

## ISLAM'S MORAL ECONOMY: A FIQHICONOMIC INTERPRETATION

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### ABSTRACT

Despite of the idealist nature of their Fiqhi enterprise, the classical jurists also exhibited an acute understanding of their economic and business environment, one that enabled them to articulate the moral foundations and efficient legal institutions of a highly successful Islamic economy. This fact led the economic historian Abraham Udovitch (1970: 261), in a meticulous and well-reasoned study of those institutions, to conclude that: “The prominence of the Muslim world in the trade of the early Middle Ages, if not attributable to, was certainly reinforced by the superiority and flexibility of the commercial techniques available to its merchants. Some of the institutions, practices and concepts already found fully developed in the Islamic legal sources of the late eighth century did not emerge in Europe until several centuries later.”

In this study, I attempt to sketch out a verbal “model” of the “classical” economy of historical Islam, one that assembles what is known of its basic “building blocks” in a coherent system that highlights its moral and legal philosophy, and encapsulates its fundamental principles and “laws of motion” in theory as well as its *modus operandi* in practice. In the process the broad lines of this model are juxtaposed to the revivalist views and doctrines espoused by “*Mawdūdi-conomists*”. In implementing this objective— besides the introduction – the paper consists of four other sections. In section II, Islam’s work ethic of “legitimate/justified gain” is expounded to reveal a doctrine of economic justice that underpins the juristic effort of the classical jurists. This doctrine is employed in section III, “The Shari'a Market Model”, to delineate/typify the economic structure of classical *Sūqs*, their moral/social embeddedness, their legal framework, and their operational and policy institutions. Section IV then addresses the microeconomic institutions of business association and financing as well as the macroeconomic conduits of financial intermediation between savers and investors. Finally, in Section V, the paper ends with a perspectival summary and concluding remarks regarding the nature of the socio-economic system typified here.

**Key Words:** Economic systems, moral philosophy.

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“Down out of the heaven, He sendeth water, and the wadis overflow each in its measure: So the torrent beareth (on its back) a mounting froth, akin to that froth (emitting) from what they smelted in the fire for making ornaments or wares. **Thus Allah depicteth the true and the false:** The froth is cast away a vanishing dross, but **that which benefits mankind abides in the earth.** So doth Allah coin His similitudes.”

*Quran, 13:17*

“The inner meaning of history . . . involves speculation and an attempt to get at the truth, subtle explanation of the causes and origins of existing things, and deep knowledge of the how and why of events. History, therefore, is firmly rooted in philosophy . . . It takes critical insight to sort out the hidden truth; it takes knowledge to lay truth bare . . .”

*Ibn Khadūn’s Muqaddimah*

“Let the *sūq* of this world below do no injury to the *sūq* of the Hereafter, and the *sūqs* of the Hereafter are the mosques.”

*al-Ghazālī’s Ihyā’*

Each economy necessarily functions within the confines of a particular social framework, defined by its distinctive moral philosophy and legal system. What makes an economy “Islamic” is *Shari’a*:<sup>1</sup> a huge corpus of moral and legal discourses, which was intended by scholars (jurists and theologians) of the second and third Islamic centuries, for guiding Muslims in their pursuits of a good and virtuous life (that also qualifies them for attaining paradise in the life after). As such *Shari’a* defined the moral economy of classical Islam, shaped its micro and macro institutions, and modulated its actual performance. And recently it has become both a symbol and a basis for revivalist Islamic movements in their attempts to Islamicize their polities and economies.

### **I. The Moral/Legal Framework**

*Shari’a* was molded by the theological and jurisprudential debates which began towards the end of the eighth century.<sup>2</sup> The *Mu’tazila*, a rationalist school of *Kalām* (philosophical theology) and self-designated as *Ahl al-’Adl* (Advocates/People of Justice), adopted a doctrine of teleological ethics and law, arguing that humans – with their divine gift of *’aql* (reason) alone – are capable not only of recognizing good and evil acts, but also of legislating good laws to regulate their lives at least in the domain of *mu’amallat* (social and economic

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<sup>1</sup> For a good overview of the concepts, structure, and development of *shari’a*, see Calder and Hooker (1997) and Gibb (1970), ch. 6.

<sup>2</sup> On these debates, see the classic survey by Watt (1973).

transactions).<sup>3</sup> And in this they were bitterly opposed by the pietistic disposition and literalist bent of *Ahl al-Hadith* (the Traditionists).<sup>4</sup> The *Mu'tazila* gradually lost its ascendancy after the termination of a *mihna* (inquisition) enacted by Caliph al-Ma'mūn (d.218/833) in a failed attempt by the state to impose Mu'tazili theological doctrine on its officials, notably the judges.<sup>5</sup> And it was in the midst of a resurgent traditionalism that the *Ash'ariya* school was founded by a former Mu'tazilite, Abul-Hassan al-Ash'ari (d.324/935), who worked out a "reconciliation" that largely accepts the rationalist doctrine and method of the Mu'tazila, but rejects their views in the all-important area of ethics and law.<sup>6</sup> In this realm, the Ash'arites accepted the Traditionists' doctrine that "God does not command an act **because** the act is just and good; it is His command (*amr*) which makes it just and good", as Gardet (1986: 1144) puts it. Eventually, the *Ash'ariya* gained ascendancy and has since become the official Kalām of Sunni orthodoxy, thereby providing the theological justification for its classical legal theory of *Usul al-Fiqh* (Sources/Roots of Jurisprudence).

Intertwined with the raging theological debate, the jurisprudential debate ultimately brought about an "idealist" concept of Shari'a as being an all-embracing system of "divine commands", which the classical jurists (*fuqaha*) set out to construct with their theory of the four sources.<sup>7</sup> Only two of these, the Qur'an and the Prophet's Traditions (*hadith*), are material sources: the former is divine, the latter quasi-divine. The third is a rational hermeneutic method that enabled the *fuqaha* to interpret the material sources, and extend the embrace of the sources' positive content to span the entire range of human experience. This formal method, centering on *Qiyās* (essentially analogical syllogistics), was intended to safeguard the integrity of divine commands from the vagaries of personal prejudice. And the entire structure of their brilliantly reasoned edifice hinged on the fourth root:<sup>8</sup> *Ijmā'* (consensus of the jurists), an authoritative

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<sup>3</sup> As Gimaret (1993: 792) puts it, to the Mu'tazila, "the revelation can only confirm that which reason tells us . . . [although] the latter is not sufficient to make us aware of everything that is evil (i.e. forbidden), nor everything that is obligatory, for example to perform a prayer to God, according to a certain ritual . . ." On the Mu'tazila, see also Martin *et al.* (1997), chs. 1-2, and Watt (1973), chs. 7-8; and on Kalām in general, see Gardet (1986).

<sup>4</sup> On *Ahl al-Hadīth*, and the context of the development of their doctrine, see Rahman (1979), ch. 3, Schacht (1986), and Watt (1973), chs. 3-5.

<sup>5</sup> On *Mihna*, see Hinds (1993) and Martin *et al.* (1997: 28-29), and on its aftermath, see Watt (1973), ch. 10.

<sup>6</sup> On the emergence of al-Ash'ari and his doctrine, see Watt (1973: 303-312) and Gardet (1986: 1144-1145).

<sup>7</sup> On the nature, structure, and development of Islamic jurisprudence, see Hallaq (1997), and the earlier works by Schacht (1964), Coulson (1969) and Coulson (1978).

<sup>8</sup> The resulting *shari'a* discourses are considered, "from the point of view of logical perfection, one of the most brilliant essays of human reasoning", according to the eminent Orientalist scholar Gibb (1970: 62).

(albeit informal and dialectical) sanctioning process which was deemed necessary for adjudicating the epistemological status of the material sources as well as the fruits of their juristic effort (*Ijtihād*). When this highly competitive and geographically diffuse community of jurists reached a consensus, the substance of their *ijmā'* was classed as *'ilm* (indubitable knowledge), and when they did not, the substance was considered *zann* (conjecture/opinion).

The classical jurists, who belonged to a number of competing schools (*madhāhib*), often disagreed, not the least in the area of economic and commercial law. Nevertheless they considered their variant opinions equally valid according to their doctrine of *Ikhtilāf*, a correlative term to *Ijmā'*.<sup>9</sup> The jurists also recognized that a mechanistic and strict application of their analogical syllogistics might lead to injustice. This was particularly so because the conclusion of their *qiyās* depended critically on the *'illa* (cogent reason); and this was more of a reason in the logical sense (*ratio*), rather than a cause in the ontological sense (*causa*), or *hikma*.<sup>10</sup> In his celebrated *Muqaddimah* (p. 26), Ibn Khaldūn (d. 808/1406) gave an incisive re-statement of the logical hazards of this classical method:<sup>11</sup>

“Analogical reasoning (*Qiyās*) and comparison are well known to human nature. They are not safe from error. Together with forgetfulness and negligence, they sway man from his purpose and divert him from his goal. Often, someone who has learned a good deal of past history remains unaware of the changes that conditions have undergone . . . .”

And in their pursuit of *tawhīdi* justice, the classical jurists invoked the material sources (especially the Qur'ān) and often exercised their analytical/speculative (as opposed to formal *Qiyās*) reasoning. In so doing – I think – they must have drawn on the concepts of the Mu'tazila theory of divine justice: namely, that Allah, being **necessarily** just, only wills what is morally

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<sup>9</sup> Hence *Ikhtilāf* and *Ijmā'* were considered in practice equally important, both epistemologically and morally. The former, *Ikhtilāf*, rested on the authority of Prophet Muhammad himself, according to *hadith*: “Difference of opinion within my community (*ummati*) is a sign of the grace/bounty of Allāh”; hence the juristic maxim: “*man lā ya'raf al-ikhtilāf lam yashumma rā'ihata 'l-fiqh*” (He/She who does not apprehend *Ikhtilāf* has not captured the true scent of jurisprudence.); quoted in Coulson (1969: 20-21). On this point see also Coulson (1969), ch. 2; and on the signification of *Ikhtilāf* and *Ijmā'*, see Schacht (1971) and Bernand (1986) respectively.

<sup>10</sup> On this point see Van Ess (1970: 27-39); see also Bernand (1986a) and Fleisch and Gardet (1986).

<sup>11</sup> Centuries later, this same epistemological hazard was noted by Sir Henry Maine (1887: 18), in his study of ancient law, who “observed that the application of analogy tends to infuse customs which may in their inception have been rational with non-rational elements”, says Udovitch (1970: 251). The original Arabic text of *Muqaddimah* was consulted, but the page reference in the text is to the abridged English translation listed in the references.

good (*hasan*), and that His motive in imposing the Law on His creatures is their welfare/benefit (*salah*).<sup>12</sup>

The first concept (*hasan*) was the root of *Istihṣān* (“seeking the most equitable solution”), the juristic method of the Hanafīs (who tended to be Mu’tazilis); the second (*salah*) was the root of *Istislāh* (“seeking the best solution for public welfare”) of the *Mālikīs*.<sup>13</sup> The Hanafī and *Mālikī* schools viewed their respective methods as a kind of *Qiyās Khaḥfī* (hidden analogy), considered them as subsidiary sources/roots, and often employed them when the solution issuing from formal *qiyās* entailed injustice or harm (*darar*), not the least in the area of economic dealings and business contracts.<sup>14</sup> And in spite of the idealist nature of their enterprise, the classical jurists also exhibited an acute understanding of their economic and business environment, one that enabled them to articulate the moral foundations and efficient legal institutions of a highly successful Islamic economy. This fact led the economic historian Abraham Udovitch (1970: 261), in a meticulous and well-reasoned study of those institutions, to conclude that:<sup>15</sup> “The prominence of the Muslim world in the trade of the early Middle Ages, if not attributable to, was certainly reinforced by the superiority and flexibility of the commercial techniques available to its merchants. Some of the institutions, practices and concepts already found fully developed in the Islamic legal sources of the late eighth century did not emerge in Europe until several centuries later.”

The preceding synopsis, which only highlights the nature of Shari’a, its principles, and how it came to be, is particularly important for recognizing that ill-conceived tendency among many Islamists to hypostatize Shari’a and separate it from its historical context, be it socio-economic, political, or technological. This tendency is evident in much of the body of literature designated as “Islamic Economics”: A vast body that is more accurately rendered – I think – as “*Mawdūdī-nomics*”, in view of the defining influence of the activist/scholar Abu’l-A’la Mawdūdī (d.1979), the founder of Pakistan’s Islamist movement Jama’at-e-Islami and the first to articulate the doctrine that continues to dominate this literature; as such he is considered the intellectual

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<sup>12</sup> On the centrality of these two concepts in the *Mu’tazila* theory, see Gimaret (1993: 790-791). Applied by the main schools, this juristic approach was the hallmark of the Hanafīs, especially in dealing with conflicts between *Qiyās* and economic imperatives. The term *tawhīdī* is used here in its Kalāmī sense, *’Ilm al-Tawhīd* (Science of Unity) being synonymous with *Kalām*, Islam’s philosophical theology.

<sup>13</sup> For a good overview of these juristic methods, see Paret (1990) and Khadduri (1991).

<sup>14</sup> They also invoked their formalist technique of *Hiyal* (Legal devices) as well as a Quranic doctrine of *Darūra* (necessity); for an overview, see Schacht (1986b) and Linant De Bellefonds (1983), respectively.

<sup>15</sup> Besides Udovitch study, which draws on his earlier work, see also Lieber (1968).

progenitor of its contributors.<sup>16</sup> The above-mentioned tendency is no more evident than in the wholesale adoption by (what I will call) “*Mawdūdi-conomists*” of the doctrine of Riba as a pivotal principle in their prescriptive paradigm of the Islamic economy.

In this study, I attempt to sketch out a verbal “model” of the “classical” economy of historical Islam, one that assembles what is known of its basic “building blocks” in a coherent system that highlights its moral and legal philosophy, and encapsulates its fundamental principles and “laws of motion” in theory as well as its *modus operandi* in practice.<sup>17</sup> In the process the broad lines of this model are juxtaposed to the revivalist views and doctrines espoused by “*Mawdūdi-conomists*”. In implementing this objective – besides the introduction – the paper consists of four other sections. In section II, Islam’s work ethic of “legitimate/justified gain” is expounded to reveal a doctrine of economic justice that underpins the juristic effort of the classical jurists. This doctrine is employed in section III, “The Shari’a Market Model”, to delineate/typify the economic structure of classical *Sūqs*, their moral/social embeddedness, their legal framework, and their operational and policy institutions. Section IV then addresses the microeconomic institutions of business association and financing as well as the macroeconomic conduits of financial intermediation between savers and investors. Finally, in Section V, the paper ends with a perspectival summary and concluding remarks regarding the nature of the socio-economic system typified here.

## II. Economic Morality and the Classical Doctrine of Riba

In their pursuit of *tawhīdi* justice and good, the classical jurists found in their material sources (Qur’an and Sunna) a divine sanction for economic activity and the work ethic in general.<sup>18</sup> They also found persistent exhortation for fair and just economic exchange.<sup>19</sup> On this basis, they formulated a meritorious doctrine of economic justice as fairness in economic dealings.<sup>20</sup> This doctrine

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<sup>16</sup> On *Mawdūdi*, see Robinson (1991) and Nasr (1986); and for a critical examination of the literature on “Islamic Economics”, see Kuran (1995), Kuran (1989), and Pryor (1985).

<sup>17</sup> The economic history of classical Islam is yet to be written, yet enough is already known to warrant the present attempt at theorizing. For an overview of the state of historical research, see Bosworth *et al.* (2000: 469-475), especially their Bibliography section.

<sup>18</sup> This basic point, an old object of contention in Orientalist literature, was examined and conclusively affirmed in recent scholarship, notably by Rodinson (1978), especially chs. 2-4.

<sup>19</sup> For a review and critical assessment of the literature on economic justice, see Kuran (1989) and Rodinson (1978), ch. 2; and on Islam’s classical moral theory in general, see Walzer and Gibb (1986). Refer also to notes (20), (22) and (37) below.

<sup>20</sup> This doctrine is complemented by another doctrine of “distributive justice” that rests on the Quranic concepts of *Sadaqa* and *Zakāt*, a complementarity that is highlighted by their juxtaposition in the Quranic verses II: 276-277; on *Sadaqa* and *Zakāt*, see the overviews by Weir and Zysow (1995) and Zysow (2002) respectively. For a brief exposition of the modern concepts

rests on two fundamental maxims: (1) The avoidance of *Gharar* (unjustified *jahl* or absence of necessary knowledge). (2) The avoidance of “unjustified enrichment” (*fadl māl bilā ’iwad*).

**(a) Gharar:** Intended essentially for obviating the possibility that a party to exchange gains an unfair advantage over the other (*Ghubn*), due to a lack of necessary information, the prohibition of *Gharar* was sanctioned by *ijmā’*: But the jurists disagreed over the content and nature of this necessary knowledge, the conditions for securing it, and the implications of their respective views to various types of sale contracts and practices. Their disagreements centered mainly on questions regarding the actual existence of the exchanged countervalues at contracting time, the actual control of the parties over those countervalues, the quantum and specification of the countervalues (precisely expressed in a genus/differentia pattern), and the question of future performance of exchange dealings as regards the risks and uncertainties involved.<sup>21</sup> Viewed in its totality, the idealized world of the classical jurists ensures a complete knowledge (of exchanged objects), one that negates avoidable risks and uncertainties (hence potential deceptions) regarding performance. As such, their world – it seems – is akin to the perfect-knowledge and perfect-foresight requirements of perfect competition, the central concept of the idealized market system of modern economics (explained below). In both worlds the community’s economic welfare is sought, notwithstanding the difference in their respective moral justification.

**(b) Unjustified Enrichment and Riba:** The prohibition of *Gharar* eliminates a significant source of unjustified advantage or enrichment. And *Riba*, generically understood, is every kind of excess or unjustified disparity between the exchanged objects or countervalues, essentially any kind of unjustified gain, a source of unjustified enrichment.<sup>22</sup> As such, in its specific sense, *Riba* assumes two different types: (1) *Riba al-Fadl*, and (2) *Riba al-Nasī’a*, according to the classical jurists.<sup>23</sup>

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of distributive economic justice and economic justice in general, see Phelps (1987) and Sen (1987) respectively; and on justice as fairness (and the related economic concept of “equity” as absence of “envy”), see Rawls (1971) and Hammond (1987); and on the structure of the modern theory of justice (and moral theory) in general, see Frankena (1973) and the textbook treatment Miller (1987), chs. 16-19 and 22.

<sup>21</sup> On the doctrine of *Gharar* and the syllogistic differences among the main jurists of Sunni schools, see Saleh (1986), ch. 3; and on the modern economic concepts of “risk” and “uncertainty”, see Machina and Rothschild (1987) and Hammond (1987a) respectively.

<sup>22</sup> On the jurists generic meaning of *Riba* as “unjustified enrichment” (*fadl māl bilā ’iwad*), a fundamental criterion of economic injustice/inequity (*Zulm*), and on its Quranic (e.g. IV: 161 and II: 279) and *Hadīth* basis, see Schacht (1964: 145-146) and al-Fanjari (1979: 154-155); and on *Zulm* and *’Adl*, see Badry and Lewis (2002) and Tyan (1960a) respectively.

<sup>23</sup> For a brief history of this classification, see al-Fanjari (1979: 155-156) and Saleh (1986: 13-14); and for an overview of the doctrine, see Schacht (1995a) and Rahman (1964).

The first type is also called “Sale riba” (*Buyū`*) because it is occasioned by a sale or exchange transaction, and is again called Sunna riba because its prohibition is regulated principally by Traditions of the Prophet. According to these Traditions, in bartering certain goods, the exchange of articles of the “same species” (*naw`*) is legitimate when the exchanged countervalues are quantitatively equal, and their delivery is not deferred.<sup>24</sup> The violation of this rule produces riba, an illegitimate or illicit excess or gain. The Traditions named only six goods (consisting of two types of precious metals, gold and silver; and four types of foodstuffs, wheat, barley, dates, and salt); and the jurists exercised their analogical syllogistics to extend the umbrella of the rule’s applicability, but disagreed in specifying the *’illa* (cogent reason), the distinguishing attributes of these particular goods. The rigor and complexities of their syllogistic differences and conclusions are compounded by their disagreements in defining the genus/species configurations (and their concrete content in each case) as well as the affinity of these differences with their variant views on *Riba*.<sup>25</sup>

**(c) Riba and Interest:** Called *Nasi`a* by the classical jurists, the second type of Riba is occasioned by deferring the delivery of a countervalue, regardless of whether the exchanged object is within or without the same species of the countervalue, and whether it does or does not generate *fadl* (gain/disparity). If the *Nasi`a* transaction stipulates a gain manifestly, this gain is an “Explicit (*Jali*) Riba”, in effect a loan interest.<sup>26</sup> The latter is also called Quranic riba because the classical jurists reached a “consensus” (*ijma`*) that the Qur`an prohibited it. It is noteworthy, however, that this type of Riba is addressed in a number of Quranic verses; and given the accepted/traditional interpretation of these verses, the Quranic position ranges from acceptance to prohibition.<sup>27</sup> The consensus prohibition by the jurists was only a consequence of their doctrine of abrogation (*naskh*).<sup>28</sup> Based on the chronology of revelation, their juristic technique (and its

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<sup>24</sup> There seems to be some disagreement on whether the category involved is “species” (*naw`*) or “genus” (*jins*). The literature in English employs “species”; see for instance Coulson (1978: 79), Saleh (1986: 13), and Schacht (1964: 145). In Arabic, however, al-Fanjari (1979: 158-159) argues for employing the term *jins*. The main *hadith* text, which he quotes (p. 156), is consistent with both – I think – although the term used is only the plural of “genus” (*’ajnās*).

<sup>25</sup> The intricacies of these differences are catalogued (in English) by Saleh (1986), ch. 1, but only for the Sunni schools; see also al-Fanjari (1979).

<sup>26</sup> This is in contrast with the *fadl/Buyū` riba*, which is characterized as *Riba Khaft* (hidden) and is occasioned by a sale/exchange transaction; see al-Fanjari (1979: 156).

<sup>27</sup> Chronologically arranged according to “traditional dating”, these verses are: XXX: 39 (Meccan); IV: 161, III: 130, and II: 275-279 (Medinan). For a brief overview of the scholarship on dating techniques and criticism, both “traditional” and European, see Welch and Pearson (1986: 415-419).

<sup>28</sup> For an overview of the doctrine and techniques of *Naskh*, see Burton (1993) and Hallaq (1997: 68-74).



application in this case), although sanctioned by *ijma'*, is open to question, for it implicitly assumes a paradoxical and unsatisfactory theology regarding the nature of God and His Law, a fact that seems to be lost on or overlooked by modern scholars.

All pre-modern jurists advocate the prohibition against loan interest: To them, the only licit loan is an interest-free loan, this being either *Qard Hassan*, a loan of fungible objects (notably money), or *'Āriyya*, a usufruct (*manfa'a*) loan of non-fungible objects.<sup>29</sup> They disagreed, however, on the scope and licitness of other types of Riba. They also employed their subsidiary methods of *Istihsān* and *Istislāh* to accommodate economic and business imperatives. And towards this accommodation, the jurists, especially the Hanafis, went further and produced treatises and manuals of legal devices (*Hiyal*) to circumvent the prohibition's deleterious effect on the economy. Modern Muslim jurists tend to reject the *Hiyal*, but disagree on the licitness of loan interest. As well, modern Muslim economists disagree on the prohibition: Muslim secularists and Islamic modernists reject the entire doctrine of Riba. In this they are vehemently opposed by *Mawdūdi-conomists*, who have been influential in the Islamic banking movement. In the interest of clarity – in what follows – I will continue employing the term **Riba** (with capital “R”) to signify the generic moral meaning of the term, a principle/essence of economic inequity, and the term **riba** (with small “r”) to signify a species of the genus *Riba*, notably loan interest (as estimated by the classical jurists).

### III. The Shari'a Market Model

The idealist world-view of the classical jurists is particularly evident in their distinctively Islamic vision of the market. Perhaps it is illustrated best by the previously stated maxim:<sup>30</sup> “Let the *sūk* [market] of this world below do no injury to the *sūks* of the Hereafter, and the *sūks* of the Hereafter are the mosques”, the abode of *tawhīd-qua-harmony*. Rendered by Abu Hamid al-Ghazali (d.505/1111), the great jurist/theologian (and anti-falsafa philosopher), this maxim is an apt representation of the Quranic view of social and economic transactions (*Mu'āmalāt*) of *al-Umma* (the Islamic Gemeinschaft):<sup>31</sup> That is, a

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<sup>29</sup> On the juristic elaborations of this position (and its variations among the Sunni schools) towards loans (*Qard*), see Saleh (1986), ch. 2.

<sup>30</sup> Quoted in Bianquis *et al.* (1997: 787); the quotation originates from the celebrated *Ihyā' 'ulūm al-Dīn*, Cairo 1326, ii, pp. 48ff., by al-Ghazālī. On al-Ghazālī and his immense and varied contributions, see Watt (1983).

<sup>31</sup> For an overview of the juristic signification of *Mu'āmalāt vis à vis 'Ibadāt* (worshiper's rituals and duties), and the classical “juristic philosophies” (*Kalām Fiqhī*), see Bernand (1993). The Quranic concept of *al-Umma* is akin to the concept of “community” (*Gemeinschaft*) articulated by Tonnies (1940: 37-39). Often misunderstood by modern writers, *Al-Umma* is a technical term which refers to the Islamic Community as defined by *sunnah*, the traditions of the Prophet. In particular, it is defined in *al-Sahīfah*, the Constitution of Medina, to include the Muslims,

consensual, free, and moral exchange, one that would establish the necessary conditions not only for a prosperous life, but also for “social harmony” and spiritual attainment (Qur`ān, IV: 29).<sup>32</sup> Ghazālī’s worldly *sūqs* are morally and “socially embedded” à la Polanyi; they provide the fora for a moral economic exchange that was carefully analyzed and systematized by the classical jurists.<sup>33</sup>

**(a) The Bay’ Model of Exchange:** Translated “Sale”, in fact *Bay’* is a normative Quranic concept which is divinely juxtaposed to “unjustified enrichment” (Qur`ān, II: 275). The classical jurists saw it as such, and developed the Bay’ contract with so much thought and sophistication that it became “the core of the Islamic law of obligations”.<sup>34</sup> Indeed, it was viewed as a paradigm of various types of contracts, including the marriage contract, not to mention the “implicit contract” between the believer and Allah as well as the “social contract” between the Umma and the Caliph (*Bay’ā*).<sup>35</sup> Asked: “How is it that you have not written anything concerning . . . *Zuhd* (ascetism)?”, Muhammad al-Shaybānī (d.189/805) answered: “I have already composed the Book of Sale” (*Bay’*).<sup>36</sup> What the great architect of Hanafi law meant was that the best way of seeking God is not by the hermetic abandonment of the community’s material life, but rather by seeking a good livelihood and opportunity for one’s family (within the community), and above all according to the law.

This socio-economic philosophy of *tawhīd-qua-harmony* – which imbues basic Quranic concepts and injunction – underpins the jurists’ careful analysis and meticulous articulation of the *Bay’* contract and the law of sale in general.<sup>37</sup> First, sale has to meet their procedural theory of justice by minimizing, if not

Christians, Jews, and pagans who agreed to its provisions with the prophet in the two *bay’ās* (constitutional conferences) of *‘Aqabah*. Amended after the Immigration, the *Sahifah* was preserved by Ibn Ishaq, a biographer of the Prophet, and consists of 47 provisions which regulate the rights and duties of the various constituencies. See Watt (1956), ch. 7, for an English translation of the Arabic document, its signification, and historical context.

<sup>32</sup> For a summary of the Islamic vision of moral exchange (in Qur`an, Sunna, and ethical works), see Bosworth *et al* (2000: 466-469) and Bernand (1993). Refer also to notes (37) below, and (19), (20), and (22) above.

<sup>33</sup> On Polanyi’s concept, see Polanyi *et al.* (1957), notably ch. 13, his article “The Economy as Instituted Process”.

<sup>34</sup> Schacht (1964: 151-154) and Schacht (1986a).

<sup>35</sup> On marriage in the Classical Islamic law, see Schacht (1995); and on *Bay’ā*, see Tyan (1960).

<sup>36</sup> Quoted in Udovitch (1985: 459). On *al-Shaybānī*, see Chaumont (1997), and on *Zuhd*, see Gobillot (2002).

<sup>37</sup> The Islamic pursuit of harmony is evident in the concept of *Umma* as Community guided by the ideals of justice, *fraternité* and cooperation; as it is evident in the institutions of *Zakat* and *Sadaqa* which cement those ideals (refer to notes 19, 20, 22 and 31 above). The same pursuit of harmony again manifests itself in the juristic doctrines of *Ijmā’* and *Ikhtilaf* (explained above) as well as the rendering of *Kalām* (Islam’s philosophical theology) as *‘Ilm al-Tawhīd*, “The Science of Unity” (see Gardet, 1986).

eliminating, “unjustified enrichment”. As such, it has to be *Gharar*-free and *Riba*-free. In fact, the classical doctrines of *Gharar* and *Riba* were developed in conjunction with the jurists’ theory of sale.<sup>38</sup> In addition, the exchange process itself has to be genuinely consensual, fair, and endowed with safeguards and mechanisms to ensure these requirements.<sup>39</sup> All in all, in the ideal world of the classical jurists, the sale conditions, process, and contract ought to minimize, if not obviate, legal dispute and inequity among the parties, thereby enhancing overall social harmony, and in the process create the necessary conditions for the good of community members *à la* Shaybānī.

The classical jurists recognized however that their *Bay’* was an ideal prototype; and they were fully aware of the substantial transaction cost of its procedures, as well as the immense information cost the doctrines of *Gharar* and *Riba* entailed. With this awareness they exhibited a profound appreciation and acute understanding of the productive aspects of the “practices and customs/conventions” (*‘ādāt* and *‘urf*) of the business community, its “implicit contracts”, an area that modern economics has begun to analyze and fathom only recently.<sup>40</sup> They deployed their juristic method of *Qiyās* to accommodate and regulate the economic and business facts of life; and when *Qiyās* failed to comprehend the necessary facts, they resorted to *Istihsān*, *Istislāh*, *darūra*, and *Hiyal*. A case in point, they went against their ideal rules of evidence and accepted the necessity of written sale contracts to the functioning of a complex, vibrant and large economy. Again, guided by their *Bay’* prototype, they developed or Islamicized a variety of practical contractual instruments which suited the complexities of economic life, albeit with the necessary informational and procedural safeguards for protecting the exchange parties and the community at large.

Among the above-mentioned instruments, the following variants of the *Bay’* contract stood out:<sup>41</sup> (1) ***Salam Bay’***, a sale that involves immediate payment, but deferred delivery; (2) ***Nasi’a Bay’***, a sale that involves immediate delivery but deferred payment; (3) ***Bay’al-’Ina***, a sale on credit; (4) ***Bay’Juzāf***, a sale whereby the good or/and price are assessed by mere viewing; (5) ***Murābaha***, a form of cost-plus resale with a specified “fair/normal” profit margin; (6) <sup>*Istisnā’*</sup>, a form of *salam* contract used for commissioning the production of

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<sup>38</sup> On this point, see Schacht (1995a: 493) and Saleh (1986: 50-52).

<sup>39</sup> See Schacht (1964), ch. 21 especially pp. 151-155; Schacht (1986a), and Udovitch (1985: 448-460).

<sup>40</sup> See Coulson (1969), ch. 4, and on *‘urf* and *‘Ādāt*, see Libson and Stewart (2000) and Bousquet (1986) respectively; see also Udovitch (1985). On the modern economic theory of contracts, see Azariadis (1987), art (1987) and Lazar (1987).

<sup>41</sup> On the details of these variants, see Saleh (1986), chs. 3-4, Udovitch (1970), chs. 4-6, and Schacht (1986a).

manufactured goods; (7) *Ijāra*, a hire/lease contract, construed as sale of usufruct (*manfa'a*); and (8) *sarf*, a currency exchange contract.

It is noteworthy that many of these contractual arrangements have been recently reworked, and extensively used by Mawdūdī-conomists in the theory and practice of modern Islamic banking, along with the classical contracts of business association (treated below).

**(b) The Classical *Sūq*:** Long before Ghazālī's time, the Islamic city planner did perceive and take his maxim seriously.<sup>42</sup> They located in the center of their city plan the great *Jami'* (academy mosque), that great "*Sūq* (market) of the Hereafter", where the jurists dwelled, taught, practiced and reflected on the Law. Next to the *Jami'* was *Dar al-Imāra* (House of the Government), the abode of Caliphal authority and guardian of the Law: A kind of "political *sūq*", where the democratic transactions of *Shūra* and *Bay'ā* should take place,<sup>43</sup> and one that Ghazālī was painfully aware of, but did not include in the maxim.<sup>44</sup> Thus socially and morally embedded, the "political *sūq*" along with the "Hereafter *sūq*" were both physically encircled by the (likewise embedded) "worldly *sūq*" according to a geometrical pattern, wherein the city's economic function – as producer of wealth and facilitator of exchange (both local and beyond) – was centered. In this pattern, the city's thoroughfares emanated from the central circle (towards the gates) and accommodated the bookmakers, merchants, financiers, currency-changers, manufacturers, etc., whose degree of proximity to the center reflected their intellectual, economic, and environmental priority to the city's welfare.<sup>45</sup>

In addition to these "linear *sūqs*", the pattern included the great conglomerations (variously called *Khan*, *Qaysariya*, *Wakala*, *Funduq*, etc.) which facilitated inter-city and international trade.<sup>46</sup>

According to our current state of knowledge, those classical *sūqs* functioned efficiently, and served their cities and the larger Community well.<sup>47</sup> In

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<sup>42</sup> On the Islamic city planning and constitution, see for instance the studies in Hourani and Stern (1970), Von Grunebaum (1961), and Bonine (1976).

<sup>43</sup> On the traditional signification of *Bay'ā* see Tyan (1960), and on *Shūra* and *Mashwara*, see Bosworth *et al.* (1997) and Lewis (1990), respectively.

<sup>44</sup> On al-Ghazālī and the tumultuous religio-political climate of his time (including the *Sūfi* ascendancy and a Batinite threat), see Watt (1983), Watt (1987), ch. 13, and Van Ess (1970: 47-50).

<sup>45</sup> This typification is based on the references in note (42), and that given by Bianquis *et al.* (1997: 788-789). The model continued to exist in a modernized form in parts of the Muslim World, notably Morocco; see for instance the meticulous ethnographic study of Sefrou by Geertz (1979), who gives a detailed account of its evolution during the 20<sup>th</sup> Century, with emphasis on the *sūq*'s cultural/social embeddedness.

<sup>46</sup> On the institutional and architectural aspects of these conglomerations, see Streck (1990), Elisséef (1990), and LeTourneau (1983).

performing their economic function, they varied in their objects of exchange and scale of operations in such a manner that reflected the occupational structures of the commercial, industrial, and agricultural sectors of the economy. As such, they are classified into three types: (1) The weekly and daily *sūqs*, held inside the city's districts and outside its walls, for supplying fresh foodstuffs and other locally produced products; (2) The central *sūq* (near the great mosque), which operated permanently supplying in larger quantities a great variety of products, largely of greater value and luxurious vintage, that were mostly imported from other regional *sūqs*; and (3) A yearly or seasonal *sūq*, a sort of international trade fair, for the diffusion of manufactured, imported, and transit products, accommodated in the above-mentioned conglomerations.<sup>48</sup>

**(c) The Market and the State:** Again, given the jurists' moral philosophy of socioeconomic harmony, the system of *sūqs* caricatured above had to be "socially/morally embedded" à la Polanyi: In effect, a "microcosm" of the larger society it inhabited and functioned in.<sup>49</sup> As such, the operation, economic transactions, and terms of trade set in the classical *sūqs* had to abide by the precepts of the jurists' doctrine of economic justice as fairness with its twin maxims: the avoidance of *Gharar* (unjustified absence of knowledge) and the avoidance of *Riba* (unjustified gain, any advantage without equivalent countervalue). And logically this brought to the fore the weighty economic questions of price formation and "fair" pricing in these *sūqs*, a subject that received considerable juristic attention and thought.

Prophet Muhammad is reported to have rejected (during an episode of severe food shortage) price fixing, on grounds of justice: "The *Musa'ir* (He who sets prices) is Allah", said the wise Prophet, with his first-hand knowledge and understanding of the workings of markets (both local and international) as a merchant.<sup>50</sup> Naturally, this doctrine of a divine "Invisible Hand", to borrow a Smithonian metaphor, was accepted – in principle – by the classical jurists, for it was compatible with the above-mentioned Quranic ideal of a free, consensual, fair, and ultimately harmonious exchange, the central principle of their *Gharar-*

<sup>47</sup> For a literature review, see Bianquis *et al.* (1997), Bosworth *et al.* (2000), and Rodinson (1978: 33-35).

<sup>48</sup> On this point, see for instance Bosworth *et al.* (2000: 471ff).

<sup>49</sup> Udovitch (1985: 459) restates Polanyi's economic/anthropological concept of "social embeddedness" by concluding that the classical jurists saw in the *sūq* "a kind of microcosm of society as a whole and the religious and ethical values by which it was supposed to live." Udovitch does not refer to Polanyi but is ostensibly influenced by the work of the cultural/economic anthropologist Geertz (1979, 1983) which motivated his own study. In his Moroccan study, Geertz (1979) does not use Polanyi's term, but does illustrate it thoroughly, and states that: "if one is going to indulge in ['characterizing whole civilizations in terms of one of their leading institutions'] it is for the Middle East and North Africa the bazaar . . ." (p. 123).

<sup>50</sup> On this part of the Prophet's career, see the meticulous work of Watt (1953: 33-39). This *hadith* is quoted in Izzi Dien (2000: 358) and Bosworth *et al.* (2000: 467).

free and *Riba-free Bay'* model: A model – it is recalled – that insists on clear, detailed, and near perfect information (on the objects and terms of exchange) in order to preclude the possibility of “unjustified enrichment” (*Riba*) due to *jahl* (lack of information).<sup>51</sup> And, as I hinted earlier, this *Bay'* type of economic operation and trading is akin to a divinely inspired world of “perfect competition”, the “ideal type” of modern economics, which was justified by the moral theory of Adam Smith and his “invisible hand” (resting on self-interest and competitive markets).<sup>52</sup>

In this regard, it is again recalled that – in enjoining consensual exchange (*tijāra*) – the *Qur`ān* (II: 275, IV: 29) juxtaposes *bay'*, the ideal type of fair exchange, with *riba* [*Buyū'*], which is castigated as iniquity, and classed as *harām* (forbidden). Analyzed by classical jurists,<sup>53</sup> this essential Quranic categorization of consensual exchange/trade into *bay'* and *riba* reveals – I think – an affinity to another Quranic distinction: namely, between *Ribh/Kasb* (justified/earned gain) and *Riba* (unjustified/excessive gain).<sup>54</sup> The latter distinction is akin to a fundamental one made in modern economics between “normal profit” and “abnormal/economic profit”: The former obtains under competitive market conditions, while the latter – an “excess” beyond the “normal” – is obtained and maintained (through market power) under monopolistic conditions. Being the basis of fair-pricing in modern regulation theory, the “normal/fair” profit concept was also critical to the licitness of various species of classical *bay'* transactions in general and the *murābaha* contract in particular.<sup>55</sup> And it appears (from what is known) that the socially

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<sup>51</sup> Udovitch (1985: 451) highlights this critical role of information stating that: “This compulsion for ‘knowing’ and this abhorrence for ‘ignorance’ in economic exchange is both a requirement of Islamic law, an inherent principle. . . , and a reflection of the day-to-day transactions in the market place.”

<sup>52</sup> On Smith’s invisible hand in relation to his moral theory of “self-love” and free, competitive markets, see Vaughn (1987); and on their elaboration in the development of the concept of perfect competition and perfectly competitive markets in relation to socio-economic efficiency/welfare in modern economics, see Stigler (1987), Khan (1987), and Roberts (1987).

<sup>53</sup> This was done for instance by the great Hanafi jurist al-Sarakhsī (d.483/1095) in his celebrated *Mabsūt*, Vol. VII, which is quoted on this point in Udovitch (1985: 459). On Sarakhsī, see Calder (1997).

<sup>54</sup> The term *Ribh* (in verbal form) occurs only once (II: 16) in the *Qur`ān*; but the cognates of *Kasb* pervades its text, according to the verse listing (*al-Mu`jam*) of Abdel-Baqi (1945: pp. 604-605). On *Kasb* and its signification, see Cahen and Garden (1990). On the meaning and role of normal/abnormal profit in modern economics, see Desai (1987).

<sup>55</sup> Based on cost-plus pricing, the *Murābaha* fixed-profit premium (and implicit cost elements) had to be imputed in the light of *urf al-tujjar*, literally the prevailing/known practices of merchants, what amount to an opportunity-cost imputation of “normal/fair profit”. On this point, see Udovitch (1985: 452-458), and Saleh (1986: 94-97). On the signification in modern economics of the notion of just/fair price, and the juxtaposition between competitive and monopolistic conditions, see Friedman (1987) and Roberts (1987), respectively.

embedded *fora* of these transactions, the three categories of classical *sūqs* typified above, had functioned efficiently and competitively (with their prices reflecting market forces) enough to give rise to the superior economy of classical Islam.<sup>56</sup>

It has to be recognized, however, that the superior performance of this economy was not because the behaviour of economic agents was Gharar-free and Riba-free by inclination, an assumption that is often made by Mawdūdī-economists in their work, and aptly construed as *Homo Islamicus*.<sup>57</sup> In fact, the thorough system of legal mechanisms and procedural safeguards, which the classical jurists structured in their sale contracts, assumed that the contracting parties were not inherently *Homo Islamicus*. And the great Ghazālī remarked that ninety percent of his contemporaries – to whom he was addressing his maxim, I assume – did “let the *sūq* of this world do injury to the *sūqs* of the Hereafter”, to use his phrase.<sup>58</sup>

Ghazālī’s observation and the previous information on the structure of classical *sūqs* suggest then that the superior performance of the classical Islamic economy is explainable by its efficient and competitive “worldly *sūqs*”. But to this, one must add the jurists and “political *sūqs*” which endowed that economy with its viable legal/institutional framework and competent economic governance.

Being part of the classical doctrine of Islamic government, this point was elegantly and insightfully expressed – in a law-like manner – by a later historian/jurist, the famed Ibn Khaldūn (d. 808/1406), in his *Muqaddimah* (p. 23):

“Dynasty and government serve as the world’s marketplace (*sūq*), attracting to it the products of scholarship and craftsmanship alike . . . Whatever is in demand in this market is in general demand everywhere else. Now, whenever the established dynasty avoids injustice . . ., the wares on its market are as pure silver and fine gold. However, when it is influenced by selfish interests and rivalries, or swayed by vendors of tyranny and dishonesty, the wares of its marketplace become as dross and debased metals.”

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<sup>56</sup> On the “stylized” pattern and movements of those prices, see Bosworth *et al.* (2000: 472), who also note (p.469) that these patterns and movements were observed and analyzed by Muslim theorists such as al-Dimashqī; and Ibn Khaldūn (1974: 276-278) in particular analyzed the pattern of prices and their movements (implicitly) using a model not unlike that of modern economics, over six centuries ago. On the superior economy of classical Islam and its business institutions, see Udovitch (1970), especially ch. VII.

<sup>57</sup> On the prevalence of this assumption in *Mawdūdī-nomics*, see Kuran (1995: 159-160). This type is ostensibly constructed in juxtaposition to that of *Homo Oeconomicus* of modern economics; and on the latter, see Hargreaves-Heap and Hollis (1987).

<sup>58</sup> This estimate, which is made via a parable in Ghazālī’s *Ihyā’*, is given in Rodinson (1978: 112).

A case in point is the institution of the *Muhtasib*, an important element in the matrix of Islamic economic governance. An Islamicized outgrowth of the institution of *'Amil al- Sūq* (The Market Inspector) – which existed in the Prophet's era and received his sanction (according to traditional sources)<sup>59</sup> – the classical *Muhtasib* was a judicial office with a much wider mandate.<sup>60</sup> The mandate covered the broad area of public morality and health, but economic morality figured steadily and prominently in it.<sup>61</sup>

The classical *Muhtasib* was responsible for checking weights, measures, and currencies, investigating and dealing with fraud and generally unlawful market practices, including illicit speculation and misleading information. In effect, the *Muhtasib* was in charge of what is now called fair trade and competition policy.<sup>62</sup> Appointed by, and accountable to the *Qādi* (the judiciary), the *Muhtasib*'s moral and technical qualifications were enormous.

The jurists prepared specialized manuals to facilitate the task, and the *Muhtasib* depended on trustworthy associates (*'Arif/Amīn*) who were recruited for their expertise in the various branches of industry.<sup>63</sup> The producers of manufactured goods (*sunnā'*: artisans) were highly organized in “guilds” (professional corporations) with a potential for exercising monopoly power, and the specialized associates paid attention to their quality standards and pricing practices for good effect.<sup>64</sup>

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<sup>59</sup> It is reported that – upon entering Mecca – the Prophet appointed Sa'īd b.al-'Ās to serve as Mecca's *'Amil 'alā al-Sūq*; meanwhile in his city state of Medina, women also served as *'Amila 'alā al-Sūq*; see *Bianquis et al.* (1997: 787).

<sup>60</sup> Called also *Sāhib al-Sūq* and *Wāli al-Sūq*, the institution was renamed about the time of Caliph al-Ma'mūn (d. 218/833), as part of the Islamicization process engineered by the Mu'tazila school under the 'Abbasīd. However, the old name continued in the *Maghrib* and Spain as they remained under *Ummayyad* rule.

<sup>61</sup> The expanded mandate was justified by the Quranic verse 9:71 (variations of which are given in 7:157, 31:17, 9:112, and 22:41) and although the terms *Hisba/Muhtasib* do not occur in the Qur'ān, the cognates of these terms, which connote accounting/calculation, recur repeatedly; see the verse listing of Abdel-Baqi (1945: 200-201) *Mu'jam*. For a brief history of this evolution, see Cahen *et al.* (1986: 487).

<sup>62</sup> On the economic mandate of the classical *Muhtasib*, see Cahen *et al.* (1986: 487-488) and Ghabin (1987: 628). This mandate varied somewhat under different dynasties, but a core economic mandate was remarkably stable, as was shown in an anthropological study by Geertz (1979) of a 20<sup>th</sup> Century Moroccan case (pp. 182-197, and note 12). On competition policy in modern economics, see Hughes (1987) and Williamson (1987).

<sup>63</sup> On the legal status and qualifications of the classical *Muhtasib* and his associates, see Cahen (1986: 487-488).

<sup>64</sup> For an overview of the artisans and their “professional corporations”, see Ghabin (1997) and Raymond *et al.* (1997).



To perform this mandate of economic morality effectively, the Muhtasib's offices were located in the city's central market, nearing Dar al-Imāra (the "political *sūq*") and the great mosque (the Hereafter *sūq*). And judging by the known results, it appears that the state's "visible hand", Smith's "invisible hand", and the Prophet's "divine hand" worked well, hand in hand.

#### IV. Business Association and Finance

Effective operation of any economy is predicated on the availability of efficient and flexible economic institutions: Institutions that facilitate the collaboration between workers and employers, between labor and capital, and between savers and investors, as it does generally between buyers and sellers. In the previously sketched market economy of classical Islam, those institutions were developed (or Islamicized) from current and pre-Islamic material, thoughtfully analyzed, and rigorously formulated and systematized by the jurists (with a view to obviate Riba and Gharar). But again the classical jurists disagreed on the particular formulations of those institutions, and – in making them licit – they often suspended Qiyās, and invoked their subsidiary methods of *Istihsān* or *Istislāh*, and innovated *hiyal* (legal devices) to accommodate economic and business imperatives. The Hanafis in particular exhibited an insightful understanding of those imperatives, and their formulations were often economically superior to the other schools as the above-cited work of Udovitch (1970) has demonstrated. It is not surprising therefore that the Hanafi doctrine was later adopted by the Ottoman empire to become the most widely accepted of the classical schools in the Islamic World. The following brief rendering of the main forms of business association relies primarily on the Hanafi formulations of those institutions.

**(a) Business Partnership and Capital:** In facilitating the collaboration between human and financial/capital resources, the classical Islamic economy had at its disposal three basic forms of business association (*Sharikāt*: companies): *Mufāwada*, *Inān*, and *Mudārabā/Qirād*, which were rigorously analyzed and systematized by the jurists in theoretical treatises and practical manuals.<sup>65</sup> All based on a principle of "fidelity" (*'Aqd Amāna*), these partnerships varied in their characteristics as regards each partner's "agency powers" (*Wakāla*) and "surety" (*Kafāla*), as well as the scope and nature of investment (capital) shares, profit/risk distribution, and authorized business activities.<sup>66</sup> Their differentiation endowed them with varied configurations which accorded with the particular needs of different sectors of the economy.

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<sup>65</sup> On the nature and signification of *Sharikat*, and their categories, see Izzi Dien (1997), Latham (1993), Udovitch (1970), ch. II, and Schacht (1964), ch. 21.

<sup>66</sup> This generalization is based on detailed review of a variety of sources, notably Udovitch (1970) and Saleh (1986), ch. 4.

The **Hanafi Mufāwada** is characterized as an “unlimited” investment partnership with full powers of **mutual** “agency” and “surety” among the partners, who also have to be “equal” in wealth and freedom of action (among other things).<sup>67</sup> Consequently, the partners share profit and loss equally, and are equally and **mutually** liable in their business dealing with outside (third) parties. As such, the Hanafi *Mufawada* anticipates the modern concept of corporation, albeit with unlimited liability. The freedom of action includes each partner’s prerogative to independently enter *ʿInān* or *Mudāraba* partnerships with outside parties, and – with the other partner’s consent – *Mufāwada* partnerships as well: An interesting feature that enables the partners to expand the capital base, and diversify the operations of their enterprise.<sup>68</sup>

By contrast, the **Hanafi ʿInān** is a “restricted” form of investment partnership, albeit with unlimited liability like *Mufāwada*.<sup>69</sup> Unlike the latter’s, however, the *ʿInān* partner is merely a **mutual** agent (*Wakīl*), not a guarantor (*Kafīl*) of other partners. And, this mutual agency applies only to the scope of business operation specified in the partnership contract, which can either be a class of goods (*Khass*: specific) or all goods (*ʿAmm*: general). Moreover, the partner’s “equality” stipulation is restricted here to the area of legal competence. And yet, like *Mufāwada*, the *ʿInān* partner can invest in a *Mudārada* to further the interest of the enterprise.<sup>70</sup>

An interesting aspect of both *Mufāwada* and *ʿInān* was the complex and varied concept of ( what I will call) the company’s “common/corporate capital”, the *sharika’s māl* which is formed by *khalt*, “mingling” of the (possibly diverse) assets contributed by the partners.<sup>71</sup> Being the basis of profit/risk sharing among

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<sup>67</sup> Inadmissible on the basis of *Qiyās*, this Hanafī version was justified by *Istihṣān* reasoning, based on the Prophet who was reported to say: “Enter into partnerships by reciprocity (*fāwidū*), for it is most conducive to prosperity”; quoted in Udovitch (1970 p. 43). Besides Udovitch (1970), chs. III and V, see also Latham (1993) on the position of other schools. It is notable, that its principles and the Prophet’s term *fāwidū*, both conjure the Polanyi (1957) concept of “reciprocity”, especially as they base business association on *amāna* and *kafāla*.

<sup>68</sup> In this direction, the partners are also free to enter other types of business relations/contracts with outside parties, including *ʿAriyya* loans, deposits, pledges, and *Ibdāʿ*; see Udovitch (1970: 97-118). Described by Udovitch (1970: 101-104), *Ibdāʿ* was a common “informal commercial cooperation or Quasi-agency” whereby a business person authorizes another to take over part of his capital to perform a business task for him as a favour without return. Amounting to an informal *Mudāraba* (without a profit share), this common Islamic practice illustrates again Polanyi’s concept of “reciprocity” mentioned above.

<sup>69</sup> On the Hanafī *ʿInān*, see Udovitch (1970), ch. IV; and ch. V on the Māliki version. See also Saleh (1986: 92-94), on the positions of other schools.

<sup>70</sup> As in the case of *Mufāwada*, the *ʿInān* partner can engage in loan, deposit, pledge, and *Ibdāʿ* transactions, among others; Udovitch (1970: 139-140).

<sup>71</sup> On this defining notion of *Khalt*, see Izzi Dien (1997: 349) and Udovitch (1970: 51-64). I use the term “common/corporate capital” here to signify the outcome of *Khalt*, a concept that Udovitch (1970) variously calls “joint capital” (pp. 51-64) and “social capital” (p. 171). While

partners, this concept received a great deal of analysis and thought. The basic form of investment was made in gold and silver coins or/and bullion: And their lack of uniformity forced the jurists – in specifying the investment shares while abiding by the doctrines of *Riba* and *Gharar* – to explore notions of equivalence, an exploration that often revealed acute economic analysis.<sup>72</sup> Another form of “common/corporate capital” was skilled labor, the basis of labor cooperatives/partnerships (*Sharikāt al-Sanā`i`*), which were formed for producing manufactured goods. Again their juristic theorizing here reveals a concept of “human capital” that modern economics started to investigate only recently<sup>73</sup> Moreover, their juristic examination of credit cooperatives/partnerships (*Sharikāt al-Wujūh*) reveals a third concept of “common/corporate capital” consisting in pooling the business and moral credentials contributed by the partners, a kind of “human/moral capital” which qualified those *Mafalīs* (literally, penniless folks) to be granted credit for financing their business.<sup>74</sup>

**(b) *Mudāraba* and Banking:** Unlike *Mufāwada* and *ʿInān*, the formulations of *Mudāraba* partnership exhibited near uniformity among the classical schools, presumably because this indigenously Arabian mode of collaboration was also practiced by the Prophet himself (as *Mudārib*).<sup>75</sup> In any event, the Hanafī *Mudāraba* consists in a contract of “fidelity” (*Amāna*) between *Rabb al-Māl* (The Capital Owner/Investor), a silent partner, and the *Mudārib* (an entrepreneurial agent/manager), who is not liable for investment loss, in the normal course of business.<sup>76</sup> In its basic form, *Mudāraba* does not involve a “common/corporate capital” in the usual sense, although it is often aptly

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“joint capital” is adequate, it does not convey the full meaning of the concept; whereas the term “social capital” commands a distinctly different meaning in recent economic thinking and terminology; refer to note (74) below.

<sup>72</sup> The complexity was compounded when other goods were contributed as investment. On these explorations, see the account given in Udovitch (1970: 48-64, 147-157).

<sup>73</sup> On the Hanafī and Mālikī versions of this type of partnership, see Udovitch (1970: 65-76, 159-163); also accepted by Hanbalis, it was rejected by the Shāfi`īs (p. 66); see also Izzī Dien (1997: 348) on this. And on the concept and analysis of “human capital” in modern economics, see Rosen (1987).

<sup>74</sup> On this type of partnership, which was rejected by the Mālikis and Shāfi`īs, see Udovitch (1970: 77-86, 158-159). On the concept of “moral/social capital” and its emerging significance in development economics, see Mehmet *et al.* (2002); and for a critical literature review of the concept, its uses, potentialities, and limitations, see Sobel (2002).

<sup>75</sup> Tradition reports that his wife-to-be Khadīja was *Rabb al-Māl*; and that leading Companions participated in *Mudāraba* partnerships as well; Udovitch (1970: 172). Not surprisingly then, it was justified by *Sunna*, *Ijmā`*, and *Qiyās* (by the Shāfi`is) as well as “the practical grounds of its economic function in society”; Udovitch (1970: 175-176).

<sup>76</sup> This basic structure applies to all *Fiqh* Schools, yet in its formulation and elaboration, the Hanafī version “emerges as at once the most comprehensive, practical, and flexible form”, as Udovitch (1970: 176) puts it.

rendered as a “partnership of profit” (*Sharikat al-Ribh*):<sup>77</sup> Profit shares have to be specified proportionally to avoid *riba*; and in case of loss, the liability of the agent/manager does not go beyond the human effort expended, while that of the investor (towards a third party) is normally limited to the capital invested.

The full agency powers, enabled the classical *Mudārib* to freely and independently pursue profit opportunities using any “legitimate” practice or transaction, in any licit field of economic activity, be it industrial or commercial; analogous associational contracts, *Muzāraʿa* and *Musāqat*, were also available for agricultural activity.<sup>78</sup> The Hanafī *Mudārib* can also enter *Mudāraba* and other arrangements (with other partners) for enhancing profit opportunities.<sup>79</sup> This flexibility and innovative profit/risk distribution of the *Mudāraba* rendered it an ideal arrangement for long-distance and international trade.<sup>80</sup> And it is not surprising that it later became an essential business arrangement in the rise of European trade as it assumed an Europeanized form known as *commenda*.<sup>81</sup>

The innovative features of *Mudāraba* betrays its fundamental economic function of combining human and financial resources in a stark manner. This vital economic role is underscored by the Māliki and Shāfiʿī rendering of it as *Qirād/Muqārada*, literally Loan provision/acquiring, a licit lending mechanism/instrument that escapes the prohibition against *riba*. And yet, unlike the Māliki and Shāfiʿī, the Hanafī *mudārib* – when endowed with an “unlimited mandate” (*iʿmal fihī biraʿika*) – was able to invest the *mudāraba* capital (combined with his own) in another *mudāraba* or even a partnership (*sharika*) with third parties.<sup>82</sup>

It was this flexible mingling of associational arrangements, as well as the licitness of a multiplicity of “agents” and “investors” in a single *Mudāraba* contract,<sup>83</sup> that made possible the mobilization and pooling of large amounts of financial resources, and ultimately – I think – the emergence of the classical

<sup>77</sup> And indeed this term can be easily construed (in modern economics) as “common/corporate capital”, which can be imputed from the profit shares through capitalization (by means of present-value calculations). On various aspects of the Hanafī *Mudāraba* (compared with other *Sunni* schools), see Saleh (1986: 101-114), Udovitch (1970), ch. VI, Udovitch (1986), and Wakin (1993).

<sup>78</sup> On these types of agricultural partnerships, see Young (1993) and Young (1993a).

<sup>79</sup> These include all variants of the *Bayʿ* contracts/transactions (detailed above) as well as *Ibdāʿ*, deposits, and pledges, among others; Udovitch (1970: 204ff).

<sup>80</sup> Labib (1969: 11) for instance reported on a *Mudāraba* partnership document between an Alexandrian and a Venetian in the early 15<sup>th</sup> century.

<sup>81</sup> On this point, see Udovitch (1962) and Lieber (1968).

<sup>82</sup> On the distinction between the “limited” and “unlimited” mandate in Hanafī law (and on the more restricted Māliki and Shāfiʿī *Qirad*), see Udovitch (1970: 204-215).

<sup>83</sup> On the licitness and modalities of these complexities, and on the Hanafī jurists acute analysis in configuring the profit/risk shares therein, see Udovitch (1970: 225-233).

banking houses, the *Jahābidha*, around the end of the ninth century.<sup>84</sup> The evolution of the *Jahābidha* into bankers (in the modern sense), a part of the general 'Abāssīd scientific, economic, and technological progress,<sup>85</sup> culminated in the enactment (ca. 302/913) of the first state/central bank, *Jahābidhat al-Hadra*.<sup>86</sup> Centered in the capital, Baghdad, probably in *Darb al-'Awn* (the financial district) of its central *Sūq* (near *Dar al-Imāra*),<sup>87</sup> this banking “partnership” appears to have effectively employed a *Mudāraba-Sharika* networking arabesque in mobilizing funds from the capital and other cities of the vast 'Abāssīd caliphate for meeting the then growing financial demands of the state.<sup>88</sup>

In view of the preceding, it is not surprising that – along with the *'Inān* partnership (*Mushāraka*) – the *Qirād/Mudāraba* method of financing figures prominently in the modern theory and practice of Islamic banking, given the latter's aim of avoiding interest and operating on the basis of profit-loss sharing (PLS). In this, the modern Islamic banks also employ formulations of the classical exchange practices mentioned above, notably the *Murābaha*, *Ijāra*,

<sup>84</sup> The story of the rise and fall of classical Islamic banking (even more than that of the Islamic economy at large) is yet to be written, but for our purposes here the early explorations of Fischel (1933 a & b), which were later summarized in Fischel (1983), are valuable in understanding its beginnings, development, and virtual extinction.

<sup>85</sup> A similar development occurred in Egypt with the growth of the Fātimid empire, as the weight of Islamic and political power gradually shifted from Baghdad to Cairo. A case in point is the *Karīmī* business class, which emerged in the eleventh century, and continued to prosper under the Ayyūbid and Mamlūk sultans until the fifteenth century. Centered in Cairo, the *Karīmī* merchants and financiers managed to mobilize huge amounts of financial resources through their special type of trading and banking houses, which operated on a global scale that ranged – at their peak – from the Maghrib to China. See Labib (1969) and Labib (1990) on this development.

<sup>86</sup> This date and a brief summary is given in Fischel (1983); the details are given in Fischel (1933a). Nearly eight centuries later (1694), the Bank of England was similarly incorporated (as a privately owned state bank) in a strikingly similar (fiscal/political/war) context to that of *Jahābidhat al-Hadra*; but the first state/central bank in Europe was the Swedish Riksbank (1668). On the beginning and evolution of central banking in Europe in general, see Goodhart (1987), and on the Bank of England in particular, see the brief overview in the *Encyclopaedia Britannica*, Vol. 4, p. 497.

<sup>87</sup> This location of the bank was suggested in Fischel (1933a: 350).

<sup>88</sup> On the nature and duration of this “partnership”, see Fischel (1933a: 349-352), and on the operations and activities of this official banking house, see Fischel (1933b: 571-591). The operations described by Fischel – it is noted – do not seem to cover the full range of modern central banking, nor should they, given the different type of economy this first central bank served, especially its tri-metallic monetary system. And as indicated in Goodhart (1987) this lesser central banking mandate was typical of the later-to-emerge state/central banks of Europe, although some of the more modern central bank functions were assumed by other classical institutions of Islamic economic governance, notably *Dār al-Darb* (Minting House) and *Bayt al-Māl* (Treasury House), among others; on these classical institutions, see Ehrenkreutz *et al.* (1983) and Coulson and Cahen (1986) respectively.

*Nasi`a Bay`*, and *Istisnā`*; and this modern banking movement has been remarkably influential.<sup>89</sup> Three countries (Iran, Pakistan, and Sudan) have “Islamicized” their entire banking systems, and Islamic banking has achieved significant inroads in over seventy countries. And yet, the Islamic banks have not been successful in fulfilling their stated primary goals. A case in point – as recent studies indicate – they scarcely supply long-term financing, and that the bulk of their lending is directed to the short-term financing of trade. Moreover, only a minor part of their lending activity is PLS-based.<sup>90</sup> The reason hinges essentially on the classical jurists’ problem of *Gharar*, the information and agency problems which modern economists call principal-agent problems, moral hazard, and adverse selection, among others.<sup>91</sup>

A recent mathematical model by Aggarwal and Yousef (2000) demonstrates (among other things) that the failure of Islamic banks in the PLS area is a rational response to this type of agency/information problems. This type of problem (among others) goes far in explaining the recent data reported by the International Association of Islamic Banks: That less than twenty percent of the banks lending is PLS based.<sup>92</sup> Curiously, this figure is remarkably close to Ghazālī’s above-mentioned estimation that only ten percent of his contemporaries “let the *sūq* of this world do no injury to the *sūqs* of the Hereafter”. And it appears, nine centuries after the great Ghazālī, that in the “real world”, the actual behaviour of Muslims bears little resemblance to the *Homo Islamicus* of Mawdūdī-conomists, a behaviour that has been remarkably stable and heterodox, at least in the “*sūqs* of this world”.<sup>93</sup>

## V. Summary and Conclusions

In attempting to typify the moral economy of classical Islam, in its historical context, I have been generally guided by the three quotations I started with: Among them they highlight the rationalist trend in Islam’s moral philosophy and its scholarly (social-science) tradition. Ibn Khaldūn (d. 1406) restated the standard of that tradition brilliantly, in his *Muqaddimah* (p. 24):

“Therefore, **today**, the scholar in this field needs to know the principles of politics, the nature of things, and the differences among nations, places, and periods with regard to ways of life, character qualities, customs, sects, schools

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<sup>89</sup> For a juristic review of their banking instruments and practices, see Saleh (1986), ch. 4, and for different reviews of their expansion and activities by economists, see Kuran (1995) and Khan and Mirakhor (1990).

<sup>90</sup> Dar and Presley (1999) examine this problem from a financial management perspective. This and other problems are also examined by Kuran (1995) and Khan and Mirakhor (1990).

<sup>91</sup> On these, see Stiglitz (1987), Guesnerie (1987), Kotowitz (1987), and Wilson (1987).

<sup>92</sup> This figure is reported in Dar and Presley (1999: 1).

<sup>93</sup> See the evidence amassed by Rodinson (1978: 35-45).

(*Madhābib*), and everything else. He further needs a comprehensive knowledge of present conditions in all these respects. He must compare similarities or differences between present and past conditions. He must know the causes of the similarities in certain cases and of the differences in others.” My emphasis).

Indeed this is a very modern standard, like “today”, a “tall order” that I have attempted to cope with inasmuch as it is possible for me within the space of a journal article.

The main objective of this article has been the construction of a verbal “model” of the historical economy of “classical” Islam, one that assembles what is known of its basic “building blocks” in a coherent system that highlights its moral and legal philosophy, and encapsulates its fundamental principles and “laws of motion” in theory as well as its *modus operandi* in practice. In order to achieve this objective, I started (Section I) by presenting a synoptic review of the nature of *Shari’a* discourses, the moral and legal framework of that economy, one that highlights the moral and epistemological doctrine of the classical jurists as well as the jurisprudential theory and method they adopted in molding this framework. In Section II, Islam’s work ethic of “legitimate gain” was expounded to reveal a concept of economic justice that underpinned the juristic effort (*Ijtihād*) of the classical *fuqaha*: A meritorious doctrine of “justice as fairness” in economic exchange and dealings (*mu’āmalāt*), one which is “procedural” in nature, as it rests on two fundamental maxims, namely, the avoidance of “unjustified enrichment” (*fadl māl bila ’iwad*) and “unjustified absence of knowledge” (*jahl; gharar*).

This was followed by Section III, the “*Shari’a* Market Model”, in which the “classical *sūq*” was characterized, and its “social embeddedness” highlighted (within the context of the jurists’ concept of justice and its underlying *tawhīdi* philosophy of harmony) in terms of their **normative** contract of *Bay’* (sale/exchange) and its variants. As well, the actual *modus operandi* of the classical *sūq*, its legal framework, and policy institutions (notably *Ihtisāb*) were sketched so as to reveal a *tawhīdi* doctrine of perfectly competitive markets and pricing, which are deemed “efficient” in the estimation of modern economic theory. Section IV, “Business Partnership and Finance”, then addressed the all-important question of business association (*vis à vis* the deployment of human and non-human resources) within the parameters of the above-mentioned concept of justice. It briefly described the three basic forms of business association (*sharikāt*) formulated by the classical jurists (namely, *Mufāwada*, *’Inān*, and *Mudāraba/Qirād*), and expounded the innovative, differentiated, and flexible set of legal instruments they had supplied for facilitating the efficient collaboration between human and financial/capital resources in commerce, industry, and agriculture. As well, the related macroeconomic mechanism of financial intermediation was briefly reviewed to show how the jurists’ formulations, which allowed flexible mingling of associational

(*mudāraba/sharika*) contracts, had facilitated the emergence of the classical banking institutions of Islam (*al-Jahābidha*) and the first state/central bank (*Jahābidhat al-Hadra*).

In the main, I have argued that – in theory – the economic system crafted by the classical *fuqaha* was essentially a “perfectly competitive market system”, albeit with a difference: A difference that stemmed from their *tawhīdi* philosophy of social harmony, which motivated their doctrine of economic justice. Thus by contrast with Adam Smith and his philosophy of self-love, the motive force of his “invisible hand”, which animates and orchestrates the “unembedded” competitive markets of modern capitalism, the classical *fuqaha* had attempted (by their *bay’* model) to “re-embed” the competitive *sūqs* of classical Islam into the Community (*Umma*), locally and beyond.<sup>94</sup>

In this article, I concerned myself primarily with typifying the institutions and workings of this *fiqhi sūq* system, and shied away from the “ism” question of comparative economic systems:<sup>95</sup> A complex question that some specialists like Pryor (1985:219-221) did not find “profitable to focus on”.<sup>96</sup> Nevertheless, the market system I have typified is compatible both with capitalism and “market socialism”.<sup>97</sup> And indeed other scholars attempted to interpret the classical Islamic system in terms of these modern categories, especially that of capitalism.<sup>98</sup> Thus examining the question from a Weberian viewpoint, Rodinson (1978:30) for instance concluded that the “merchants of the Muslim Empire conformed perfectly to Weber’s criteria for capitalistic activity”. Adopting the same perspective, albeit with a Neo-Orientalist bent, Labib (1969: 93) found that “Islamic capitalism was mainly a commercial and consumer-credit capitalism”, rendering it as “Oriental Capitalism” (p. 96). Again, Rodinson (1978: 56) examined the question using a Marxian conceptual framework, and concluded that “the Muslim . . . capitalistic sector . . . was apparently the most extensive and highly developed in history . . . until the sixteenth century”.

In contrast, others, including some Maudūdi-conomists, emphasize the socialistic/egalitarian strand in Islamic doctrine and history to argue for an

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<sup>94</sup> I use the term “re-embed” because, as Rodinson (1978: 28) puts it, “The society in which Islam was born... was already a centre of capitalistic trade... It was indeed an “unembedded” economy.”

<sup>95</sup> On the criteria used by economists for classifying economic systems, see Neuberger (1979) and Rosser and Rosser (1995), ch. 1.

<sup>96</sup> Pryor reached this conclusion in his attempt to characterize the “Islamic economic system” in the writings of Maudūdi-conomists.

<sup>97</sup> For an overview of the economic theory and practice of “market socialism”, see Brus (1987).

<sup>98</sup> This should not be surprising in view of the rationalist orientation of Islamic thought at the time, which is comparable to the situation in Europe when modern capitalism rose. On the problematic nature of the “meaning of capitalism” in modern economic literature, see Lane (1969).



“Islamic Socialism”, but historical studies in this area are meager (to the best of my knowledge).<sup>99</sup> An interesting line of research in this direction is the historical experience of the *sunna*’ (producers of manufactured goods) and whether their “professional corporations” (*Asnāf*) constituted a form of “guild socialism”.<sup>100</sup>

Finally, the preceding (modern) interpretations of the economic system of classical Islam, among others, are all interesting and plausible, each commanding an element of truth, some more so than others. And this judgment may suggest a different “type”, one that combines these elements in a manner that is truer to the “animus” of that economy, and to its historical, cultural, and technological setting.<sup>101</sup> But, alas, the search for this “type” goes beyond the objective of this article.

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<sup>99</sup> Often this kind of argument is based on re-interpreting certain Quranic verses (e.g. 41:10) on the nature of ownership (of the means of production) as well as the historical experiences of “socialist figures” (e.g. Abu Dharr al-Ghifari) and the Ismaili sect (especially the Qarmatians), among others.

<sup>100</sup> On *Asnāf*, see Raymond *et al.* (1997) and Ghabin (1997).

<sup>101</sup> Additional elements of this “type” are the jurists doctrine of distributive justice (alluded to in note (20) above) and the classical fiscal regime (in theory and practice), and the role of the institution of *Awqāf/hubus* as a form of community ownership, among others.

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