ali Negm, was especially vocal in criticizing the companies and warning their depositors. Yet the companies remained defiant. In November 1986, following news reports about heavy losses incurred by Al-Rayyan, a run on deposits occurred. Al-Rayyan withstood the panic (reportedly with help from local banks and possibly from Saudi banks), but not without launching a counter-campaign against the government. In advertisements in Egyptian publications, it accused the government of plotting against it. When, in the following days, the Central Bank governor was replaced, Al-Rayyan claimed victory (though it was unclear whether the two events were connected).[42]

Yet despite the inability (or unwillingness) of the government to move decisively against the IMMCs, their dividend policy was clearly unsustainable. And indeed, as the competition heated up, they had to increase their 'dividends' (some offered over three per cent a month). It was a matter of time before many simply became huge pyramid, or Ponzi, schemes.[43]

The Egyptian society was deeply polarized. The 'new bourgeoisie' that emerged from the infitah, as well as returning migrant workers, were the beneficiaries of the new system. The traditional business establishment in contrast viewed the IMMCs as dangerous upstarts and as a potentially destabilizing force in the economy. Other splits occurred along religious and political lines. The more secularly inclined Egyptians viewed the

IMMCs as a vehicle for further Islamicization of the Egyptian society. A number of prominent political figures were now on the payroll of the major IMMCs; some were offered even more attractive 'dividends' than typical depositors. By the same token, certain segments of the media were kept at bay since they were increasingly dependent on large advertising and printing contracts. A propaganda war erupted between the official banking sector and the companies, which were accused of making false promises to investors and of being hypocritical, since they were using religion to enrich themselves. The IMMCs retorted that the official banks were simply jealous of their success, and that they were spreading rumours intended to cause their downfall. Throughout the 1985–8 period, despite a string of failures, politicians were unable to agree on the regulation of IMMCs.[44]

The official banking sector was strongly opposed to these new rivals. Its main argument was that the unregulated IMMCs engaged in unfair competition against the regulated banking system, and that their practices threatened the entire financial system. It should be noted that in the confrontation between the IMMCs and the official banks, Islamic banks, such as the Faisal Islamic Bank of Egypt, were on the side of the official banks, of which they were part. (To complicate things further, a number of conventional Egyptian banks had since the early to mid-eighties created Islamic branches of their own.) Still, on a number of occasions, IMMCs attempted to cross over into the official banking sector. Apparently, the only successful attempt was the acquisition by the Al-Sharif company of 30 per cent of the shares of the International Islamic Bank for Investment and Development (IIBID).[45] The Al-Rayyan group tried unsuccessfully to become a member of the International Association of Islamic Banks.

By 1988, the majority of IMMCs were facing problems of liquidity. Many of their owners fled the country. Under pressure from the International Monetary Fund, the government finally reined in the IMMCs, requiring them to maintain a capital-to-deposit ratio of 10 per cent, channel their accounts through commercial banks, and publish audited financial statements. But it was too late. By then a large number of Islamic companies had failed, or were beyond rescue. It was a matter of months before Al-Rayyan encountered the same fate. The impact on the Egyptian economy was considerable. By some estimates, $3 billion – 15 per cent of Egypt's GNP – had evaporated.[46]

Soon afterwards came the 1989 Tantawi fatwa, which was a mixed blessing for both conventional and Islamic finance.[47] It legitimated interest, and in the long-standing battle between Islamic and conventional banks, stood on the side of conventional banks. But from an Islamic banking standpoint, it helped ease the suspicions that had long surrounded all areas of finance. In particular, it drew attention to the role of secular experts and to the need for religious scholars to pay heed to them.[48] Thus, although controversial in the Islamic world, it was a milestone in the evolution of Islamic finance. Challenging the dogmatic fixation on riba-as-interest, it allowed for a new pragmatism and set the stage for a growing convergence between Islamic and conventional finance.

4.5 The Growing Pains of Islamic Banks

Despite the Islamic injunctions against gharar (see Chapter 3), and despite the fact that Islamic finance frowned against short-term, solely profit-driven commodity investments, a number of Islamic banks engaged in dangerous speculation in gold, foreign currencies, and commodities. Many bankers invoked the lack of suitable investments, especially given the combination of worldwide recession and falling oil prices since the early eighties, as well as the absence of riba and the acceptability of investment in commodities. Inevitably, a number of banks suffered heavy losses. Some were on the brink of insolvency. Thus, the International Islamic Bank for Investment and Development (IIBID) incurred heavy losses speculating in US commodities markets and was temporarily taken over by the Egyptian Central Bank.[49]

Another setback was the collapse of the Bank of Credit and Commerce International (BCCI) in 1991. Although not itself an Islamic bank, BCCI had set up in 1984 an Islamic Banking Unit in London, which at its peak had $1.4 billion in deposits, and had generally made heavy use of Islamic rhetoric and symbolism.[50] More importantly, however, the scandal brought Islamic institutions into the international limelight and raised questions about the management and regulation of transnational banks. The Price Waterhouse report commissioned in the wake of the bank's closure revealed that of BCCI's $589 million in 'unrecorded deposits' (which allowed the bank to manipulate its accounts) the major part – $245 million – belonged to the Faisal Islamic Bank of Egypt (FIBE). This amount was supposed to be used for commodity investments, though there was no evidence that such investments were ever made.[51] Similarly, the Dubai Islamic Bank (DIB) had placed $86 million with the bank. Although neither FIBE nor DIB was suspected of wrongdoing, the image of Islamic banks suffered a blow. Islamic banks came under closer scrutiny, and post-BCCI international regulation tightened the screws on transnational banks, thus complicating the strategies of the main Islamic banking groups, Dallah Al-Baraka and DMI.[52]

The proliferation of problems highlighted the flaws in the Islamic banking system and the need for sound management practices. It also had a demonstration effect that strengthened the 'modernist' interpretation of the Shariah: the literal/legalistic interpretation – i.e., focusing on an unduly restrictive reading of the Shariah, focusing on the prohibition of interest – can lead to a large number of possibly worse transgressions such as fraud (ghosh) or speculation (gharar). It was thus a combination of internal problems and external events that led to a transformation of Islamic finance.

4.6 Towards a Second Aggiornamento

By the late 1980s, the global political economy had undergone a profound transformation which posed new challenges to Islamic finance. It is not an exaggeration to talk about a new aggiornamento, reflecting a radically different era, chaotic and still unsettled. Old hierarchies and political alignments have crumbled; a new economic order has emerged; the world of finance is unrecognizable. The second aggiornamento, still in the making, is somewhat amorphous and characterized by pragmatism. It can be defined by its diversity, multipolarity and convergence with conventional finance.

The early Islamic banks, organized under the umbrella of the International Association of Islamic Banks (IAIB), had a virtual monopoly on Islamic finance. They now constitute only one part of a much broader and much more diverse group of companies, most of which do not belong to the IAIB. New poles of influence have appeared. One such pole is Malaysia, whose political/economic profile and religious traditions are quite different from those of the countries involved in the first aggiornamento (Persian Gulf states, Egypt and Pakistan). At least until the 1997 Asian economic crisis, Malaysia was a 'model' economy, with a thriving middle class and growth rates approaching the double digits. Mahathir Mohammed, Malaysia's leader, harnessed Islam to his goal of economic growth through the embrace of high technology and modern finance. His brand of Islam was fused with other influences (nationalism, capitalism, 'Asian values') to produce a unique ideology of development.[53] His approach to Islamic finance was highly pragmatic. Rather than using what was Islamically acceptable as a starting point, he adopted the opposite approach, challenging the Malaysian ulema (learned men) to an ijtihad designed to generate new ideas. A number of Islamic research centres and universities engaged in a vast effort to legitimate modern finance, and in particular an 'Islamic capital market' using specially designed interest-free bonds and other securities.[54] Many Malaysian 'innovations' in that area are not deemed acceptable to Shariah boards in more conservative Gulf states.

In recent years, most Islamic countries – and a few non-Islamic ones – have encouraged the creation of Islamic financial institutions. But in devising a legal framework for their Islamic institutions, countries are no longer relying primarily on the guidance of the IAIB or the Islamic Development Bank (IDB), but on national interest considerations, with positioning in the global economy a key factor. Domestic factors and the diversity of national circumstances (including of course the impact of indigenous forms of Islam) have inevitably added to differences across countries. To put things differently, the assumption of the first aggiornamento was that there was a unique model transposable to all members of the 'umma', under the guidance of the IAIB and the IDB, that would (at least theoretic-