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## Berkeley Program in Law and Economics, Working Paper Series

### Title

Law and Economics from a Moderate Islamic perspective (LEMI)

### Permalink

<https://escholarship.org/uc/item/73b274rn>

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### Publication Date

2009-09-01

## **Law and Economics from a Moderate Islamic perspective (LEMI)**

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### **Abstract\***

Economic science is a high powered analytical discipline as such that can explain and predict the human and social behavior. Production and extension of law and economics is one of such developments. Religious oriented behaviors are, in my view point, amongst other dimensions of human life. In this paper I am going to analyze **Law and Economics** from a **Moderate Islamic perspective, LEMI**. Contract law is our case study in this regard. By using “moderate” term, we are excluding the religious extremist view points. One further fact which inspired me to insist on **LEMI**, was recent combating of two distinct Islamic view points (extremist and moderate) during current Iranian election (June 2009). In developing this paper, we are using a coherent synthesis of law and economic theories at one hand and moderate Islamic teaching at the other. I maintain on one or two points (or arguably one or two contributions) in this paper; the sacredness of humanity in **LEMI**, and its remarkable compatibility with conventional law and economics. Analyzing the interrelationship between economics and law from Islamic perspective, and comparing **LEMI** with other schools of economics and law, are possibly some new scientific debates.

**Key words:** Law and economics, Islamic law, contract law, religious law, moderate law and economics, comparative law and economics

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\* Author strongly appreciates Professor Robert Cooter, Herman F. Selvin Professor of Law, Berkeley Law, for his fruitful guiding and his wonderful comments in finalizing this paper.

## **I. Introduction and Methodology**

The central responsibility of this paper is to describe “law and economics from a moderate Islamic perspective” **LEMI**. Our case study is “Contract Law in Islamic Teachings, **CLIT**. We pose **LEMI** or its case study **CLIT**, as a school of thought along with other schools of thought (Chicago law and economics, public choice law and economics, institutional law and economics, new institutional law and economics, new haven approach, civic republican approach, Austrian approach, social norm law and economics, etc). In order to define the **LEMI** we emphasis on the following presuppositions: a) regarding religious teachings, we actually, deal with the interpretations and perceptions of scholars which would not, necessarily coincide on original and Divine ones. For instance, if Divine and original Islam, is a complete teaching, it does not mean that the interpretation of any specific jurist or believer is complete, too; b) thus (returning back to the above assumption), any Islamic perception could be criticized. Satisfying this assumption in turn, could be considered as a resolution for the problem of dogmatism in some religious teachings. For, although exact speech of the God (for example) is infallible, but that of any religious Jurist or religious believer will not so, and it might be disputable or even wrong. To illustrate, we mention two totally different Islamic standpoints in current governance in Iran. First one is a special jurist viewpoint inwhich Islamic government is directly legitimized by the God (and only indirectly, if any, by people). According to this extremist worldview, any activity, even killing people, is justified by Islamic government. However, fortunately, there is a second and more solid idea thereof which maintains that Islamic government like secular government is infallible. We saw that some grand ayatollahs among moderate camp in Iran, rejected the above ideas and even illegitimated that extremist Islamic government (Warren 2009). According to this latter moderate standpoint, the legitimacy of Islamic government like

other democratic ones, depends on the voting of the majority of people; c) we deal with a diversification of religious ideas or one can say, there is a “reasonable” (and not “orthodox”), pluralism in religious teachings; d) we believe that there is common grounds between religion and secularism within which one can suppose peaceful relationship thereof; both religion and secularism, while have distinctive characteristics, are real entities in actual life; and finally, e) Islamic teachings, other things being equal<sup>1</sup>, are compatible with main findings of science, reason and rationality. Contract law in Islamic teachings, **CLIT**, would be formulated based on the above **LEMI** system. We will see that: a) in considerable dimensions, **CLIT** is compatible with Current Contract law, **CCL**; b) **CLIT** plays a supplementary role regarding **CCL** (it is not necessarily going to supplant **CCL**); and c) it does have following substantive characteristics: First, it is both positive and ethical oriented, hitherto, the incentives of law and economic agents are both selfish and non selfish as well. Sacredness of humanity within **LEMI** is one constituents of the above feature. Second, it follows a flexible and non-dogmatic framework. Third, it is systematic in principle; forth, it is dynamic in nature, and finally fifth, it is diversified and is based on multi-method (or one can say that **LEMI** is based on methodological pluralism).

Accordingly, **CLIT** employs Shariah rule along with rational methods used in **CCL**. I emphasize on another methodological point here. I call this “a general rule of Shariah regarding **LEMI**” and **CLIT**, or simply “general rule”. That is, a famous Shariah rule states that: “the majority of economic transactions and contracts are in domain and scope of the reason and rationality and not necessarily in domain of specific Shariah rules”. Accordingly there would not be a meaningful contradiction between Islamic teachings and related reason oriented findings in economic transactions; including contract law (Masud 1977, Shatibi 2006, Sherbini, 1988). Obviously this general rule would be very helpful within our reasoning system regarding **LEMI**

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<sup>1</sup> That is, provided that, it’s basic doctrines are satisfied.

and CLIT. Meanwhile, we assume that there is a significant ground for co-integrating current law and Islamic teachings. For that reason, we mainly employ “law oriented Islamic teachings” LIT rather than “Islamic law”. We can pursue the above arrangement as a dominant soul of LEMI throughout the paper. I stress on one further point and that is, there is a remarkable gap between the theoretical dimension of LEMI and the actual performance of law and economics of Muslim countries. By describing the potentialities and anatomizing the theoretical bodies of LEMI, this paper is not responsible to explain the gap in question. In other word, the shortcomings and the inefficiencies of law and economics in Muslim countries is not related to Islam itself, but it is vividly pertaining to the Muslim people and governance of their countries. This may be due to double think manner of some Muslims or other related factors, which remind us this proverb that: “I wish Muslims obey Islam”!

#### A. Feasibility of LEMI in a comparative framework

A great law thinker stipulates that: “it is somewhat surprising that so conspicuous a truth as the interaction of economics and law should have waited so long for recognition .Some of those who question it maintain the independence and self-sufficiency of law, while others maintain that of economics. He finally concludes that in reality law and economics are ever and everywhere complementary and mutually determinative (Berolzheimer 2002)”. Indeed, increasingly economic science is being extended beyond its traditional precincts of the market-place and extended even beyond its traditional with law as well. This kind of extension or special development of economics regarding law could be construed either as another example of the “economic imperialism” phenomenon, Kenneth Boulding has termed, or other characteristic of economic science. We argue that, LEMI is another reasonable ground in economic development.

Launching these kinds of research, in turn, could be accounted as a new contribution in literature of law and economics itself. The analytical power of economic science and its multidisciplinary nature are amongst other key characteristics of a science as such, to analyze, law and religious law as well. In addition, there are some special techniques or some exact conceptual frameworks in economics which can be used generally in other social sciences. Rationality, cost benefit analysis, efficiency, accountability, optimum decision making, paying attention to scarcity, competition and equilibrium are amongst others. **LEMI** can be defined generally, as the application of economic theory to examine the structure and economic impact on law oriented Islamic teaching, **LIT**, and its legal institutions. **LEMI** can be accounted as a new paradigm along with other schools of law and economics. Although, Chicagovian approach does have some dominancy on other approaches but, scientifically speaking, we can enumerate institutional law and economics, public choice law and economics, new institutional law and economics, new Haven law and economics, Austrian law and economics, social norm law and economics among others. We can add ethical law and economic and religious law and economics as well (**LEMI** is mentioned typically). While the roots of law and economics go back at least to Hume, Ferguson and Smith, and modern scholars identify the genesis of the research program, in the year 1960 (when Ronald Coase published his famous article entitled ‘the problem of social cost), we can see some basic titles within the works of Ibn Khaldun (a Muslim thinker), about 4 centuries before Hume and Smith (Ibn-Khaldun 2005). Of course, Hume (1739) in “a treatise of nature”, Ferguson (1767), in “an essay on the history of civil society”, and Smith (1776) pose some debates of law and economics. Also Bentham argued for direct implementation of economic policies through legislation (Posner 1979). Alternatively we can find out remarkable economic and law outlines in Medieval Muslim scientists (Boulakia 1971).

Obviously, the role of notable figures in establishing the first ideas of the modern version of law and economics is crucial. Whereas Ronald Coase, Guido Calabresi, Henry Manne, Gary Becker and Richard Posner, could be construed as the founders of Chicago school of law and economics, James Buchanan and Gordon Tullock can be mentioned as the fathers of public choice law and economics. The famous figures of institutional law and economics are Henry Carter Adams, Richard Ely, John Commons and Wesley Mitchell. In addition, the works of some founding fathers of institutional economics have basic impact on this school of law and economics, Thorstein Veblen, Walton Hamilton, Robert Hale, Karl Llewellyn, can be mentioned typically. Harold Demsetz, Armen Alchian, Eirik Furubotn, and especially Douglas North and Oliver Williamson among others are famous figures of new institutional and general institutional law and economics. Guido Calabresi and Susan Rose- Ackerman in developing the new haven school of law and economics have had much more pioneering role. Ludwig Von Mises, Friedrich Von Hayek and Gottfried Habertler are among key figures of Austrian law and economic. Finally Robert Cooter, Lawrence Lessig, Richard Mcadams, Cass Sunstein and Eric Posner are famous figures of social norm law and economic approach. We introduce and analyze the doctrines and structure of a moderate version of the religious law and economics (**LEMI**) in this paper as a new sub-school of law and economic approach. When we review the basic characteristics of different schools of law and economics, we can find out the sufficient ground for posing “**LEMI**” approach. We emphasize on the multicultural nature and a pluralistic framework of law and economics, within which **LEMI** or **CLIT** approach could, obviously coexists with other different approaches. Nevertheless, there are so much agreements and disagreements in applying economics to law. Some famous figures in this field stipulate that: law and economics as scholarly disciplines would seem to conflict in more ways than they

complement each other. They comprehend distinctly different logical systems for looking at the world and solving its problems. Economics is scientifically rigorous and its value lies mainly, in its ability to predict future outcomes and to explain the causes of past events. Law on the other hand has traditionally been a morally oriented, mechanistic system of dispute settlement which by the standard of economics generates apparently random results. It gains its greatest majesty in societies where, as Buchanan correctly says, the idea of a “rule of law, not man, is sacred”. In this paper we will indicate, however, that in **LEMI** framework, the human being (and not the rule of law), is sacred, and this potentially speaking would be a crucial point. In other word, one basic aspect of **LEMI** is its belief on the sacredness of human life. Quran the main source of Islamic reasoning stipulates that: human being is sacred (Quran 17/70). This level of appreciation of God regarding human being, we think, is much more powerful than that assigned by conventional human right. This is one reason we rely on a “moderate” religious insights and not on a general religious jurisprudence.

## **II. Background and Original Structure**

Generally speaking, the sources of law oriented Islamic teachings, **LIT**, and its economic law paradigm, **LEMI** are the Quran, the tradition of prophet (“Sunnah”), consensus of scientists and reason. A basic point is that **LIT** must indeed be used with the proviso that it is a part of a system of other duties, blended with non-legal elements. Another key point is that, although **LIT** does have some sacred dimensions, it is by no means inflexible and irrational; it was created by rational method of interpretation. In this way it acquired its intellectualism exterior. **LEMI** (as a subsystem of **LIT**), is systematic and it represents a coherent body of doctrine. Its several institutions are well put into relation with another. Furthermore, the whole of its law teaching is



permeated by religious and ethical considerations, such as the prohibition of unjustified enrichment, the prohibition of uncertainty (Gharar), the concern for the equality of the two contracting parties and the concern for the just means and just instruments for enforcement of contracts. Although, basing on a multi-methodic structure, **LIT** employs both analytical method (which leads to the creation of logically organized legal norms in an ascending order), and analogical one (leads to the organization of legal subject matter by parataxis and association), it presents this latter type of systematizing in great purity. An important criterion of the sociology of Islamic law is distinguishing **LIT** with the “Islamist jurist law”; these two, are not necessarily coinciding each other in all their aspects. Some extremist viewpoints are indeed related to jurist law. There is a significant analogy between jurist law and orthodox traditional Roman law. Jurist law often obeys from dogmatic and inflexible framework. Thus confusing **LIT** and **LEMI** with “jurist law” would be problematic. Meanwhile, there is a considerable and ongoing exchange between **LIT** and the Jewish and Christian laws (Schacht, 1974). Accordingly, **LEMI** and **LIT** are not just jurisprudential and mere rule based prepositions, but they consist of moral, historical and social codes as well. Their theoretical bodies contain almost all branches and topics in current law ,including international law (Malekian 1994), tort law, law of business, organization and partnerships , commercial law, contract law, law of family, marriage, divorce and inheritance (Anderson 1959).

There is a living technology in Islam, applying which will reinforce the dynamic dimensions of **LIT** and **LEMI**. This is called Ijtihad (independent reasoning technology). By employing this technology, **LIT** can revise and modify its theories and models. Some orthodox jurist views, however, insisting on conservative and static approach, do not allow any remarkable reform, whereas some radical others, by including so many secular elements in **LIT**, go ahead in

direction to a kind of reductionism in this regard. Insisting on law and economics, in a moderate Islamic perspective, **LEMI**, poses a non-extremist paradigm of **LIT**. In extremist views, law is regarded fundamentally as divine entity, and a system as such would be obviously immutable. Accordingly there would be a dichotomy between orthodox versions of religious law and western secular one. In **LEMI** paradigm of **LIT**, however, other things being equal, there could be a peaceful coexistence and friendly relationship between **LIT** and current secular law. It may be interesting to mention that all approaches of **LIT**, **LEMI** or others, obey the very basic religious doctrines, thus, they are different paradigms of the same religion. In other word, as a great western specialist of law stipulates: “Islamic law, guarantees its unity in all its diversity” (Schacht 1984, 200). This diversity can include orthodox, dogmatic and absolute sacred view points, radical and secular oriented paradigms, and rational moderate ones (like **LEMI**).

Completely sacred, religious law might possess certain irrational features. The failure of current Iranian law and governance (“absolute velayate” 2009), I think, was due to obeying of one version of the irrational insights. The general Islamic law, however, permeated almost every side of social life and every branch of Islamic literature (Gibb 1962, 106, Numan 2004). In other world, for Muslim there is an ethical and rational quality in every human action, however, it might depend on some divine revelation too (Goitein 1960), which does play a supplementary role regarding reason, science, and rationality. Whereby, all human actions are categorized as: 1) obligatory duties; that are required and whose performance is rewarded and whose omission is punished. They are both individual and social (Fasting and paying tax by believers are mentioned typically); 2) Recommended duties or acts that are recommended but not required (for instance after midnight prayers); 3) Indifferent duties whose performance or omission is neither rewarded nor punished (wearing fine clothes for example); 4) reprehensible actions that are disapproved, it

is better to keep away from them, but one who avoids such acts may expect to be rewarded, but one who does not avoid them will not be punished (prayer without internal concentration is one example in this regard); and finally 5) Forbidden, actions that are prohibited, hence, punishable, such as drinking wine, stealing and adultery. Obviously, much of these categories could never be enforced by existing courts. Thus, **LIT** is mainly a doctrine of duties and a code of obligations (Fyze 1981, 29). Hitherto, “**LIT**” is not restricted to positive law literature, but it also includes moral and ethical aspects and the jurisprudential processes in itself. **LIT** and **LEMI** are much wider than current law; **LEMI** takes systematically, into the consideration of the whole of human conduct.

#### A. A Typical Performance of LIT and LEMI

To illustrate the actual function of **LEMI** and **CLIT**, we prefer to describe one of its elements. Law of succession and inheritance in Islamic teachings is examined, here, typically. This can be illustrated as a faithful Islamic contract. From a **LEMI**'s sociological stand point the laws of inheritance reflect the structure of family ties and the accepted social values and responsibilities within the Islamic community. There is a particular rule that the duty of a person to maintain his needy collateral relative is dependent upon his right to inherit from that relative. In providing for the continuity of the family group as one cell of the universal Islamic community, the laws of inheritance appear as a vital aspect of the individual supreme duty to this religion. Generally speaking, the supreme purpose of the Islamic inheritance and succession law is material provision for surviving dependants and relatives for the family group bound to the deceased by the responsibilities which stem from blood relationship. Relatives are marshaled into a strict and comprehensive order of priorities and the amount or quantum of their entitlement is meticulously defined. Legal heir in the Islamic context is a term which is properly applied only

to those relatives upon whom property devolves, after the decease of its owner by operation of the law. The power of the deceased to dispose of his property by will is recognized but it is basically restricted to one-third of his net assets. Only where the legal heirs are prepared voluntarily to forgo their rights will testamentary disposition in excess of this limit be operative. In Islamic legal philosophy the rules of inheritance propound the ideal way, for the deceased to fulfill his duty to his surviving family. In the case of the heir's rights in the estate we can emphasize that: for the purposes of the law of succession the estate of a deceased one, comprises all the property that he owns. Movables and immovable realty and personality, make up the single entity of the estate in which each entitled heir is given a quantitative or fractional share. The right of a legal heir therefore is that of a defined quota share in each and every item of property that comprises the estate. Rights of inheritance rest upon two principal grounds of marriage and blood relationships. A spouse relict succession law is one whose marriage is valid and existing at the time of the decease. In the tribal society of pre Islamic, the systems of inheritance was designed to keep property within the individual tribe and maintain its strength as a fighting force. Under the Islam, however, the political and social scheme which had supported this system was transformed. For within the brotherhood of Muslims there was no place for inter-tribal hostility or warfare, and Islam emphasized the more family tie existing between all members of the family. Quran stipulates that: it is ordained for you that anyone who is at the point of death, and has goods to leave, should bequeath equitably to his parents and near relatives. This is an obligation upon the pious (Quran, 2/180, 240,).As we see noticing to human rights, keeping warm and promising the family environment, noticing to the moral considerations, and, in one word, attention to sacredness of the human being is at the center of the above arrangements.

### III. Basic Dimensions of CLIT

In addition to reason and general rationality (not instrumental rationality), faith and ethical content of contract law in Islamic teaching, **CLIT** are among its crucial dimensions. Equity and justice, sacredness of human life, consistency of speech, action and intention of Muslim agents and considering law as a duty, are among other faith and moral oriented dimensions of **LEMI** and **CLIT**. As we already maintained one characteristic aspect of religious teaching which could have an inspiring role in long run stability of current law is the “sacredness of human life”. This is a key element and hard core of **LEMI** too. Because sacredness, generally speaking is devoted to heaven and sky, thus God is going to greatly appreciate the “Humanity”, when assigns to it sacredness. One obvious meaning of this could be: “every processes and trends of the law and the legal system have to be human oriented”. Accordingly law, religion, economic and political systems would play as the devices and instruments for achieving humanity. God in the most famous source of religious law stipulates: “We have honored the children of Adam, and they are sacred) (Old Testament 3/21, Quran 17/70). Obviously this particular moral premise is inherently religious and cannot be justified by secular means. And that is: “all humans are sacred.” Thus in any secular society, this fundamental principle should be accepted and considered in action, regardless of its religious root. Religion in a broad sense is composed of three key elements: ethics, faith (and belief), and jurisprudential propositions (religious law). Ethics does have the central place and other two elements do play auxiliary and logistic role regarding ethics. We argue that considering the religious teachings in connection with the law; can enhance the stability of the secular rules of law as well. In part because the

sacredness of human life, hardcore of religious teaching in connection with the law, is, absent in secular teachings.

One of ethical considerations regarding **CLIT** is its equity considerations. Equity does have key role in contract law in Islamic teachings, **CLIT**. Equity in **CLIT** includes those decision rules that humans employ to define how and when a just and fair distribution of valued resources obtains between actors. Some Muslim thinkers stipulates that school of law in Islam can be coincided on school of law in justice, and some emphasizes if a rule is unjust it is not Islamic as well (Ibn-Hindi 1985, Sadr 1985, Motahari, 1985). On behalf of centrality of justice in **CLIT**, the conscience does have a remarkable place in it. For the principle of conscience holds that the judge must find the law not merely in books or reason but also in his own sense of justice (Berman et al, 1996, 476). Surprisingly and according to our general rule, attention to justice in **CLIT** is consistent with efficient economic systems. For equitable principles of contract can be used to solve the shortcomings of free market in market failure framework. In contrast with laissez faire approach, there is a friendly relation between market and government in **CLIT**, which keep them in a complementarily situation. Since the decision making in laissez faire is based on the autonomous actors making wholly free utility maximizing choices in competitive markets (Mooney 1995, 1131). Obviously this framework could possibly be consistent with efficiency but not necessarily compatible with justice. The actual field of contracting is not one of pure competition, but is characterized by inequality of bargaining power and asymmetrical information. So, unrestricted freedom of contract is likely to cause both inefficient and unjust consequences. Thus, an equitable counterpoise is needed to produce of fair exchange, and **CLIT**, we think, produces one. **CLIT** obeys from dynamic processes, accordingly proceeds along with the changing circumstance. Thus concept of justice for the early Islamic era (6 century) required

in contracts balancing of gains and losses on both sides, in modern days of 21 century, however, the Shariah rule justifies the using of modern contract theories. This trend is at least vivid in the case of financial contracts (Harvard 2008, Berkeley 2009). In doing so, **CLIT** can compromise the old and new ideas of other religious and also moderate secular opinions. **CLIT**, because of coinciding on **LEMI**, goes a head in a moderate manner between complete laissez faire free market contracts and complete planned contracts. According to the laissez faire philosophy, the state is an inefficient and harmful instrument, and society's framework is inherently competitive and not cooperative. So freedom of contract, in turn, becomes an arena of survival of fittest. In **CLIT** framework, however, values other than freedom of contact do play role too.

Generally speaking contract law can be seen as developing on two tracks; the formalized freedom of contract and the informal equitable contract line. The formalized track has dominated the doctrine and rules from the 19<sup>th</sup> century. Morality and ethics, especially equity and justice, does have crucial role in informal contracts. Any system or institution of justice must constantly provide evidence of its credibility and the demand of credibility ensures the use of equitable principles within the contract law. Even Adam Smith emphasizes on an institutional framework of contract in which self interest is made compatible with the public benefit (Sobel 1979). In mainstream theories of contract law, the ethical and social aspect is decisive too. Contract law is construed as a norm generator and societal corrective and as a device to influence individual preferences to conform social norms. Law inevitably affects preferences and that it is legitimate for law to shape preferences in the right way. If the rules of contract are structured to apply to contracting parties as citizens, then they should reflect norms that can encourage attention to the public good. Surprisingly, Adam Smith recognized rules of conduct as necessary constraints upon freedom of contract in a well ordered society (Sunstein 1997, 91). Even Hayek, who rejects

any place for distributive justice, does sanction the use of rules of just conduct in order to ensure proper individual conduct. By inclusion of ethics or religious considerations in contract laws, self interested behavior can be modeled by an institutional framework. **CLIT** obeys from a kind of multi-dimensional framework, in which freedom of contract along with distributive justice are harmonized. At the same time, it focuses in enhancing efficiency and wealth. In **CLIT**, freedom of contract is supplemented by other ethical principles. It is concerned about both aggregate wealth and distribution of wealth as well. However, in wealth maximization theory it does not matter how gains or losses in wealth are distributed (Posner 1985). Obviously, concentrating on exclusive wealth maximization may hurt other values. Main Islamic sources, addressing people stipulates that: Keep your promises, do not deceive, do not coerce, have concern for the other party's interests, do not cheat, and so on. There is an explicit and obligatory verse in Quran that a person should not break a promise (Quran 5/1). Every instance of promise breaking tends to damage the social trust necessary for the cooperation that makes mutually beneficial contractual exchange possible. In **CLIT**, contract law serves a moral education function and it teaches virtue. Law is one of few institutions whose officials are in a position to teach morality. In early Islamic era, law makers were educators as well and judges were ethical leaders too. It seems to be that this aspect is a characteristic to **CLIT**, for other approaches little to teach virtue by means of contract law. The wealth maximizing approach for instance, is concerned about mere efficiency, not virtue.

In **CLIT** framework, the remedies for nonperformance contracts go ahead in a encouraging and modification rather than mere punishment. At the same time, like conventional contract law, **CCL**, expectation damages, specific performance and in a very rare case, punitive damages are used as remedies for breaching the contract in **CLIT** too. For breach of an



economic exchange, contract expectation damages are normally appropriate. When money damage is inadequate a specific performance is used as a remedy for breach. Thus, characteristics of **CLIT** are mainly ethical, diversified, flexible, moderately rationalistic, systematic, dynamic and communitarian. It is both rule oriented and consequence oriented too. So, it is not mere teleological (as natural law is) and it is not mere rule oriented, as Nozick's view is, and not mere consequential as traditional utilitarian are. **CLIT** also is communitarian and asserts that its legal system should promote the common good. It is moderately rationalistic, but it does not agree with all dimensions of instrumental rationalism (the hardcore of orthodox approach in law and economics). Thus, **CLIT** evaluates reasons for propositions, applies logical standard to the arguments, synthesizes disparate propositions into coherent system of thought, pays attention to accountability, scarcity and employ a broad cost- benefit analysis and opportunity cost as well. However, **CLIT** does not agree that human reason is sufficient to resolve all the problems and argues to supplement reason and rationality with faith, revelation, cultural tradition, social norms and even individual intuition too. A purely rationalistic approach in orthodox law and economics leaves no room for traditional and cultural affairs, let alone for individual intuition. When we compare other foundations of contract law, including: a) freedom of contract; b) wealth maximization; c) public choice; d) distributive justice; and e) institutional perspective, with that of **CLIT**, we can realize much more its moderate contents. For **CLIT** does not suffer from either over simplification or reductionism. Wealth maximization for instance, will give adverse advice in cases where aggregate wealth is not the only social relevant factor. Utilitarian case suffers from reductionism, it attempts to reduce all factors to one more measurable factor but some cases cannot be measured in terms of utility, social trust is one example.

**Original Codifications:** We can add some other aspects that may differentiate **CLIT** from conventional contract law (CCL):

1. Some other general rules:
  - a. In **CLIT** a promise may not be legally enforced if it contradicts some ethical values (Quran 61/2).<sup>1</sup>
  - b. Contracts and transactions have to be based on mutual consent (4/29).
  - c. God has made any contract lawful, but prohibited unproductive ones, like usury (2/275).
  - d. **LEMI**, provides freedom of contract so long as the terms do not contradict with its basic doctrines and its general rules.
2. Disclosure of contracts: If the purpose of a contract is to serve the people, involved in contracts, they do have the right to know exact information about the effects of operations of those contracts on their well-being. Thus in **CLIT** format, truthful and relevant disclosure of information is important in different aspect of contract. Quran also emphasizes that: stand out firmly for justice in your contracts. Transactions are relevant only when they include the attribute of truth, fair and accurate disclosure of matters at hand (Quran 2/68-71, 4/135). Accordingly, disclosure of all necessary information for the accomplishment of faithful obligations is a key element in **CLIT**. In addition, the information should not deceive the user nor decrease understanding in such way as to lead to a wrong decision.
3. Record keeping, reliability and transparency: According to the Quran, the parties of contract are required to keep exact records of their indebtedness and the like (2/282). Under pinning Islamic belief is thus the requirement that doubt and uncertainty be removed from any contract. Rights and obligations of all parties are to be fully documented for verification and exploration. So many verses place emphasis in the reliability of matter (2/ 283, 3/122, 4/58, 7/89, Askari and Clark 1997). If published information in contracts is not reliable, the

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<sup>1</sup> - O, believers do not profess [in your contracts], what you do not practice. This is obviously consisting with findings of some experts of law and economics (Cooter 2008).

engaged parties may be unable to accomplish their responsibilities. Reliable information must also be presented correctly and fully, including details of all contracts undertaken.

Transparently report of all undertaken contract and provision of them without any deceit or fraud is thereby essential for accomplishing the obligation of the parties (11/84-85).

4. Where the subject matter of the contract is either unknown or incapable of delivery, it cannot work in **CLIT** framework. This proposition is called “Gharar” which is analogous to uncertainty. In addition, mutual consent of parties is necessary in performing the contract.
5. The **CLIT** would have to vivid its position regarding some basic subjects. Explaining the place and role of contract, enforcement of contract, bargaining, the role of efficiency, making sense of duress, and breach remedies might have been illustrated. In the case of remedy, **CLIT** goes ahead in a multi-methodic framework, so, potentially speaking, Coasian, Pigovian and regulatory manners are emphasized. Accordingly, in the case of no damages or specific performance, Coasian theorem is employed; expectation or reliance damages are its Pigovian solutions; and remaining cases of contracts (marriage as a typical example), are mainly the scope of regulation. So **CLIT**, like its original role model, **LEMI**, is processing in a moderate framework; coexisting with other rational paradigms, moderate regulation, diversifying method, and ethical oriented are among its other aspects.

#### **IV. Other substantive features and compatibility with CCL**

One distinguished aspect of **CLIT** is its normative capability along with its positive one. This makes it much more compatible with nature of the law. For, what orthodox law and economics actually leaves out is a normative understanding of contract law. However, law students are extensively involved in normative questions. Since they must ask: why contracts

should be enforced? Whether it much matters how a case turns out? How can public law be distinguished from private law? And so on and so forth. In addition, the law and economics in religious perspective has to pay attention to ethical requirement of contracts. Generally speaking, a theory of contract: a) must recognize that promising is an institution; b) must account for the promisor's fidelity duties; and c) must explain the basic rules of contract law, all of which are satisfied in **CLIT** in both positive and normative structure (of course, as I already maintained, there is a considerable gap between **CLIT** theory and what Muslim countries, perform in action. In reality a kind of "double think" is prevalent in these countries. For it depicts a condition where the ideal Islamic principles, for instance regarding **CLIT**, is held officially and proclaimed energetically by leaders of Muslim countries, but violated in practice. This situation produces what Child calls "mental cheating" (Lal 1999, Ali 2005)). Further, some researches argue that all law is ideological; hitherto its value judgment dimension is inevitable. For instance, the leading doctrines of English law of contract reflect two principal ideologies; market-individualism and consumer welfarism (Browsword 2006, p.137). Also freedom of contract has been the dominant norm of Anglo-American contract jurisprudence. Of course the freedom of contract norm was the legal adjunct to laissez fair economics. During the second half of the 19<sup>th</sup> century the courts began to erode the classical theory of contract, as they sought to do justice (Manchester 1978, p.275). Norms, generally speaking, are philosophical foundations up on which, judges obtain the rationales and the reasons for the fabrication of the rules of contract. There are similar characteristics regarding normative aspects in current contract law, **CCL**, and in **CLIT**, as well. For in both, justices, efficiency, security and freedom are more or less emphasized (Summers 1978, Sadr 1985). In addition, although different theorists and different

schools of law and economics have advocated one or another of those four norms, **CLIT** compromises and try to coordinate and harmonize all of them in **LEMI** models.

In traditional contract, based on Walrasian economics, it is assumed that economic agents possess complete information (Savage 1954). This was rejected by Akerlof (1970). Also incomplete contract theory replaced complete one. The new institutional transaction cost theory along with finding of bounded rationality, has had another considerable role in the development of contract theory. Religious perspective on contract law can be analyzed as a new paradigm in extension of social norm law and economics along with mainstream Chicagovian, institutionalism (old and new), public choice, feminism, etc. **LEMI** as a sub-discipline in law and economics can supplement the orthodox mainstream one. As Coase stipulates, mainstream law and economics, has become more and more abstract over time and it is in fact little concerned with what happens in the real world (Coase 1984). New developments in law and economics involve the recognition that contracts adopted by transactors are incomplete. This trend is indeed, consistent with the **CLIT** assumption regarding incomplete information.<sup>1</sup> Thus **CLIT** is compatible with non-orthodox conventional contract law, **CCL**. Another analogy between **CCL** and **CLIT** is that in Islamic literature, contract is originally a legal (and not economic) concept, and it is true for **CCL** too. In **CLIT** framework the contract is binding in just circumstances, which is similar to some paradigms in current law and economic perspectives. For instance, social utility law and economics, equality law and economics, and feminist law and economics are insisting in just contracts as well (Gordly 1995).

Some propositions of **CLIT** can play role in enforcements of **CCL**. For instance, the Quran injunction, “fulfill your obligations”, is the fundamental principle which governs the

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<sup>1</sup> As we implicitly stated, **CLIT** is analyzed in an incomplete information and disequilibrium environment as well. For, the consistency of assumptions with real life is crucial for **CLIT**, is ontologically, crucial.

sanctity of contracts. According to that principle Islamic state has no right to cancel or alter a contract by unilateral action. Similarly, Muslim law does not discriminate against foreigners or non-Muslims in matters of contract, and the Muslim communities have a well defined duty to respect their contractual obligations towards non-Muslims. Quran stipulates in this regard: fulfill their (foreigner's) covenant up to (the end of) its period and God loves those who show piety regarding them (Quran 9/4). The only condition required according to the Quran for validity of any contract is (other things being equal) the mutual consent of the contracting parties (Quran 4/29). Obviously this is similar to the doctrines of freedom of contract in **CCL**. There is a reasonable presumption that all contracts are valid unless they are expressly forbidden by rule of law or public morals. Also where the law is silent, the contract is valid (Ibn Qayim, without date). The basic nominate contracts are: 1- sale (its Arabic term is "Bay"), where right of ownership passes for consideration; 2- gift (Hiba), where right passes without consideration; 3- Hire (Ijarah), where transfer of possession occurs for consideration; 4- loan (Ariya), where transfer occurs without consideration; 5- a contract for delivery with prepayment (Salam); 6- partnership agreement and; 7- mortgage deposit, general partnership, piecework and agency.<sup>1</sup>

In **LEMI**, the basic foundations by which a contract would become validly concluded are: a) an agreement; b) free consent and intention to contract; c) contracting parties with eligibility to contract; d) object of sale and valid cause, and e) consideration. The agreement is formed by the linking of offer (Ijab) and an acceptance (Qabul) which may either express, tacit, by conduct or even by gesticulation.<sup>2</sup> Intention (as we already mentioned), and consent have become the two fundamental precepts to any contract in **LEMI** and **CLIT**. Another basic

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<sup>1</sup> These are of course traditional outline in **CLIT**, in addition, technology of Ijtihad opens up the using other new contractual terms which Muslim countries, are involved in 21 century.

<sup>2</sup> Based on that for instance, in Bahrain contract law (as one Muslim country), Art 15 defines consent: two or more person are said to be consent when they agree upon the same thing in the same sense (one can see also Art 129 of United Arab Emirates, UAE, another Muslim country).

element in Islamic contract is the contractual capacity and eligibility. This is a prime consideration of the validity of contract. Capacity is generally governed by family law in Muslim countries but outlines of persons competent to contract are provided in the civil codes. Maturity and sound mind are among the restrictions to capacity. So, every person entering into a contract must have reached the age of maturity and quality of a sound mind or prudence. Also consent is a main pillar in **CLIT**, within which intent of the contractual parties should be formulated as well. Mistake, fraud and duress are some impediments to consent in **LEMI** and **CLIT**. The fraud is the deliberate and deceitful causing to fall into mistake of the contracting party which persuades him to contract. Fraud consists of: a) exploitation by means of trickery, and b) inducement of the contracting party. Prohibition of usury and “Gharar” are basic propositions in **LEMI**. All usury (Riba) is banned absolutely by the Quran (2/275- 276 and 2/278-280, 3/130, Bukhari 1984). Usury or Riba is actually an earning which is not based on a productive and reasonable activity. Interest paid on an unproductive loan is a typical case. Of course, earning a gain on a productive loan is not prohibited. Such activities are undertaken according to profit and loss sharing contract (PLS) in Shariah framework.<sup>1</sup>

## **V. Complementary Rules and Comparative Codifications**

The basic theme of this paper is describing and analyzing, “**LEMI**” which is related to Shariah rule, the possible theoretical backbone of legal system of nearly 60 Muslim countries, in the world. These are at least: Afghanistan, Albania, Algeria, Chad, Egypt, Guinea, Indonesia, Iran, Jordan, Kuwait, Lebanon, Libya, Malaysia, Mali, Mauritania, Morocco, Niger, Pakistan, Palestine, Saudi Arabia, Senegal, Sudan, Somalia, Tunisia, Turkey, Yamane, Bahrain, Oman, Qatar, Syria, United Arab Emirates, UAE, Sierra Leone, Bangladesh, Gabon, Gambia, Guinea-

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<sup>1</sup> There is ongoing and rapid growth in establishing PLS contract in Islamic teachings (Ayub 2008, Berkeley 2009).

Bissau, Uganda, Burkina Faso, Cameroon, Comoros, Iraq, Maldives, Djibouti, Benin, Brunei, Nigeria, Azerbaijan, Albania, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan, Suriname, Togo, Guyana, Cotedtvoire, Bosnia and Herzegovina. Thus, discovering the structure and framework of law and economics in about 30% countries of the world, could be a viable effort. In addition, ethics, morality and social norms are among the hardcore and basic doctrines of Islamic teachings which can affect the behavior of both law agents and economic agents as well. Law often grows from social norms and can change even the individual values of rational people. In doing so, the operation of social norms in law is a kind of “soft-regulation” (Cooter 1997, Eisenberg 1999). In **CLIT**, contracts must be voluntary, in mutual consent framework, and must not impose cost on persons who have not entered in contract. Quran, generally speaking, even uses contract as a metaphor for people’s relationship with God which will render them a potential benefit (9/11).

### **Complementary Rules:**

1. Valid contract requires that consideration be definite at time of contract (prohibition of Gharar).
2. Profits of partnership must be shared according to pre-agreed contracts.
3. Islamic finance is a rapid growing system in **CLIT** framework. In 2009, there are over 310 Islamic financial institutions, in 76 (Muslim and non-Muslim) counties, whose asset size reaches to \$800 billion. It is estimated to reach \$1 trillion by 2010.
4. Cost plus markup sale is used for short-term trade contracts.
5. There is credit sale contract (Salaf) and forward sale contract (Salam) as well.
6. Contract of manufacture is much more flexible.
7. Leasing (or Ijarah) is another Islamic contract.
8. An Islamic bond (Sukuk) is important component in Islamic finance. Thus one new contract in **CLIT** framework is in connection with Sukuk, and
9. In reward contract, payment earned only upon completion of specific task (Bukhari 1984, Sadoogh1996).



## **Comparative Codifications:**

1. There are two fundamental questions in contract law; what promises should be enforced, what should be the remedy for breaking enforceable promises. According to bargaining theory, a promise is legally enforceable if it is given as part of a bargain. Not surprisingly, **CLIT** (other things being equal), is consistent with bargaining theory and this theory has worked in the early Islamic era as a rational rule. Contracts facilitate exchange, and freedom of contract is a necessary part of an economy. Transaction cost models as rational theories, for transaction cost analysis seeks to complement the market based approach by emphasizing on uncertainties associated with contractual activities, thereby can be used in **CLIT** framework. Of course, in the contrary to Posner's view (1979), **CLIT** focuses on both efficiency and justice in analyzing contract.
2. The usual remedy for breach of contract in **CLIT** is damages which almost fully compensate the non-breaching party. There are several damage measures commonly used; expectation, reliance and restitution are mentioned typically. The expectation measure requires the breaching party to pay an amount to the other that puts her in the position she would have been in, had the contract been performed. Under the reliance measure the breaching party compensates the other party for his expenditure induced by relying on the contract. The restitution measure returns only monies paid to the breaching party. Mistake, anticipatory breach, non conforming tenders, and specific performance are among other contract law remedies which can be used similarly in **CLIT** in different circumstances (Rayner 1991, Goldziher, 1981). Obviously when we compare this **CLIT** finding with the CCL we will find some remarkable similarities between those two (Dimatteo 2001, Mather 1999, Cooter, Ulen 2007).

3. Reciprocity, transparency, truthfulness, peaceful relationship, paying attention to competition, efficiency, justice, cooperation, mutual interest and mutual respects, using exact measurement in transaction, prohibition of: a)- “Gharar”; b)- usury; c)- bribery; d)- stealing; e)- trick and cheating are among other ethical considerations in **CLIT**. Some studies indicate that: making wealth requires people to do what they say. In relationship and repeat transactions, reciprocity makes people do what they say, even without contract law. According to the contract principle of economic cooperation, the law should enable people to commit to doing what they say (Cooter 2008, 1107). In **CLIT** framework, however, ethics and morality play as an endogenous factor in encouraging stranger to work cooperatively. In addition, in **CLIT** framework, justice and efficiency at one hand, and reasonable (and not rivalry) competition and cooperation at the other, do not contradict and rather, are synergizing each other as well. For **CLIT** considers the long run benefits which could be obtained by reasonable competition and cooperation.
4. Obviously, the rules of contract law seem to perform a number of economic functions. One is to enforce those agreements that are likely to increase efficiency. Second could be keeping low the cost of administering contract. Third is to allocate risks that are not expressly allocated by the parties. Finally it seems clear that much of contract law is devoted to concerns about distributive consequences of the bargains people have made.
5. The economic analysis of contract law provides a unique perspective on the rules, categories and boundaries of the evolving legal doctrine of contract law. Contract law concerns the structuring of contracts, the negotiation of settlements among the parties of interest in a dispute over their asserted legal rights. If the contracting parties take the time and incur the

costs to incorporate into the contract terms, there would be no occasions for the courts to prescribe remedies; these are other rational justifications, strongly supported by **LEMI**.

6. **LEMI** as a school of law and economics emphasizes its own mode of reasoning and maintains its own stance on issues in legal economic policy and, in doing so, brings out different facets of legal economic problems and their potential resolutions. As Medma, correctly maintain: “one cannot claim that there is the best approach to doing law and economics”. He introduces at least 8 schools of thought in law and economics and concludes that each of these schools of thought is far too narrow in scope to do justice to the breadth and totality of the interrelations between legal and economic processes. Taken together however, they unlock the black box of legal economic relationships that had so long been ignored in the development of economics and legal thinking (Mercuro and Medema 2006). Hitherto **LEMI** goes its own way in direction of development along with other schools of law and economics.

## **VI. Conclusion**

Contract law in Islamic perspective helps people to cooperate by enforcing, interpreting and regulating promises. By enforcing promises, **CLIT** enables people to make credible commitments to cooperate with each other, and creates incentives for efficient cooperation. Cooperation is efficient when the promise invents in performing at the efficient level and the promisee relies at the efficient level. By laying out guidelines for information that must be revealed, **CLIT** seeks to induce optimal informational exchange within the contractual relationship. By regulating contracts in **LEMI** framework, the courts can correct some elements of market failures too. By correcting market failures, **CLIT** can reduce the threat of opportunistic behavior that undermines the willingness of people to make commitments to each other. Finally

**CLIT** helps to solve the problem of cooperation with minimal reliance on the apparatus of the state. Consequently and in sum: 1- **LEMT** can appear as a distinct school of thought along with other schools of law and economics, which at the same time synergizing other schools. 2- It can have a decisive role in extending the literature of current law and economics. Paying attention to sacredness of human being and consistency of action and intention in **LEMI** and especially in **CLIT** is crucial in increasing the actual wealth of the society. 3- It is consistent with general framework and basic structures of conventional law and economics and it does have friendly and peaceful relationship with other branches of **CCL**. 4- Its ethical content can assist some orthodox and extreme secular approaches to simmering down their orthodoxies. 5- It produces some scientific and empirical models to be used in legal systems of about 60 Muslim countries and even some non-Muslim countries as well. 6- Of course there is a remarkable gap between actual performance of contract law in Muslim countries and **CLIT** theory. 7- There are remarkable performances of some **CLIT** versions, especially regarding financial contracts (Ayub 2008, Harvard 2008, and Berkeley 2009).

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