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Timur Kuran

THE ECONOMIC SYSTEM IN CONTEMPORARY ISLAMIC THOUGHT: INTERPRETATION AND ASSESSMENT

INTRODUCTION

Since the late 1940s, and especially since the mid-1960s, a wealth of pamphlets, articles, and books have appeared that constitute the corpus of what is now known as "Islamic economics." This literature, whose exponents call themselves "Islamic economists," purports to provide the blueprint of an economic system consonant with the original sources of Islam. The central feature of the proposed system is that individuals are guided in their economic decisions by a set of behavior norms, ostensibly derived from the Qurʾan and the Sunna. Two other features stand out: *zakāt*, a tax considered the basis of Islamic fiscal policy, and the prohibition of interest, viewed as the centerpiece of Islamic monetary policy. Virtually all Islamic economists consider this trio—the norms, zakāt, and zero interest—the pillars of the Islamic system.[1]

Although some details of the system are yet to be worked out, there is widespread agreement within the Islamic school that since the pillars of the desired model are already in place, it is possible to predict how an Islamic economy would operate. The next three sections of this paper examine each of the pillars in turn and offer some thoughts as to whether they are capable of supporting the intended structure.

Certain readers may object to the evaluation that follows on the grounds that the Islamic economists' claims and proposals are based on divine revelations which human beings cannot refute. To counter this sort of objection I should point out that the Islamic economists go to great lengths, like other social scientists, to buttress their case with logic, scientific theory, and empirical evidence. It is reasonable, then, to subject their works to the same review process that is undertaken routinely throughout the social sciences. This may entail criticizing them for using faulty logic or spurious evidence. It would be inconsistent to accept their contention that they are offering reasoned arguments but then allow the flaws in their writings to disappear behind a veil of divine revelation.

A critical survey of Islamic economics, if it is to fit in a journal article, requires taking a sample of writings as representative of the entire literature. The sample used here comprises the following English-language sources: the papers presented at international conferences on Islamic economics held between 1976 and 1981; the major economic treatises available as of this writing through Islamic bookstores and research institutes, including publications of the International Center for Research in Islamic Economics (Jeddah), the Institute of Policy Studies (Islamabad), the Islamic Foundation (Leicester), Sh. Muhammad Ashraf (Lahore), and Islamic Publications (Lahore); and finally, a number of widely-cited recent articles published in scholarly journals devoted to the dissemination of the Islamic viewpoint. The pioneering tracts of Sayyid Abul Aᶜla Maududi and Sayyid Qutb are excluded from the sample, even though they are still in print and widely read. I have favored recent publications, which, while drawing on such early works, tend to be relatively more sophisticated.

Some of the major assumptions and arguments in the burgeoning Islamic literature are common to a variety of other economic doctrines, notably the Judaic, Christian, Gandhian, Buddhist, and Marxist. But, while many of the following criticisms also apply to other proposed systems, I shall not present a comparative critique. Nor shall I deal with imperfections in *existing* economic systems. The issue here is not whether existing systems can be improved, but whether Islamic economics offers a viable alternative.

BEHAVIORAL NORMS

Roles in Proposed System

In the system envisaged by the Islamic economists the individual is guided by a set of behavioral norms derived from the Qurʾan and the Sunna, the latter comprising recollections of Prophet Muhammad's words and deeds. An Islamic education insures that the behavioral standards specified by these norms are enforced, for the most part, by the individual's own conscience. The primary role of the norms 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. According to Afzal-ur-Rahman, author of a trilogy on the Islamic system, the Islamic norms provide "a practical solution of [*sic*] the modern economic problem."[2]

The Islamic norms can be grouped in two categories: production norms, which also include norms involving trade activities, and consumption norms.[3] Regarding the former category, proponents of the Islamic system are careful to point out that Islamic man is free to produce and trade for personal profit. They move on, however, to state that in exercising this freedom, the individual is required to avoid causing harm to others.[4] He is also obliged to refrain from earning more than his efforts justify. This means that he must pay "fair" wages, charge "reasonable" prices, and be content with "normal" profits.[5] It means, moreover, that he must not engage in speculation and monopolization, or make deals, like insurance contracts, that allegedly involve gambling, uncertainty, and exploitation.[6]

In his consumption activities, the Muslim is bound by three sets of norms. First, he must not spend his resources on activities like adultery, or commodities like wine, which are deemed illegitimate. Second, he is required to show moderation in consumption, and, therefore, to refrain from "displaying pomp and grandeur."[7] One side effect of moderation in consumption, it is argued, is the elimination of the scarcity problem through a lowering of aggregate demand; another is the prevention of demand-pull inflation.[8] Finally, the Muslim must make voluntary donations to less fortunate members of the Islamic community. One Islamic economist notes in this connection that "the ideal is not merely to give others from the surplus . . . of income over expenses but even to sacrifice and forego one's own share if the need of others is more urgent."[9]

These and other similar norms, say the Islamic economists, would perform better than a planning board or the so-called invisible hand in fulfilling society's needs. For instance, Mian M. Nazeer of Peshawar University argues that if individuals' consumption and production decisions were guided by the Islamic norms, "the composition of demand and the range of goods and services provided by the market [would] be in consonance with one another."[10] Implicit in all such statements is the assumption that the norms would perform equally well by Islamic standards in any society, regardless of its history, level of development, size, or degree of heterogeneity.

The principal ingredient in all of the proposed norms is altruism. Social problems are to be solved by having people put the interests of society above their narrow personal interests. A question of importance is how the Islamic economists define "society." Their working definition appears to vary from context to context. In writings on specific fiscal and monetary institutions, they equate society with any primarily Muslim nation, such as Algeria or Indonesia. But in other writings, particularly abstract essays on the ultimate Islamic order, they seem to have in mind nothing less than the entire community of believers, the *umma*, which currently would incorporate about a sixth of humanity.

Critique

There are at least two reasons for questioning the soundness of the arguments regarding the effectiveness of the Islamic norms. First of all, the implications of these norms are ambiguous in most of the contexts where they are expected to operate. A pious Muslim eager to follow them may be thoroughly confused as to what wage is "just" and what profit rate is "normal." Likewise, he may be unclear about the meaning of "moderation" in consumption and of the practical implications of the injunction against causing harm to others through his productive activities. The ambiguity inherent in the Islamic norms suggests that the actions he takes may subject him to charges of opportunism by other equally pious individuals who happen to interpret the relevant norms differently. Accusations of this sort would threaten the legitimacy of the Islamic order, reducing people's incentives to abide by the norms. The obscurity of the norms also suggests that they are susceptible to modification over time. Modifications could be instigated either by self-serving persons or by altruistic individuals trying to strengthen the norms through clarification and systematization.

The ambiguity problem is, of course, very general, arising as it does in the day-to-day interpretation of any social principle. In all existing social systems, well-intentioned people who ostensibly hold the same principles of justice and efficiency will often clash over the application of these principles.

The second basis for questioning the argument that the Islamic norms would achieve wonders in a modern society is the substantial amount of evidence pointing to an inverse relationship between the size of society and the effectiveness of norms of altruism. A variety of studies by sociologists and economists show that in a small commune or tribe, where people live in fairly continuous contact and share similar experiences and preferences, individual members tend to display considerable altruism toward the community at large.[11] This makes it economical for the community to base exchanges on interpersonal trust, and for its members to rely on each other's support in the exigencies of daily life. On the other hand, in a large society, where people's perceptions of reality and their preferences vary widely, individuals generally feel far greater loyalty toward some segments of the community than others; their sympathies tend to be concentrated on people with whom they can identify on the basis of such characteristics as kinship, locality, tradition, and occupation. In such a society the average individual exhibits a strong dose of indifference to the well-being of most other members, even though he might pay lip service to the ideal of universal brotherhood. The role of trust in exchange diminishes, making it necessary to protect buyers and sellers through legal institutions. Furthermore, individuals come to doubt whether in times of need they can count on others' assistance, and they demand formal insurance. If these observations are correct, then one is justified in questioning whether *generalized* altruism, the intent of the proposed norms, can be achieved in a modern society with millions of people.

One might think that since the evidence uncovered by modern social science comes primarily from the European and North American experiences, its relevance to the Muslim world is marginal. To counter such doubts I shall demonstrate, later in this section, that the Muslim experience is consistent with the Western experience. For now, however, I will move on with the argument.

These criticisms should not be taken to mean that the Islamic norms would be totally ineffective in a large society. Even in the largest existing societies, norms of altruism play an important role in governing relationships within groups like the household, the residential community, and the work team—not to mention cartels and political lobbies. Regarding the exchange process within such groups, for example, norms economize on transaction costs by lessening the need for formal contracts and enforcement mechanisms.[12] It is quite possible, therefore, for at least a portion of the Islamic norms to serve some constructive purpose in a large society: they could reduce the costs of cooperation by reinforcing altruism and trust within subsets of the society. As for generalized altruism, one would expect it to come about only in very special circumstances, such as a foreign invasion or a natural disaster—and then just for a limited time.

At least one Islamic writer, Waqar Ahmed Husaini, recognizes that in an Islamic society of many millions, people might acquire complex affiliations that supersede their devotion to the community at large. He is nonetheless optimistic that the Islamic spirit would prevent the individual's ties with subgroups of society from weakening the community's cohesion: "Special interest groups such as labour and professional unions . . . might exist; but their goal and function might be information gathering and dissemination, rather than *a priori* unconditional loyalty to special or vested interests. . . ."[13] But unlike Husaini, most Islamic economists do not acknowledge that the size of a society might hinder the establishment of generalized altruism.

A factor reinforcing the argument that norms of altruism are relatively ineffective in a large society is that, unlike the member of a small society, that of a large one cannot expect to influence perceptibly the general welfare through personal acts of altruism. This suggests that even if he ascribes superiority to the Islamic economic system, the member of a large society may be tempted to violate the norms on which this system rests. But if most people were to deviate from the norms in the belief that their personal influence is negligible, the system would collapse. This dilemma, known in neoclassical economics as the free-rider problem, confronts societies in countless contexts. Societies are not, of course, incapable of resolving the dilemma. They successfully confront it in some contexts by making adherence to the norms intrinsically pleasurable and in others by instituting various forms of coercion.[14] But in many contexts, for example environmental preservation, a satisfactory solution remains elusive. To my knowledge, the Islamic economists have so far evaded the free-rider dilemma, too. Without providing a single example of a large society that has resolved this problem through religious faith, they have simply assumed that in a society of pious Muslims, rational processes would not displace moral motives.

There remains the point that altruism, if taken too far, can produce undesirable results. If everyone in a burning skyscraper were to insist on being the last to leave, the consequence would be unmitigated disaster.

Role of the State

We have seen that the Islamic economists appear convinced that members of a modern Islamic society would correctly interpret the norms laid out for them, and what is more, conform to these norms out of their own volition. People, they believe, would abide by the norms even when given the option of doing otherwise, because they would have internalized them. On this note, one Islamic economist writes that "in Islam what the Communist[s] seek to achieve . . . through the state is to be established by the agency of man himself."[15]

Does this mean, then, that the state's role in the Islamic system is only ceremonial? After all, one of the principal functions of any existing state is to resolve free-rider problems by *coercing* agents into behaving in accordance with the perceived public interest. There is an immense literature, going back at least to Hobbes, on the conflicts between state action and individual freedom. Contributors to this literature include some renowned Muslims, among them ᶜAlī ᶜAbd al-Rāziq, an Islamic reformist who published extensively in the early part of this century. ᶜAbd al-Rāziq wrote that "there is no state which is not based on the sword, and sustained by virtue of violence and subjugation."[16]

While contemporary Islamic economists hold widely divergent views on the role of the state, many maintain (in at least parts of their writings) that the economic role of the Islamic state is to be minimal.[17] According to them, the state's main role is to prevent violations of the norms. Thus, it is to impose price ceilings when sellers charge "unreasonable" prices, and pass legislation to foster cooperation when the relevant norms turn out to be deficient. Beyond this, there is no consensus. For just about any type of program, whether job creation, development of natural resources, or prevention of land fragmentation, one can find supporters as well as opponents among the Islamic economists. Interestingly, some who explicitly advocate restricting the role of the state see no contradiction in subsequently proposing an extensive list of governmental duties.[18]

What is not clear is why there is any need to have the state enforce the norms if people would, as the Islamic economists claim, dutifully conform on their own. Further, the contention that the system would be largely free of coercion is perplexing in view of the fact that many of the programs advocated by the Islamic writers involve massive resource transfers and sharp restrictions on individual freedom. The prevention of land fragmentation, for instance, can only be accomplished through legislation that constrains individual choices regarding land bequests. One is left with the impression that the Islamic economists either do not *really* believe that coercion will be absent or are assuming that individuals will somehow internalize state-imposed constraints and voluntarily transfer substantial resources to the state.

A related issue is whether individuals running the state apparatus can realistically be expected to forego the temptations of wielding the powers at their disposal to their own advantage. Most writers are confident that officials of an Islamic state would not abuse their powers. They offer four distinct reasons for this optimism. First, as members of an Islamic society, state officials would have been inculcated with the Islamic norms. This means, if one believes that the norms provide unambiguous behavioral guidance, that actions of state officials would conform to Islamic social objectives. Second, the leadership of the state would be "established on the basis of consent of the people."[19] Third, in performing their functions elected officials would routinely consult the community or its representatives to ensure that important decisions are reached by consensus (*ijmāᶜ*). Finally, the community would be vested with "the power to dismiss the officers of the state."[20] This power, it is said, would effectively eliminate the temptation to abuse the resources of the state.

Even a cursory consideration of these four arguments reveals that the Islamic economists' optimism is unwarranted. The first point can be dismissed on the grounds, already discussed, that the Islamic norms are ambiguous. Ambiguity implies that a state official commands no definitive criteria for determining whether his actions conform to Islamic principles.[21] The second point, that officials would be chosen by consensus, is unrealistic, at least insofar as it applies to large societies where people's experiences and preferences tend to differ enormously. The third point, that the political leaders would consult the community, overlooks the fact that people's opinions can be manipulated for the advantage of a select few. Since in a large, complex society the average individual has neither the capacity nor the motivation to become informed about the multitude of issues that influence his well-being,[22] he can be persuaded by organized groups, including those at the helm of state, to support policies that are not in his best interest. As for the last point, it disregards the risks incurred by a citizen who publicly expresses his desire to replace a state official.

Some of these difficulties can, of course, be mitigated by decentralizing the state's operations and controlling officials through organizational checks and balances. But such considerations are alien to the Islamic economists' philosophical outlook.

Evidence from Islam's Past and Present

The Islamic economists do not consider themselves defenseless in the face of the foregoing criticisms. The historical record of Islam, they contend, amply demonstrates that it is possible to create a society whose members adhere to the Islamic norms and which embodies a benevolent state. "For about a thousand years," writes the Pakistani writer Ikram Azam, " . . . there was no accumulation of wealth in a few hands, no hoarding and no profiteering, as these had been tabooed by Islam . . . the state was responsible for providing a living wage or relief to every inhabitant . . . there were neither slums nor multi-millionaires . . ."[23] Other writers do not go so far as to claim that the system performed adequately for an entire millennium. The majority believe that the system performed ideally during the Prophet's lifetime and subsequently during the tenure between 632 and 661 A.D. of the four "rightly-guided" caliphs, but that the system began to fall ever shorter of the ideal thereafter.[24] Nonetheless, they maintain that the record of this brief "golden age" constitutes sufficient proof that the order they envisage can be established in the modern world.

Even this more modest account of early Islam is questionable. Historical research indicates that even in the first few decades of Islam physical force played a role in enforcing the Islamic norms, and that some norms, like those requiring moderation in consumption and sharing with the poor, were nonetheless inconsistently followed.[25] The evidence also demonstrates that the support enjoyed by officials of the Islamic state fell considerably short of the ideal: Muslims had varying perceptions of the state's role as well as the limits of their rulers' authority, and many complained, often to no avail, of the sinfulness of various officials, including the caliph. This view is supported by the fact that two of the four "rightly-guided" caliphs met violent ends at the hands of fellow Muslims. The evidence suggests, contrary to what is often claimed, that the early Islamic community was not a perfectly just and harmonious society—and certainly not up to the high standards put forth by contemporary Islamic economists. It was a society where people were able, at least occasionally, to get away with reprehensible acts, either by using physical force or by manipulating the public conception of Islamic norms.

All this is not to say that early Islamic society was not relatively more united than coeval non-Muslim societies, or that it was not run more efficiently from an economic standpoint. My point is simply that the picture of early Islam is not spotless as the Islamic economists would have us believe.

It is appropriate to point out that even the earliest Islamic society chose, as it expanded, to supplement its norms by coercive measures. On the eve of the community's migration (*hijra*) from Mecca to Medina, when it numbered no more than 80 people,[26] relationships among members were governed almost entirely by norms. In Medina, with the community growing at a phenomenal rate—it had 1,500 members shortly after the hijra,[27]—the sense of brotherly cooperation that had prevailed in Mecca weakened, and as my earlier argument regarding community size would suggest, formal institutions were created to bolster the norms. It is at this stage that Islam's voluntary redistribution mechanism was supplemented by the formal tax-cum-subsidy scheme known as zakāt, and that coercion started to play a major role in controlling prices and preventing speculation.[28]

Despite the historical evidence, the Islamic writers tend not to recognize that the Islamic economic system was highly dynamic in its early years. They consider the system to have maintained essentially its original form throughout the tenure of the Prophet and the first four caliphs. This mythical conception allows them to maintain the mistaken belief that the Islamic norms could play a central role in a modern society. Surely, if these did not enjoy complete adherence even in the community which boasted the Prophet among its thousand-plus members, one should not expect them to be very effective in contemporary societies of many millions.

In fact, one might expect the norms to be increasingly less effective with the passage of time. All indications are that the trends which surfaced as the Prophet's community began to grow, and which have continued unabated until now, will not be reversed in the future. Consider the advanced industrial societies, where the movement from the personal life of isolated settlements to the largely impersonal life of the metropolis has gone farthest. In these societies, coercion by the state and by other organizations plays a key role in the social order; the formal institutions adopted in the course of modernization have not been replaced by norms of brotherly cooperation.

Let us stick, however, with the Muslim world. There is a large literature which demonstrates that even in the most pious segments of Muslim society, the individual's commitments to the Islamic community are taking a back seat to commitments to his occupational, territorial, and ethnic networks.[29] Apparently, while many Muslims continue to subscribe to the principle of equal treatment of all believers, and while most are reluctant to acknowledge that they themselves ever violate this principle, their devotion to the Muslim community is in fact being overridden by their other interests. The class conflicts and ethnic divisions that we observe throughout the Middle East, North Africa, and elsewhere are, of course, nothing new for Islamic civilization. In no corner of the Islamic world has Muslim solidarity, in its extreme form envisioned by the Islamic economists, ever become a reality for any protracted length of time. While it is true that Islam has helped achieve social cooperation in certain limited contexts, it is equally true that the divisive forces that have accompanied modernization in non-Muslim societies have also been part of the Muslim experience.

The Islamic economists have a tendency to attribute divisions within Islam to Western influences. For instance, in their official communiqué, the participants in the First International Conference on Islamic Economics, held at Mecca in 1976, ascribe such divisions to slavish imitations of capitalist and Marxist ways.[30] This sort of argument, which mistakes universal social processes for Westernization, explains neither why Muslims have felt compelled to imitate Westerners, nor why they have persistently chosen not to adopt the ways they believe were followed during Islam's golden age.

ZAKĀT

The Proposed Scheme

By tradition, zakāt (literally, "purifier") is one of the five requirements of Islam, the others being belief in one God, prayer, one month's fast, and pilgrimage to Mecca. As the only requirement with an explicitly economic objective, zakāt is accorded a prominent place in contemporary writings on the Islamic economic system. It is considered to be the central, if not the only, component of fiscal policy.

The most striking aspect of the zakāt scheme advocated by Islamic economists is that it applies to few of the forms of wealth and sources of income observed in any existing economy, developed or underdeveloped. This is so even though the proposed scheme encompasses a variety of taxes, like *ᶜushr*, which historically were collected under other names. Regarding wealth, one can distinguish two main categories of holdings that are said to be subject to zakāt: precious metals and livestock. Provided they have been in a single individual's possession for an entire year, articles in these categories are subject to zakāt at a rate that varies according to a complex set of criteria.[31] Gold and silver are subject to a 2.5 percent tax. In the second category, zakāt is levied in kind for some species, but in money for others. A person who owns up to twenty-four camels, pays one goat for every five camels. Horses, on the other hand, "are taxable according to their value at 2.5 percent."[32] Among the animals for which the owner is not obliged to pay zakāt are mules and elephants, the former because they "do not breed," and the latter because they "breed seldom or after a long time."[33]

The sources of income to which zakāt applies are mining and agriculture. In the former category, the rate is set at 20 percent. In the latter, the rate varies according to the source of irrigation: 5 percent of the product if the land is irrigated by the owner and 10 percent otherwise.[34] Numerous writers consider various agricultural commodities to be exempt from zakāt. Some hold that vegetables are exempt because they are perishable.[35] Others maintain, because of a statement by the caliph ᶜUmar I, that while dates and grapes are subject to zakāt, peaches and pomegranates are not.[36]

In each category of wealth, zakāt is payed by people whose holdings exceed a certain minimum called *niṣāb*. Those whose holdings fall below the niṣāb are exempt. For gold and silver the niṣābs are, respectively, 7.5 tolas (3 ounces) and 52.5 tolas (21 ounces)—exactly the levels stipulated by Prophet Muhammad.[37] This means, as of 1984, that each member of an Islamic economy can hold roughly U.S. $1,100 worth of gold and $200 worth of silver without paying zakāt. It is not clear whether there are additional exemptions based on other considerations. Some maintain that children and the insane should be totally exempt from zakāt obligations, but there is no agreement on the matter.[38]

The beneficiaries of zakāt fall into several categories. The poor, the handicapped, the unemployed, and orphans are all entitled to assistance, as are dependents of prisoners, travelers in difficulty, and debtors whose debts stem from "legitimate" activities. Zakāt resources are also to be used to free prisoners and slaves, to spread Islam, and to pay the salaries of the zakāt collectors.[39] While there is wide agreement among Islamic economists regarding the list of beneficiaries, there is none concerning the exact allocation among the various categories. Some advocate dividing each year's zakāt fund equally among the categories, while others would rather grant the head of state the right to disburse resources as he sees fit.[40]

This redistribution scheme, whose essence I have tried to capture through a few illustrations, is viewed by proponents of the Islamic system as a potent weapon against numerous economic problems. Zakāt, they say, would reduce dramatically the level of income inequality, and serve as a legitimate social insurance scheme that dampens fluctuations in people's incomes.[41] Another effect of zakāt would be the stimulation of demand, since the beneficiaries of zakāt would have a relatively high marginal propensity to consume.[42]

These effects, one might argue, can just as well be attained through an alternative taxation scheme. But the Islamic economists see an immense difference because of the religious nature of zakāt. Afzal-ur-Rahman writes: "the very fact that Zakat is paid to seek the pleasure of God is enough to encourage people to use their capital as far as possible for productive purposes, so that they may earn more wealth and pay more Zakat, thereby earning still greater pleasure of God."[43] In a similar vein, Sheikh Mahmud Ahmad, an educational advisor to the Pakistani government, contends that zakāt would wash away the "greed and acquisitiveness of the wealthy, [making] them alive to and responsible for solving the problem of poverty."[44] On a separate note, Mohammad Abdul Mannan of the International Center for Research in Islamic Economics, claims that the problem of evasion, which haunts all secular tax schemes, is unlikely to exist with zakāt.[45]

Critique

The Islamic argument regarding zakāt is open to criticism on at least three counts. Most obviously, all existing economies include tax-cum-subsidy schemes designed to redistribute wealth and income. And in most, further redistribution is brought about through a diverse array of other measures, including entry regulations, price controls, affirmative action policies, and emergency relief programs—not to mention elaborate social security systems. It is true, of course, that in some countries redistribution is chiefly from the poor to the rich. But such perverse redistribution could also arise in a country where zakāt is in place. Since zakāt rates vary from one commodity to another, with many rates set at zero by default, it is not at all clear that the zakāt burden would fall primarily on the rich.

This brings us to another problem, that the scope of zakāt is far too restrictive for its intended purpose. In its proposed form, zakāt would serve a major redistributive function only in a primitive agricultural economy resembling that of seventh-century Arabia. In any contemporary economy, whether in Saudi Arabia, Morocco, or Pakistan, a substantial portion of the national product is derived from the manufacturing, transportation, communication, and service sectors, which receive virtually no attention in the Islamic economists' zakāt proposals—even though rates on certain livestock, fruits, and grains are specified with great care. If the proposed zakāt scheme were put into effect today, most of the burden would fall on low-income peasants, and virtually none on shipping tycoons, industrial bosses, and bureaucrats. Therefore, while the imposition of zakāt on such commodities as cows, goats, camels, dates, grapes, and wheat might well reduce inequality in an agricultural economy, one would expect this to have the opposite effect in a contemporary economy, even an underdeveloped one.

The third basis for criticism is that the proposed scheme is suited not to an economy where relative prices fluctuate freely, but to one where they stay fixed at levels that prevailed in seventh-century Arabia. If rates on animals are expressed in terms of other animals, and the niṣābs for precious metals in terms of weight, two equally wealthy people (as measured by market prices) may have highly unequal zakāt obligations. I already hinted at one such possibility by pointing out how imbalanced the niṣābs for gold and silver are when these are measured at today's prices. This particular inequity means that the niṣāb of a person who holds his wealth in gold is 5.5 times more valuable than that of a person who holds his wealth in silver. The niṣābs for livestock and grains entail similar inequities.[46]

There is, of course, a simple solution to the last problem: turn all the levies into *ad valorem* taxes payable in money. Under this system, each person whose wealth exceeds a specified level would be obligated to give a certain percent of his wealth to a relief fund. Parity among the obligations of people whose wealth is stored in different commodities would be maintained even if relative prices changed drastically. But as far as most Islamic economists are concerned, such an innovation would spell the abandonment of zakāt. They feel that zakāt is synonymous with the specific forms and rates set 14 centuries ago by the Prophet and his companions—change these, they say, and you have done away with zakāt.

The Contemporary Experience

The pitfalls of instituting the traditional system of zakāt in a contemporary economy are confirmed by examining two of the several major schemes currently in operation. An empirical study by two Malaysian economists shows that in Malaysia the recently imposed zakāt scheme actually accentuates inequality.[47] Malaysia collects zakāt from paddy-producing agricultural households, 88 percent of which lie below the poverty line, while exempting most property owners and wage earners for whom no explicit allowance is made in the traditional sources of Islam. Within the agricultural sector, the zakāt burden is progressive at the lower end of the income scale because of the usual exemptions, but it is regressive at the upper end, due in part to evasion. This latter finding obviously calls into question the claim that because of its religious nature, zakāt would not be afflicted by the evasion problem.

In contrast to the Malaysian scheme, the Saudi Arabian one has a somewhat broader base than the scheme used by the first Islamic community. According to Abdin Ahmad Salama of Riyadh University, a series of rulings issued by the Great Mufti, beginning in the 1950s, subjected some types of profit and dividend income as well as non-traditional assets such as machines, houses, and hotels to zakāt; however, this revolutionary broadening of the zakāt base was subsequently curtailed by exempting assets not meant for sale. Thus, a hotel, a factory, or an automobile is no longer "zakātable," unless the owner is trying to sell it. Regarding livestock and agricultural products, zakāt is levied strictly in the traditional manner. Amazingly, in view of the widespread sensitivity to tampering with traditional rates, the legal zakāt obligation on many types of wealth and income was reduced in 1959 from 2.5 to 1.25 percent, following complaints from Nejd and Hejaz. People were left to distribute the remainder of their religious obligations at their own discretion. Four years later the zakāt department reverted to collecting the full 2.5 percent from all eligible Saudis.[48]

In 1973–74, the most recent fiscal year for which Salama provides complete data, total zakāt revenue amounted to a miniscule 0.01 percent of Saudi Arabia's gross national product, and it covered a small fraction of the government's expenditure on poverty relief.[49] One reason these figures are so low is that people were evading their zakāt obligations either by taking advantage of loopholes, or simply by disguising their assets and earnings. Like their brethren in Malaysia, Saudi citizens are apparently willing to avoid paying zakāt if they can get away with it. The zakāt department is finding out that it has a serious zakāt evasion problem, similar to the tax evasion problem faced by secular administrations all around the globe.[50] In any case, even if the present scheme were enforced more strictly, total zakāt revenue would hardly come close to paying for Saudi Arabia's poverty relief and social security programs.[51]

Historical Evolution of Zakāt

The problems associated with the zakāt schemes currently in operation and with the Islamic economists' proposals stem in part from a failure to understand the context in which zakāt evolved and the rationale for the particular forms it assumed. Zakāt was not developed all at once, as the uninformed reader of contemporary tracts could easily come to believe. Rather, it was developed in piecemeal fashion to meet the community's rising revenue needs. As in any reasonable taxation scheme, commodities that could not be taxed at low cost with the available technology were exempted. For instance, certain jewels that are effectively indivisible and that could not be appraised accurately in the absence of an organized market were deliberately declared tax-free.[52] The evolution of zakāt on horses provides another revealing example. Horses were exempt during Muhammad's lifetime when they were rarely raised for trade. The expected revenue was evidently not worth the effort. By the caliphate of ᶜUmar I, however, the volume of horse trade had become substantial, so the coverage of zakāt was extended to horses.[53] This last example signifies that, at least in the early years of Islam, zakāt was not conceived as a perfect and unchangeable system of redistribution. It was regarded as a scheme that can change with time—which supports my earlier statement that during Islam's early years the structure of the economy was not considered immutable.

The fact that zakāt was levied in kind for some commodities is attributable to the low degree of monetization in the seventh-century Arabian economy. The particular niṣābs undoubtedly reflected the prevailing perception of minimum human needs. As for the rates, it is likely that special-interest groups played a role in their evolution. We know that from the very beginning they generated controversy. The contending schools of Islamic law often took different sides, and they failed to resolve many of their differences.[54] Within each school, for reasons that cannot be analyzed here, zakāt eventually became an ossified, dysfunctional ritual, increasingly divorced from its original purpose. An important consequence of this development was that subsequent Muslim rulers found it personally hazardous to tamper with zakāt.

Some of the confusion among contemporary Islamic economists over the form and rates of zakāt—such as their disagreements about the obligations of the insane, and the applicability of zakāt to vegetables, mirror unresolved ancient controversies. Such confusion is, of course, inevitable as long as they base their proposals on traditional positions without first dealing with traditional inconsistencies.

Reforming Zakāt

Not all Islamic economists have been totally averse to modifying the rates and forms of zakāt. Recognizing the senselessness of superimposing the traditional system of zakāt on a modern economy, and seeing that contemporary applications—like the Saudi Arabian scheme—have had to incorporate a few innovations, some have begun to favor a reformation. In 1962, a group meeting in Damascus found it appropriate to impose zakāt on industrial machinery at 10 percent. While challenging this particular rate on the grounds that it would retard industrial growth, Mannan supports the extension of zakāt to forms of wealth and income unknown in the early days of Islam. He also favors allowing particular rates to be modified, resting his case partly on the fact that the Caliph ᶜUmar "imposed Zakāt on horses, whereas before him horses were exempt from Zakāt."[55] Another ardent advocate of reform bases his plea on the observation that the Qurᵓan is vague about the sources and rates of zakāt. Taking this to mean that determination of details was left specifically to the transitory judgment of the Muslim community, he reaches the conclusion that some characteristics of the system used by the first Muslims can be discarded by a modern Islamic state.[56]

But the advocates of reform have displayed hardly any inclination to lead the way in designing a zakāt scheme in tune with modern realities. Not only that, but most of them devote extensive passages, in the very chapters or articles in which they plead for reform, to the rates for camels, while neglecting to suggest a rate for automobiles. More amazing still is the fact that many writers are inconsistent in their positions on reform. For example, Salama, some of whose findings concerning the Saudi Arabian scheme I reported above, advocates expanding the zakāt base "to include all incomes earned," after having maintained that "no authority on earth has any right to alter the *Zakāt* rates."[57]

Other Islamic economists have devised ingenious ways of combining reformism with staunch orthodoxy. One such economist is F. R. Faridi of King Abdulaziz University, who favors both a traditional zakāt scheme and an activist fiscal policy whose instrument would be a separate "Islamic tax system."[58] In Faridi's scheme, the government sets targets for variables such as aggregate savings and employment, and then ventures to meet these by choosing appropriate tax rates. If it feels that transfers caused by zakāt have resulted in an "unbalanced intersectoral allocation of the community's resources" or some other situation "that runs counter to the overall objectives of the Islamic society," it simply makes the necessary corrections, in the spirit of a Keynesian fine-tuner, through the tax system. A simple example will highlight what this system might entail. Suppose zakāt requires A to give B $300, and that the state considers this transfer to be inflationary due to B's higher marginal propensity to consume. To counteract this effect, the state could simply impose an Islamic tax of $200 on B and give a subsidy of the same amount to A. The net transfer from A to B is reduced to $100, but the state can proudly claim that zakāt is being fully implemented in its traditional form.

There are, finally, Islamic economists who vigorously oppose modern reforms even though they seem to approve of the changes undertaken in Islam's early years. Among them is Afzal-ur-Rahman who first writes that "the source[s] and the rate[s] of Zakāt . . . can never be changed by any person or Government," and then later notes that ᶜUmar's decision "to levy Zakāt on horses was a need of the time. . . . Horses were never bred for trade on a large scale in the time of the Holy Prophet, and so the decision of the Holy Prophet could not have covered a thing which did not exist at that time."[59]

Zakāt and the Behavioral Norms

Perhaps the greatest puzzle in the Islamic economists' zakāt proposals becomes apparent when one juxtaposes these with their claims regarding the Islamic norms. Why does an Islamic society need an obligatory levy if, as they contend elsewhere in their writings, individuals would voluntarily perform the altruistic acts prescribed by the behavioral norms? The puzzle disappears when one takes account of the problem of community size discussed earlier. In a large community one cannot rely on voluntary redistribution alone to overcome the problem of poverty. Charity must be supplemented by obligatory taxes.

For evidence in support of this explanation we do not have to go beyond the beginnings of Islam. In its earliest years that community did not resort to any specific taxes, but relied solely on voluntary charity. As a formal obligation, zakāt made its first appearance about two years after the hijra, or over a decade after the formation of the Islamic community, at a time when the community was expanding rapidly and becoming increasingly heterogeneous.[60]

Once again, we see that the history of Islam's early period contains valuable lessons concerning the need to devise new institutions to cope with new circumstances. But these lessons require sound historical interpretation, which is not where the Islamic economists are strongest. One writer, who realizes that zakāt was imposed after the Islamic community had grown substantially, fails to draw any lessons from this fact regarding the applicability to today's huge societies of the behavioral norms he and his colleagues advocate.[61]

PROHIBITION OF INTEREST

Rationale for the Prohibition

Well known throughout recorded history, the institution of interest has been a potent source of dissension everywhere. Until very recently, for instance, the Western world was sharply divided over the moral and economic merits of interest. And today, although interest is widely recognized as a permanent fixture of the economic system, feverish controversies prevail over the alleged determinants of interest—which include the productivity of capital, liquidity preference, and positive time preference—as well as over its socially optimal rate. Within the Islamic school of economics the prevalent view is that the institution of interest is neither indispensable nor ineradicable. In the belief that the Qurʾan unequivocally bans interest, most Islamic economists maintain that interest should be prohibited regardless of its level and of the nature and purpose of the loan involved. Confident that a prohibition of interest could be enforced, they believe that such a ban would greatly improve the performance of an economic system.[62]

Actually, it is not at all clear that the Qurʾanic ban covers that institution of interest as it exists today. What the Qurʾan bans is the ancient Arabian practice of *ribā*, which entailed the doubling and redoubling of debt when the borrower failed to make restitution on time. In pre-Islamic Arabia, ribā was responsible for the effective enslavement of substantial numbers of people, whose debts mounted exponentially following a single default. The purpose of the Qurʾanic ban must have been the elimination of this potent source of inequality and communal friction. If the ban was in fact intended to apply to *all* forms of interest, this was not clear even to the early Muslims, whose extensive doubts concerning the issue have been documented by Fazlur Rahman.[63]

This has not kept the Islamic economists from categorically opposing interest. They contend that historical controversies notwithstanding, a ban on interest makes a great deal of sense. One problem with interest, they say, is that it results in "unearned gain," by which they mean that the lender makes money without exerting any effort. Financial intermediaries who lend at a higher rate of interest than they offer to depositors are characterized by one scholar, for example, as "abominable creatures who fatten on the labor of others."[64] Closely related is the argument that guaranteeing a fixed-percentage return to the lender while the borrower's return from his business is uncertain violates Islamic standards of justice.[65] Another criticism of interest is that it "transfers wealth from the poor to the rich, increasing the inequality in the distribution of wealth." A consequence of this redistribution, given that recipients of interest income tend to have a lower propensity to consume than payers, is a fall in aggregate demand.[66] Some scholars further contend that interest has undesirable attitudinal effects. "Interest," says one Islamic economist, "inculcates love for money and the desire to accumulate wealth for its own sake. It makes men selfish, miserly, narrow-minded and stone-hearted."[67] In the same vein, another writes that interest "drives away from the heart of a person the feeling of human brotherhood and converts him into a 'Shylock' always insisting on his pound of flesh, no matter how distressed his fellow being may be."[68] Among the other evils attributed to interest are that it deprives society of the labor and enterprise of the rentier class,[69] and that it "provides banks with unproductive channels to employ their capital."[70]

Islamic Alternatives to Interest

It is one thing to pronounce that interest is forbidden. It is quite another to develop sound alternative institutions to take over the roles of interest in allocating resources between the present and the future and in inducing people to save and invest. The Islamic economists have found the task problematic, partly because the Qurʾan provides little guidance.

The director of the Pakistan Institute of Development Economics, Syed Nawab Haider Naqvi, is convinced that in an interestless economy people would save and invest optimally only if forced to do so by the state. So he wishes to empower a planning agency with the right to decide how society should allocate its resources.[71] But this is a minority position, as evidenced by the adverse reactions it evoked at the Mecca seminar on the Monetary and Fiscal Economics of Islam.[72] The dominant view is that the practice of profit sharing would ensure the adequacy of savings and investment.

Under profit sharing, depositors, lenders, and investors receive not a fixed percentage return (which would constitute interest), but instead a predetermined share of any income generated by the projects financed through their contributions. They also share in any losses, again according to a predetermined formula. Among the several variants of profit sharing which have received attention in the contemporary literature, the most important is *muḍārabah*, also known as *qirāḍ*. Examples of muḍārabah include the borrowing and lending operations of Islamic banks. These banks are engaged in muḍārabah both when they accept deposits from individuals in return for a share of the proceeds from these deposits and when they lend to firms in return for a share of these firms' corresponding profits.[73]

In the ideal interest-free system put forth by the Islamic economists, people are able to earn a return on their money only by subjecting themselves to the risks involved in profit sharing. Thus, an individual who wishes to make money on his retirement savings has to incur the risks inherent in a muḍārabah account. If he does not want to incur these risks, his alternative is to have the bank simply hold his funds, without investing them, in which case he not only gets no return, but might also pay service charges. Similarly, a bank cannot lend to a firm for a fixed payment. It can lend only on condition that it shares in the firm's profits and is exposed to its losses.

Participants in a muḍārabah venture are in principle free to choose whatever profit-sharing ratio they consider most appropriate. Yet there is a concern that, if full freedom of choice is allowed, the weaker participants might be exploited, and that, moreover, the supply of money might slip out of control. Echoing the preferences of most Islamic economists, Pakistan's Council of Islamic Ideology recommends that the best resolution of these problems lies in government regulation of profit-sharing ratios.[74] Another problem, according to at least some Islamic writers, is that enterprises could underreport the profits stemming from the funds they borrowed. The principal remedy offered for this problem is to let banks audit the accounts of firms to which they lend.[75] A few Islamic economists recognize that banks could find auditing the accounts of small firms unduly expensive. To prevent such firms from being squeezed out of the credit market, they recommend having the government either subsidize audits of these firms, or simply guarantee the loans they receive.[76] Short-term loans made to firms for their liquidity requirements present yet another sort of difficulty: they are generally not attributable to specific projects. To cope with this problem, one writer recommends making these loans interest-free, rationing them if demand exceeds supply.[77] Others have suggested schemes that involve service fees or average rates of return.

It is appropriate to ask, as we did earlier in a more general context, how the Islamic economists reconcile their advocacy of regulatory measures with their claim that opportunistic behavior would be absent from a society imbued with Islamic norms. The answer is that these measures are expected to be largely redundant once the Islamic order has been established. They are expected to play an important role only during the period of transition, which, the Islamic economists stress, has just barely begun even in societies that have explicitly committed themselves to an Islamic way of life.

Regarding loans, we have so far considered only those intended to finance productive ventures. What about personal loans taken in order to meet consumption expenses? Given that profit sharing is inapplicable to these cases, the Islamic economists suggest making all consumption loans interest-free.[78] In the system they envisage, individuals lend on an interest-free basis to their brethren in need. In addition, banks set aside a portion of their deposits, whose origin is left unspecified, for such loans.

The Islamic economists recognize that in the absence of interest, which performs an equilibration function in existing economies, the demand for consumption loans could exceed supply, making some form of rationing necessary. Most do not, however, explain what sort of rationing scheme they have in mind. An exception is M. Fahim Khan of the Islamic University in Islamabad, who suggests that, as far as banks are concerned, rationing should be based on two criteria: clients' credit records and the nature of their needs. Illustrating his scheme, Khan writes that an "old client" who needs a "loan for his son's education" has priority over a "new client" who wants a "loan to buy an air conditioner."[79] Khan does not say whether an old client who wants to buy an air conditioner has priority over a new client desiring to finance his son's education. Nor does he say whether a bank has any obligation to provide consumption loans to non-clients in need.

In any case, it is believed that rationing would be an uncommon occurrence in an Islamic society because the two institutions discussed in earlier sections would keep the demand for consumption loans under control. In the first place, everyone's demand would be curtailed by the Islamic norms that exhort them to shun "borrowings for lavish expenditure, artificial standard of living [and] conspicuous consumption."[80] Second, people with the most urgent needs would receive assistance from zakāt funds, and therefore would not need loans.

Another problem that receives attention is the possibility that recipients of interest-free consumption loans would peddle their funds for interest on the black market. The temptation to do this would certainly be present, as very profitable firms that can obtain legal business loans only on a profit-sharing basis would prefer to borrow at an interest rate equal to the normal rate of return. The solution to this problem, as with many others, is sought in the Islamic norms. People, the argument goes, will no longer desire to do business on the basis of interest once their "false values" have been eradicated by Islamic training.[81] A few writers hold that the behavioral norms are so crucial to the enforcement of a ban on interest that an immediate prohibition "would be just like constructing a huge university building without making any provision for teachers."[82] But most favor the prohibition of all forms of interest without delay, in the belief that the use of interest can be reduced dramatically even if few members of society have been inculcated with Islam's value system.

Regarding the treatment of interest-free loans under inflation, there is no consensus. Some writers consider full indexation to be the Islamically just approach.[83] But others say that indexation would violate the *sharīᶜah* principle requiring the same quantity to be returned as borrowed. Just as, they say, someone who borrows five bushels of wheat must return exactly five bushels even if the price of wheat has changed in the meantime, so too must the person who borrows $100 return $100 even under galloping inflation. Significantly, in its lengthy report on interest, the Council of Islamic Ideology takes no clear stand on the issue.[84]

Critique

There are a number of flaws in the proposed alternatives to interest. It is true, however, that profit sharing constitutes a useful scheme. In many markets, and for various types of lenders, borrowers, savers, and investors, profit sharing is the preferred mechanism for allocating returns even when interest is a legally available option. This is supported by the fact that in many places, including the Arabian peninsula, profit sharing has been practiced since long before Islam.[85] In contemporary societies, Muslim or non-Muslim, the practice takes a variety of forms, including money-market funds, industrial partnerships, and joint ownership of firms by workers.

It hardly follows, though, that it is reasonable to make profit sharing the basis of *all* productive ventures. Replacing interest with profit sharing redistributes not just returns but also risks. And while some segments of society, such as diversified firms, are willing to bear certain risks, others are not. Consider the problem facing a handicapped octogenarian who relies on her savings for a living. By forcing her to open a muḍārabah account instead of an interest-bearing account, the Islamic economists could make her bear risks that are borne better by others. She would, of course, possess the option of having the bank simply hold her funds, but this would deprive her of income.[86] This octogenarian's dilemma—income or security—illustrates a general problem that would afflict borrowers and lenders alike. People engaged in financial deals would be deprived of the right to allocate risks among themselves according to their relative willingness to bear risk.

A second reason why interest may be preferable to profit sharing is that, by fixing borrowers' obligations, interest removes their incentives to behave opportunistically. Because of informational asymmetries between borrower and lender, these incentives are present both in depositor-bank and bank-firm partnerships. In each of these cases, the borrowing enterprise has full knowledge of its revenue and cost structure, whereas the lender can only form estimates. Given this unavoidable asymmetry, the borrower can understate its earnings and overstate its costs. Alternatively, it can deliberately let its costs soar by granting, say, inordinately high benefits to its employees. If this sort of opportunism does in fact arise, lenders might want to prenegotiate a lower bound on their returns, which would amount, in effect, to interest.

Although they sense the possibilities of opportunism which exist under profit sharing, the Islamic writers do not regard interest as a legitimate solution. They suggest that the problem can be overcome partly by inculcating members of society with Islamic norms and partly by closely supervising borrowers' activities. The suggestion that opportunistic behavior can be controlled through Islamization is belied, however, by the experiences of the recently established Islamic banks, which I shall touch on later. As for the second component of the suggestion, it overlooks the fact that effective supervision can be extremely costly. Suppose, for the sake of illustration, that a bank lends to a firm operating at the forefront of electronics. The cost of supervision is apt to be very high, because this has to be done by specialists in the industry's latest technical developments. It is not correct that the bank's "keen business outlook and experience" can only make the firm's investments more healthy or that bank supervision would necessarily benefit "the march of economic progress."[87] Banks, like all other enterprises, specialize in only certain areas of knowledge, and it may not always be economical for them to engage in detailed supervision of their customers' operations. In cases where supervision would be too costly, the bank, and by implication its depositors, might well wish to settle for a fixed return, even if by doing so they forego the upside earnings potential.

All these problems of feasibility and efficiency aside, the logic behind the prohibition of interest raises doubts about the merits of predetermined wages, to which few Islamic economists object. Consider a firm operating in an uncertain environment. If this firm pays its employees according to a predetermined scale, all risks are borne by the shareholders: while workers would earn the same return on their efforts regardless of the firm's revenue, shareholders could either make or lose money. Clearly, then, it would be inconsistent to ban interest without also banning fixed wages. The very logic used to justify muḍārabah would also require employees to share in the firm's risk.

One of the few Islamic economists who detects the inconsistency in allowing fixed wages but not interest is Syed Aftab Ali of the Bureau of Statistics in Ottawa. In the belief that "the existing [capitalist] institutional framework . . . restricts the choice of risk-taking only to owners of capital,"[88] Ali suggests that all workers receive wages tied to the profitability of their firms. The problem with Ali's proposal is that some workers prefer fixed wages even if they must accept a cut in their expected earnings to get them. From an efficiency standpoint, fixed wages are appropriate when employees are more risk-averse than the firm and have limited access to information about the firm's financial flows. In any case, a ban on fixed wages would be unenforceable.

Regarding interest-free consumption loans, the Islamic argument is open to criticisms analogous to those related to profit sharing. It is quite reasonable to expect people to make such loans to relatives and close friends. In all societies, Muslim or non-Muslim, most people are usually willing to help those with whom they routinely associate, not only through interest-free consumption loans, but also in other manners, including outright donations. In a small community like an isolated village, this might mean that in his moment of need an individual receives assistance, which may take the form of interest-free loans, from a substantial fraction of the community. Interest-free loans to strangers constitute quite a different matter. There is no evidence that such loans have been sufficiently common in any large society to justify extensive reliance on them in the proposed Islamic society where each individual would be unknown to the vast majority of members.

A question that has received insufficient attention in the literature concerns the possibility of excess demand for interest-free consumption loans. The Islamic economists' position on the matter has already been outlined: they argue that excess demand can be dealt with through rationing, but that in any case the problem would rarely arise, as Islamization would put a damper on demand. Aside from the unresolved issue of how rationing is to take place, there is the issue of whether those who are rationed can obtain loans from the countries where interest is legal. The Islamic writers do not consider this particular possibility, although some of them realize that there will exist outside opportunities to engage in interest-based transactions. Faridi would prevent Muslims from taking advantage of these opportunities by prohibiting capital mobility between interest-free and "interest-laden" societies.[89] His suggestion amounts, of course, to a tacit acknowledgement of how futile it is to expect behavioral norms to keep members of an Islamic society from violating the injunction against interest.

Evidence from the Past

The Islamic economists' ultimate defense against these and other criticisms hinges on their interpretation of Islam's golden age. They believe that both interest-free consumption loans and profit-sharing ventures were common among the early Muslims, and that the system was not plagued by the problems I have described.

Although they offer hardly any evidence in support of their claims, their basic interpretation is not implausible. Throughout history consumption loans have been interest-free in predominantly agricultural communities that are small, isolated, and operating at the brink of subsistence. In such communities, where technological and transactional considerations inhibit the establishment of a formal insurance system, an individual member's survival depends on others' assistance whenever his own production falls short of his subsistence needs. Assistance may take the form of outright charity or an interest-free loan; the loan must be interest-free because otherwise fraternal assistance would be turned into a business deal, thereby reducing individuals' sense of security. Thus, the rationale for the prohibition of interest is the protection of the community's viability.[90] Not surprisingly, the ancient Jews abolished interest when they became an isolated tribe, and the medieval Christians put greatest emphasis on the biblical prohibition of usury in times of contracting population and shrinking agricultural output.[91]

As for profit sharing, conditions in the earliest Islamic community were undoubtedly conducive to its widespread use. In that community, everyone knew each other personally and by modern standards could assess the profitability of each other's economic activities rather well.[92] Therefore, both the motivation to behave opportunistically and the possibilities for doing so must have been substantially more limited than they are in any modern economy.

The real issue, however, is not whether interest-free loans and profit sharing were common in the early years of Islam, but whether interest-based financial deals were uncommon. A wealth of evidence gathered by Maxime Rodinson shows that especially after Islam's first few decades the Qurʾanic prohibition of interest was routinely violated throughout the Muslim world, even by pious individuals.[93] Violations occurred in the context of various ruses (*ḥiyal*) which were developed by Muslim jurists to circumvent the prohibition of interest while safeguarding the letter of the Qurʾan. The following example illustrates a widely practiced ruse. Person A sells an object to person B for $110, to be paid after a year, but promptly buys it back for $100, payable immediately. While technically no interest payment is involved, this double transaction is equivalent to a single transaction in which A lends $100 to B for one year at 10 percent interest. Evidently, people were exhibiting such a pressing need for borrowing and selling at interest that the jurists found it prudent to legitimize their roundabout methods.

The fact that the prohibition of interest ceased to be observed on a general scale soon after Islam's birth is not surprising in view of the economic rationale I offered for it earlier. If it is indeed true that the prohibition serves an insurance function in small communities operating close to subsistence, one would expect its effectiveness to have progressively declined as the Islamic community grew and prospered. Just as the prohibition lost its appeal among Jews and Christians in times of territorial expansion and economic growth,[94] so too would Muslims have deemphasized and reinterpreted it as the umma increased in size and wealth.

The Contemporary Experience with Islamic Banks

The Islamic economists' empirical defense of their claims concerning the desirability and feasibility of a ban on interest is not confined to a recitation of what they believe to be the early Islamic record. They draw additional support from the records of the Islamic banks recently established in Saudi Arabia, the Gulf Emirates, Egypt, Sudan, Jordan, and Pakistan, among other places. They point out that all of these banks have proved profitable even though they have been offering depositors a higher yield than their interest-paying rivals. Impartial investigators, including Ingo Karsten whose research was conducted under the auspices of the International Monetary Fund, have verified that the Islamic banks have been successful from the standpoint of both owners and clients.[95]

But one must be cautious in interpreting the evidence. Before jumping to conclusions about the superiority of Islamic banking over traditional banking, one must consider that in the countries involved both the dividends of the Islamic banks and the interest rates offered by traditional banks are controlled by monetary authorities who may well be under special orders to enhance the attractiveness of the Islamic banks. While I know of no study concerning subsidies to Islamic banks, some evidence on the matter can be gleaned from comments made at the Islamabad conference on the Monetary and Fiscal Economics of Islam by Fouad Agabani of the Faisal Islamic Bank of Sudan.[96] According to Agabani, not only are the Faisal Bank and its employees exempt from taxation, but the bank enjoys most-favored-enterprise status in all of its dealings with the government.

Yet even if the Islamic banks did not enjoy such privileges, it would not be surprising that muḍārabah accounts yield greater returns than interest-bearing accounts. Since muḍārabah accounts are riskier, few people would be attracted to them unless they provided higher yields. But it does not follow that *everyone* would become better off if all banks were forced to offer only muḍārabah accounts. Depositors with a strong preference for security, who currently choose to hold their savings in regular accounts in spite of the higher expected earnings of muḍārabah accounts, would become worse off if forced to hold a risky portfolio.

A related issue is whether the establishment of Islamic banks may, as some Islamic economists claim, have provided a stimulus to aggregate savings. While there exist no reliable data on the matter, the claim is certainly plausible. This is so because in countries where Islamic banks are in operation the stock market performs inadequately, and, because from the standpoint of the individual saver-investor, muḍārabah accounts serve the same function as stocks. The bulk of the individuals who have switched to Islamic banks are probably relatively less risk-averse savers who would, if the economy were more developed, be holding stocks. If this conjecture is correct, one can infer that the establishment of Islamic banks has stimulated savings by introducing a new financial service. This does not mean, however, that savings could be increased further by abolishing the traditional banking system, for, as noted earlier, the highly risk-averse customers of traditional banks may not feel comfortable with muḍārabah.

What about the other features that the Islamic economists say would characterize Islamic banking? None of the Islamic banks studied by Khan had ever provided an interest-free consumption loan.[97] Another of his findings is that the banks are exhibiting a marked preference for investing in "projects which give quick returns." One bank, the Kuwait Finance House, has invested almost exclusively in short-term commercial deals and in the notoriously speculative real estate market. This finding suggests that Islamic banks operate as personal-profit maximizers, not as social-welfare maximizers intent on upholding Islamic principles of justice. But Khan refrains from drawing this conclusion and attributes his finding to the "the prevalent trend in local markets . . ."[98]

It appears, moreover, that participants in profit-sharing ventures engage in many types of behavior that, we are told, should be absent in an Islamic setting. Agabani complains that some of the clients of his bank tend "to ignore the terms of [their] contracts . . ."; that they are "prone to hoarding"; and that they are "reluctant to liquidate [their] operations in the agreed time, . . . preferring to wait for 'golden chances' to sell at 'appropriate' periods."[99] The experiences of the Faisal Bank suggest that Islamic banks are not immune to the problem of opportunism, which haunts non-Islamic banks in a multitude of contexts. Although it is too early to judge how serious the problem is, it is safe to say that, just like their non-Islamic counterparts, the Islamic banks will have to rely on the force of law to get their clients to abide by provisions of their contracts.

We come at last to the most crucial question of all: whether Islamic banks are finding it practical to eliminate interest. Judging by the recent report of the Council of Islamic Ideology, they are not. Like the medieval jurists before them, contemporary Islamic economists are apparently being pressured by practitioners to legitimize a variety of practices that amount to interest in disguise. One of the practices accepted by the Council (on condition that it not be used indiscriminately) is *bayᶜ muʾajjal*, which is intended for short-term loans to industrialists, farmers, and traders. The Council illustrates bayᶜ muʾajjal through the following example involving a firm that needs to buy fertilizer on credit. "If the current cost of a bag of fertilizer to the bank is Rs. 50, the bank may sell it . . . at Rs. 55 subject to actual payment of this price after an agreed period."[100] If one assumes that the period in question is one year, this deal is technically indistinguishable from a one-year loan of Rs. 50 given at 10 percent interest.

Another ruse approved by the Council is "financing on the basis of normal rate of return." Under this method a public agency estimates the normal rate of return in each industry, and banks then provide loans on condition that their returns from these loans not fall below the relevant normal rates. If this were all, the method would have to be viewed as involving unadulterated interest. It does contain, however, an additional proviso. If a borrower's actual profit turns out to be above the normal rate, it *voluntarily* transfers the difference to the bank. On the other hand, if the actual rate falls short of the normal rate, the firm may have its obligation reduced by convincing public officials that it has not cheated. The Council feels that this method does not violate Islamic principles. Yet it is wary that because of "existing moral standards," the practice might "degenerate into pure interest with the passage of time." It recommends, therefore, that the method be restricted to transactions involving small entrepreneurs.[101]

Among other legitimate ways of getting around the prohibition of interest, the most ingenious one is called "time-multiple counter-loans." The Council uses the following example to illustrate this method. Person A wishes to borrow Rs. 100

from bank B for three months. To get the loan, A agrees to maintain a deposit of Rs. 10 with B for 30 months. A repays Rs. 100 to B at the end of three months, and B repays Rs. 10 to A after having profited from the use of this sum for a full 30 months.[102] This deal is technically free of interest, as it involves no fixed charge. But it is closer in spirit to interest than to profit sharing, since both A and B keep 100 percent of the profits generated by their borrowings.

Given all this, it would be hard to argue that the Islamic banks are operating according to the ideals put forth by Islamic economists. Faced with realities of the marketplace, the banks seem to be finding it prudent to abandon profit sharing for interest—concealed, of course, in Islamic garb.

CONCLUDING REMARKS

The foregoing discussion, which has scrutinized the three most fundamental features of the proposed Islamic system, raises serious questions about the claim that this framework provides a functional alternative to existing systems. The suggested behavioral norms are not only riddled with ambiguity, but also unlikely to enjoy widespread adherence in a large society. In practice, many of them would have to be treated as state-enforced laws. There is no way of ensuring, moreover, that state officials would behave in an Islamically "correct" manner. These criticisms are borne out by the fact that throughout most of the past fourteen centuries, members and officials of Muslim communities have had a tenuous link with Islam's behavioral norms, even when they have more or less agreed as to what these norms mean.

Another major feature of the envisaged system, zakāt, is essentially a redistribution scheme resembling those already in operation all over world, except that it is far less comprehensive and rather regressive. The problems with the proposed zakāt scheme stem largely from the Islamic economists' attachment to the particular rates and exemption limits set by the early Muslims. Since these rates and limits were generally expressed in kind, they would constitute an illogical taxation scheme in the contemporary world where relative prices differ enormously from those in seventh-century Arabia. Although a few writers have toyed with the idea of reforming the traditional scheme, they have yet to specify the nature of the reforms they favor.

As for the prohibition of interest, it is effectively unenforceable in a large, heterogeneous society. While the muḍārabah accounts, which are presented as an alternative to interest-bearing bank accounts, constitute a beneficial instrument in the absence of a well-functioning stock market, they do not obviate relatively risk-averse individuals' need to lend for interest. There is no reason to believe, moreover, that all banks would be content with lending to firms on a profit-sharing basis, or that firms would necessarily desire to borrow on this basis. The problems are similar in the case of interest-free consumption loans: in a large society, people would not voluntarily make such loans except to personal acquaintances. Unless one can show that people's need to borrow and lend at interest would disappear with the establishment of an Islamic system, it is reasonable to expect interest to persist, if in thinly disguised form. This argument is supported by the fact that even within the existing Islamic banking system, no less than in medieval financial circles, various indirect forms of interest have been legitimized.

The unrealistic assumptions, contradictory proposals, and fallacious inferences that permeate the Islamic economists' writings can be traced to two basic methodological flaws. First of all, there is a serious tension between their professed desire to derive the entire blueprint of the Islamic economy from the Qurʾan and the Sunna, and their realization that these sources do not offer a comprehensive economic framework. Indeed, the Qurʾan is a book of moral principles that contains few specific injunctions, while the Sunna expresses the perceived institutional and normative ideals of the first few generations of Muslims that produced it.[103] Neither one deals with the pressing economic issues of the present age, which could not have been imagined in the seventh century. It follows that, if a *functional* alternative to existing economic systems is to be developed, its intellectual foundations must either be created anew or be drawn from sources outside the Qurʾan and the Sunna. Most Islamic writers are aware of this, but they are by and large unwilling to break away from the few specifics found in the traditional sources. And when they do break away from ancient specifications, they do not acknowledge this. We saw, for instance, how they have ratified several forms of interest while steadfastly maintaining that they are unconditionally opposed to it.

The other major methodological flaw in Islamic economics is that it shuns confrontation with historical evidence. Among the documented facts that it has largely disregarded are that generalized altruism gave way to incessant factional struggles as soon as the Islamic community began to grow; that the community split into many discordant nations only a few decades after Muhammad's death; and that the spirit of the ban on interest was routinely violated throughout Islamic history. This flaw also shows up in the Islamic economists' interpretation of Islam's golden age. Ignoring evidence that even in Prophet Muhammad's time institutions were modified or abandoned as circumstances warranted, they maintain, in many contexts, that the institutional structure of the first Islamic economy emerged all at once and in unalterably perfect form. This interpretation, which forms the basis of the argument that the early Islamic institutions are suited to the modern world, is erroneous, as I have tried to show.

There is, of course, much one can learn from the experiences of early Islamic society. One should not, however, expect to find the ideal institutions for a modern society embodied therein. The value of such study is, rather, the lesson that successful economic growth and development requires a measure of institutional flexibility.

DEPARTMENT OF ECONOMICS
UNIVERSITY OF SOUTHERN CALIFORNIA

NOTES

Author's note: The earliest version of this paper was presented at the Fourth Conference on Major International Economic Issues, held in honor of Professor John Elliott at the University of Southern California on January 5–6, 1984. I am grateful to Nikki Keddie and Jeffrey Nugent for having given me the benefit of their thoughts on that version, and to the anonymous reader of *IJMES* and its editor for their suggestions that led to further improvements. An abbreviated version was presented at the Middle East Studies Association Conference held in San Francisco on November 28–December 1, 1984.

[1]For explicit statements to this effect, see F. R. Faridi, "*Zakāt* and Fiscal Policy," in Khurshid Ahmad, ed., *Studies in Islamic Economics* (Leicester: The Islamic Foundation, 1980), pp. 119–20; and Ziauddin Ahmed, Munawar Iqbal and M. Fahim Khan, eds., *Fiscal Policy and Resource Allocation in Islam* (Islamabad: Institute of Policy Studies, 1983), pp. 2–5.

[2]Afzal-ur-Rahman, *Economic Doctrines of Islam*, vol. 1 (Lahore: Islamic Publications, 1980), p. 56. For a similar contention, see Muhammad Abdul-Rauf, "The Islamic Doctrine of Economics and Contemporary Economic Thought," in M. Novak, ed., *Capitalism and Socialism: A Theological Inquiry* (Washington, D. C.: American Enterprise Institute, 1979), p. 129.

[3]The first half of the present section constitutes a brief summary of a paper, "Behavioral Norms in the Islamic Doctrine of Economics: A Critique," *Journal of Economic Behavior and Organization*, 4, 4 (December 1983), 353–379, in which I outlined in detail and critiqued these norms. The rest of this study concentrates on issues not covered in that earlier paper.

[4]See, for example, Abdul-Rauf, "The Islamic Doctrine," pp. 134–40; Monzer Kahf, *The Islamic Economy: Analytical Study of the Functioning of the Islamic Economic System* (Plainfield, Indiana: Muslim Students' Association, 1978), ch. 4; and Mian M. Nazeer, *The Islamic Economic System: A Few Highlights* (Islamabad: Pakistan Institute of Development Economics, 1981), p. 18.

[5]Such criteria are found in virtually all of the Islamic writings. For some examples, see Muhammad Nejatullah Siddiqi, *The Economic Enterprise in Islam* (Lahore: Islamic Publications, 1972), pp. 100–114; Ikram Azam, *Pakistan and Islamic Economics* (Lahore: Amir Publications, 1978), pp. 38–49; Muhammad Akram Khan, "Inflation and the Islamic Economy: A Closed Economy Model," in M. Ariff, ed., *Monetary and Fiscal Economics of Islam* (Jeddah: International Center for Research in Islamic Economics, 1982), pp. 245–248; and Syed N. H. Naqvi, *Ethics and Economics: An Islamic Synthesis* (Leicester: The Islamic Foundation, 1981).

[6]While some writers are opposed to all forms of modern insurance, others find nothing wrong with insurance per se; they object only to profits derived from it. For an outline of the controversy, see Muhammad Nejatullah Siddiqi, *Muslim Economic Thinking: A Survey of Contemporary Literature* (Leicester: The Islamic Foundation, 1981), pp. 26–28; and Azam, *Pakistan*, ch. 6. Also prohibited, in the view of some scholars, are transactions in which the quantity is not numerically specified but the price is. Accordingly, an agreement to buy or sell a day's catch of fish at a price fixed in advance is in violation of Islam's normative system. See Anwar Iqbal Qureshi, *Islam and the Theory of Interest* (Lahore: Sh. Muhammad Ashraf, 1967), pp. 88–92.

[7]M. Umar Chapra, "The Economic System of Islam," 4 parts, *The Islamic Quarterly*, 14 (1970), p. 152. See also Siddiqi, *The Economic Enterprise*, pp.15–22; and Kahf, *The Islamic Economy*, ch. 2.

[8]See Abdul-Rauf, "The Islamic Doctrine," p. 146; and Khan, "Inflation," pp. 242–245.

[9]Chapra, "The Economic System," p. 153.

[10]Nazeer, *The Islamic Economic System*, p. 16.

[11]See Reuven Brenner, *History—The Human Gamble* (Chicago: University of Chicago Press, 1983), ch. 2; and David Collard, *Altruism and Economy: A Study in Non-Selfish Economics* (New York: Oxford University Press, 1978).

[12]For a detailed argument along these lines, see Oliver E. Williamson, *Markets and Hierarchies* (New York: Free Press, 1975).

[13]S. Waqar Ahmed Husaini, *Islamic Environmental Systems Engineering* (London: Macmillan, 1980), pp. 113–114.

[14]See Mancur Olson, *The Logic of Collective Action* (Cambridge: Harvard University Press, 1965); and Russell Hardin, *Collective Action* (Baltimore: Johns Hopkins University Press, 1982).

[15]Inamul Haq, *Principles and Philosophy of Democratic Socialism in Islam* (Karachi: By the author, 1966), p. 2. See also Muhammad Muslehuddin, *Economics and Islam* (Lahore: Islamic Publications, 1974), pp. 88–90; Syed N. H. Naqvi, *Individual Freedom, Social Welfare and Islamic Economic Order* (Islamabad: Pakistan Institute of Development Economics, 1981), pp. 9 and 25; and Afzal-ur-Rahman, *Economic Doctrines*, vol. 1, p. 42.

[16]As quoted by Hamid Enayat, *Modern Islamic Political Thought* (Austin: University of Texas Press, 1982), p. 64.

[17]See, for instance, Abdul-Rauf, "The Islamic Doctrine," pp. 136–137; and Siddiqi, *Muslim Economic Thinking*, p. 13.

[18]In *Economic Doctrines*, for instance, Afzal-ur-Rahman ascribes many major duties to the state although elsewhere in the same trilogy he opposes an interventionist state.

[19]Husaini, *Islamic Environmental Systems*, p. 93. On this point and the other three, see also Muhammad Nejatullah Siddiqi, *Some Aspects of the Islamic Economy* (Lahore: Islamic Publications, 1978), esp. pp. 61–73; Chapra, "The Economic System," pp. 238–239; Muslehuddin, *Economics and Islam*, ch. 3; and Husaini, *Islamic Environmental Systems*, ch. 5.

[20]Siddiqi, *Some Aspects of the Islamic Economy*, p. 72.

[21]The free-rider problem, on the other hand, is less pronounced for a state official than for the average citizen, because the former can perceptibly influence the welfare of society through his actions.

[22]See Anthony Downs, *An Economic Theory of Democracy* (New York: Harper, 1957), chs. 11–14.

[23]Azam, *Pakistan*, p. 97. The author attributes this passage to a book published in 1952 by S. A. Siddiqi.

[24]See, for instance, Husaini, *Islamic Environmental Systems*, chs. 2 and 5. Strictly speaking, this entire period is an object of affection and reverence for the Sunnis but not the Shiᶜis. The latter, who regard the first three caliphs as impostors, believe that apart from Prophet Muhammad's lifetime, the Islamic social order has existed only during the short caliphate of ᶜAlī.

[25]Maxime Rodinson, *Islam and Capitalism* (New York: Pantheon, 1973), ch. 3, provides a wealth of evidence on economic practices in early Islam. On communal disunity and the role of the state in enforcing the norms, see Marshall G. S. Hodgson, *The Venture of Islam*, vol. 1 (Chicago: University of Chicago Press, 1974), ch. 3; M. A. Shaban, *Islamic History A.D.* 600–750 (*A.H. 132*) (Cambridge University Press, 1971); and Montgomery W. Watt, *Islam and the Integration of Society* (Evanston: Northwestern University Press, 1961).

[26]Hodgson, *The Venture of Islam*, vol. 1, pp. 167–172.

[27]Salih Tuğ, *İslam Vergi Hukukunun Ortaya Çıkışı* (Ankara: Ankara Üniversitesi İlahiyat Fakültesi Yayınları, 1963), p. 29.

[28]For evidence of these and other coercive practices, see Montgomery W. Watt, *Muḥammad at Medina* (Oxford: Oxford University Press, 1956), chs. 5–9; Maxime Rodinson, *Muḥammad* (New York: Pantheon, 1980); and Hodgson, *The Venture of Islam*, vol. 1, pp. 146–230.

[29]See, for instance, Daniel Lerner, *The Passing of Traditional Society: Modernizing the Middle East* (New York: Free Press, 1958); and S. N. Eisenstadt, "Convergence and Divergence of Modern and Modernizing Societies: Indications from the Analysis of the Structuring of Social Hierarchies in Middle Eastern Societies," *International Journal of Middle East Studies*, 8, 1 (January 1977), 1–27.

[30]See Khurshid Ahmad, ed., *Studies*, p. 353.

[31]Detailed commentaries on zakāt are given by Afzal-ur-Rahman, *Economic Doctrines of Islam*, vol. 3 (Lahore: Islamic Publications, 1976), chs. 14–18; Shaikh Mahmud Ahmad, *Economics of Islam*, 2nd. ed. (Lahore: Sh. Muhammad Ashraf, 1952), ch. 4; and Mohammad Abdul Mannan, *Islamic Economics: Theory and Practice* (Lahore: Sh. Muhammad Ashraf, 1970), pp. 284–302. For a brief survey, see Siddiqi, *Muslim Economic Thinking*, pp. 22–25. Recent expositions include Z. Ahmed et al., eds., *Fiscal Policy*, chs. 1–4; and Faridi, "*Zakāt*."

[32]S. M. Ahmad, *Economics of Islam*, p. 91. See also Afzal-ur-Rahman, *Economic Doctrines*, vol. 3, pp. 218–224.

[33]Ibid., p. 206.

[34]S. M. Ahmad, *Economics of Islam*, p. 90; and Afzal-ur-Rahman, *Economic Doctrines*, vol. 3, pp. 206–207.

[35]Ibid., p. 205; and Azam, *Pakistan*, p. 100.

[36]Afzal-ur-Rahman, *Economic Doctrines*, vol. 3, p. 217.

[37]S. M. Ahmad, *Economics of Islam*, p. 89; and Afzal-ur-Rahman, *Economic Doctrines*, vol. 3, pp. 225–226.

[38]See Abdin Ahmed Salama, "Fiscal Analysis of Zakāh with Special Reference to Saudi Arabia's Experience in Zakāh," in Ariff, ed., *Monetary and Fiscal Economics*, p. 344.

[39]See Afzal-ur-Rahman, *Economic Doctrines*, vol. 3, ch. 16.

[40]Ibid., p. 243.

[41]See Mannan, *Islamic Economics*, pp. 298–301; Afzal-ur-Rahman, *Economic Doctrines*, vol. 3, pp. 198–203 and 250–252; and Muslehuddin, *Economics and Islam*, p. 80.

[42]Afzal-ur-Rahman, *Economic Doctrines*, vol. 3, pp. 248–250; and M. M. Metwally, "Fiscal Policy in an Islamic Economy," in Z. Ahmed et al., eds., *Fiscal Policy*, p. 64.

[43]Afzal-ur-Rahman, *Economic Doctrines*, vol. 3, p. 246.

[44]S. M. Ahmad, *Economics of Islam*, p. 78.

[45]Mannan, *Islamic Economics*, p. 296.

[46]Abdool Aziz Shaik, one of the few Islamic economists who is at once an ardent advocate of zakāt and a critic of using the traditional exemption limits today, notes that the niṣāb for cows is 5 times higher than that for goats. Shaik's calculations, which are based on current South African prices, also show that the niṣāb for goats is, in turn, 12 times higher than that for silver. See his "Concept of Zakah: A Survey of Qurʾanic Texts and their Explanations in Shariah and Contemporary Economics," in M. Raqibuz Zaman, ed., *Some Aspects of the Economics of Zakah* (Gary, Indiana: Association of Muslim Social Scientists, 1981), p. 28.

[47]Ismail Muhd Salleh and Rogayah Ngah, "Distribution of the Zakāt Burden on Padi Producers in Malaysia," in Zaman, ed., *Some Aspects*, pp. 80–153.

[48]Salama, "Fiscal Analysis," sect. 3.

[49]Ibid., Tables 1 and 6.

[50]Ibid., p. 354.

[51]Ibid., pp. 361–362.

[52]See Shaik, "Concept of Zakah," p. 26; and Tuğ, *İslam Vergi Hukuku*, p. 56.

[53]See Nicholas P. Aghnides, *Mohammedan Theories of Finance* (Lahore: Premier Book House, 1961), pp. 236–239.

[54]On these differences, see ibid., esp. pp. 181–273.

[55]Mannan, *Islamic Economics*, p. 293.

[56]Husaini, *Islamic Environmental Systems*, pp. 134–139.

[57]Salama, "Fiscal Analysis," pp. 364 and 342.

[58]See F. R. Faridi, "A Theory of Fiscal Policy in an Islamic State," in Z. Ahmed et al., eds., *Fiscal Policy*, pp. 27–45.

[59]Afzal-ur-Rahman, *Economic Doctrines*, vol. 3, pp. 197 and 223.

[60]See Tuğ, *İslam Vergi Hukuku*, pp. 16–82.

[61]See Muslehuddin, *Economics and Islam*, pp. 76–77.

[62]For a general survey of the Islamic position on interest, see Muhammad Nejatullah Siddiqi, "Islamic Approaches to Money, Banking and Monetary Policy: A Review," in Ariff, ed., *Monetary and Fiscal Economics*, pp. 25–39. Detailed expositions are contained in the proceedings of the recent seminars on the Monetary and Fiscal Economics of Islam: Ziauddin Ahmed, Munawar Iqbal and M. Fahim Khan, eds., *Money and Banking in Islam* (Jeddah: International Center for Research in Islamic Economics, 1983); and Ariff, ed., *Monetary and Fiscal Economics*. Other contributions include Qureshi, *Islam and Interest*; Afzal-ur-Rahman, *Economic Doctrines*, vol. 3, chs. 1–13; Mannan, *Islamic Economics*, pp. 157–176 and ch. 9; S. M. Yusuf, *Economic Justice in Islam* (Lahore: Sh. Muhammad Ashraf, 1971), ch. 6; and Muhammad Samiullah, "Prohibition of Riba (Interest) & Insurance in the Light of Islam," *Islamic Studies*, 21, 2 (Summer 1982), 53–76. For critical reviews of this literature, see Ingo Karsten, "Islam and Financial Intermediation," *International Monetary Fund Staff Papers*, 29, 1 (March 1982), 108–142; and Siddieq M. Noorzoy, "Islamic Laws on Ribā (Interest) and their Economic Implications," *International Journal of Middle East Studies*, 14, 1 (February 1982), 3–17.

[63]Fazlur Rahman, "Ribā and Interest," *Islamic Studies*, 3, 1 (March 1964), 1–43.

[64]Yusuf, *Economic Justice*, p. 86. See also Afzal-ur-Rahman, *Economic Doctrines*, vol. 3, pp. 59–60.

[65]See Siddiqi, *Some Aspects*, pp. 91–92; and S. M. Ahmad, *Economics of Islam*, p. 41.

[66]Siddiqi, *Muslim Economic Thinking*, p. 63. See also Afzal-ur-Rahman, *Economic Doctrines*, vol. 3, pp. 57–61.

[67]Ibid., p. 55.

[68]Samiullah, "Prohibition of Riba," p. 54. See also S. M. Ahmad, *Economics of Islam*, p. 41.

[69]See Siddiqi, *Muslim Economic Thinking*, p. 63; and Qureshi, *Islam and Interest*, p. 47.

[70]S. M. Ahmad, *Economics of Islam*, p. 28. See also Azam, *Pakistan*, p. 76; and Afzal-ur-Rahman, *Economic Doctrines*, vol. 3, pp. 57–58.

[71]Syed N. H. Naqvi, "Interest Rate and Intertemporal Allocative Efficiency in an Islamic Economy," in Ariff, ed., *Monetary and Fiscal Economics*, pp. 75–95.

[72]See, in particular, Muhammad Anas Zarqa's comments in Ariff, ed., *Monetary and Fiscal Economics*, pp. 98–106.

[73]For detailed accounts of profit sharing in the Islamic system, see Muhammad Nejatullah Siddiqi, *Banking Without Interest* (Lahore: Islamic Publications, 1980); Mannan, *Islamic Economics*, pp. 221–231; and Mahmud Abu Saud, "Money, Interest and Qirāḍ," in K. Ahmad, ed., *Studies*, pp. 59–84.

[74]See Council of Islamic Ideology, "Elimination of Interest from the Economy," in Z. Ahmed et al., eds., *Money and Banking*, esp. p. 122. Another defense of state regulation is put forth by Muhammad Nejatullah Siddiqi, "Economics of Profit-Sharing," in Z. Ahmed et al., eds., *Fiscal Policy*, pp. 163–185.

[75]See Council of Islamic Ideology, "Elimination," pp. 125–126.

[76]See, for instance, M. Umar Chapra, "Monetary Policy in an Islamic Economy," in Z. Ahmed et al., eds., *Money and Banking*, p. 42.

[77]Siddiqi, *Banking Without Interest*, ch. 4.

[78]See Council of Islamic Ideology, "Elimination," p. 112; and Mannan, *Islamic Economics*, pp. 224–225.

[79]M. Fahim Khan, "Islamic Banking as Practised Now in the World," in Z. Ahmed et al., *Money and Banking*, p. 267.

[80]Council of Islamic Ideology, "Elimination," p. 145.

[81]Ibid., p. 106.

[82]Mannan, *Islamic Economics*, p. 166.

[83]See, for instance, Munawar Iqbal's comments in Z. Ahmed et al., eds., *Money and Banking*, pp. 52–57.

[84]See Council of Islamic Ideology, "Elimination," pp. 115–116.

[85]See Abraham L. Udovitch, *Partnership and Profit in Medieval Islam* (Princeton: Princeton University Press, 1970), p. 8. For some evidence from Bahrain, see Samar K. Datta and Jeffrey B. Nugent, "Bahrain's Pearling Industry: How It Was, Why It Was That Way, and Its Implications," in Nugent and Theodore H. Thomas, eds., *Bahrain and the Gulf: Past Perspectives and Alternative Futures* (New York: Macmillan, 1985), pp. 25–41.

[86]A side issue here is that this would keep her funds idle, a practice the Islamic economists condemn in other contexts as "hoarding". They seem to overlook the fact that some of the Prophet's closest companions, among them ᶜAʾisha and ᶜUmar, invested money left in their safekeeping in profit-sharing ventures. On this last point, see Udovitch, *Partnership*, p. 173.

[87]Mannan, *Islamic Economics*, p. 229. The same argument is made by Siddiqi, *Banking Without Interest*, ch. 2.

[88]Syed Aftab Ali, "Risk-Bearing and Profit-Sharing in an Islamic Framework: Some Allocational Considerations," in Z. Ahmed et al., eds., *Fiscal Policy*, p. 265.

[89]Faridi, "*Zakāt* and Fiscal Policy," p. 120.

[90]An illuminating discussion concerning the prohibition interest in primitive societies is presented by Richard A. Posner, "A Theory of Primitive Society with Special Reference to Law," *Journal of Law and Economics*, 23 (April 1980), 1–53.

[91]For a detailed exposition of the ban's appearance and decline in Judaism and Christianity, see Brenner, *History*, ch. 3. See also Benjamin Nelson, *The Idea of Usury: From Tribal Brotherhood to Universal Otherhood*, enlarged 2nd ed. (Chicago: University of Chicago Press, 1969; first ed. 1949).

[92]This is not to say that these activities involved no risks. Long-distance trading could be very hazardous. What made profit sharing possible even in this instance was that it was relatively difficult to conceal the resulting income. See M. J. Kister, "Mecca and Tamīm (Aspects of their Relations)," *Journal of the Economic and Social History of the Orient*, 8 (November 1965), 113–163.

[93]See Rodinson, *Islam and Capitalism*, esp. ch. 3.

[94]See Brenner, *History*, ch. 3.

[95]See Karsten, "Islam and Financial Intermediation."

[96]These comments are in Z. Ahmed, et al., eds., *Money and Banking*, pp. 277–284.

[97]Khan, "Islamic Banking," p. 267.

[98]Ibid., p. 264.

[99]See Z. Ahmed et al., eds., *Money and Banking*, p. 283.

[100]Council of Islamic Ideology, "Elimination," p. 118.

[101]Ibid., pp. 119–120.

[102]Ibid., pp. 120–121.

[103]Modern scholars have shown that most of the words and deeds attributed to the Prophet in authorized compilations of the Sunna, which date back to the tenth century, are inauthentic. Apparently, the Prophet was assumed to have said or done countless things on the basis of a long list of oral transmissions of this form: A attests that he heard it from B who was told by C that D was present when E, the Prophet's companion, mentioned that. . . . Many of these transmissions were undoubtedly fabricated by individuals seeking religious sanction for policies they favored. See Ignaz Goldziher, *Muslim Studies*, vol. 2, ed. S. M. Stern, trans. C. R. Barber and S. M. Stern (London: George Allen and Unwin, 1971, first German ed. 1889); and Joseph Schacht, *The Origins of Muhammadan Jurisprudence*, 3rd ed. (London: Oxford University Press, 1959).