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Sacred Profit: A Sociology of Islamic Finance

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A Sociology of Islamic Finance

By

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Abstract

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by

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The first commercial Islamic bank was founded in 1975. Today, Islamic finance is a $1.6 trillion global industry that has been growing at over 20% per year since the year 2000. It offers financial products ranging from Islamic auto loans to Islamic derivatives, all of which adhere to rules derived from Islamic texts — most notably a ban on interest.

In light of the short history and sudden growth of Islamic finance, this dissertation asks three main questions. First, why is there a thriving *Islamic*-finance industry today, yet no other large-scale form of religious finance — no Christian-finance industry or Jewish-finance industry, for example? Second, why has Islamic finance grown so fast, especially since 2000? And third, how do Islamic financial institutions manage to offer the same kinds of products that conventional financial institutions do while remaining "Islamic"?

The answer to these questions centers largely on one group — religious jurists — and their changing relationship over time to the forces of capital. In most religious traditions at most times in history, religious jurists have been guardians of a relatively formalistic approach to law. In the case of the ban on interest, I show in Chapter One that religious jurists in Judaism, Christianity, and Islam during the medieval period all performed very similar roles: they elaborated complex formal rules as to when financial transactions did or did not violate the ban, and thus helped merchants devise ways of circumventing the ban while not running afoul of religious law. The jurists helped religious law evolve to accommodate commercial needs. However, in Judaism (except for Orthodox Judaism) and Christianity, religious jurists faded from their high social significance between the 16th and 19th centuries. The interest ban itself faded and disappeared too. In Islam, by contrast, religious jurists have remained a respected and significant social group until the present. They help

guard the beliefs that (a) the interest ban is part of God's law and (b) that adherence to legal form is a crucial condition for piety.

Chapter Two explores how this dual survival in Islam — of the interest ban and of religious jurists — set the stage for the emergence and efflorescence of the Islamic-finance industry in the late 20th and early 21st centuries. In the 1970s, petrodollars flooded the Gulf region. Pious Muslim entrepreneurs experimenting with the possibility of interest-free banking enlisted the support of religious jurists to certify that their products were indeed in compliance with Islamic law. This alliance between financial capital and relatively conservative religious jurists concerned with legal form gave rise to the modern Islamic-finance industry, which sells "shariah-compliant" financial products certified by the jurists that circumvent interest using formally acceptable combinations of asset trades and leases.

Chapter Three argues that Islamic finance is today an "ethical-consumption certification apparatus" akin to the fair-trade and socially-responsible-investment movements. All three center on highly technical means of certifying that consumer products are indeed ethical. These certification schemes give customers peace of mind, but also create new technical understandings of the ethical.

Chapter Four returns to the jurists at the heart of Islamic finance, who are known today as "shariah scholars" and who sit on the "shariah supervisory boards" that oversee each Islamic financial institution. This chapter describes how shariah scholars, despite some internal differences, maintain a strong corporate identity that valorizes deep technical knowledge of Islamic law. A perfect marriage ensues between the scholars' scientific-technical understanding of shariah and the bankers' scientific-technical engineering of new financial instruments.

Chapter Five examines ethical contests within the industry, especially surrounding sale-based products such as *bayʿ al-ʿīnah* and *tawarruq*. It shows how even the most contentious debates within Islamic finance today entrench the formal-technical approach to religious law guarded by the shariah scholars.

In sum, Chapters Two through Five show that the accommodation between financial capital and religious law that jurists facilitated throughout medieval history has become the basis for a new, highly technical, certification-oriented form of 21st-century capitalist finance.

子供の頃にうんと世話をしてくれたおわやんへ

To Kazuko Matsuura, who has carried me far

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ACKNOWLEDGEMENTS

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The people who kindly agreed to be interviewed for this project are too numerous to name individually, and in some cases prefer to remain confidential. Yet I owe each of them a large debt of gratitude for their time and insights. This manuscript would be lifeless without them. Whether shariah scholars, financiers, lawyers, journalists, commodities specialists, or academics, all work long hours not just to earn a living, but to bring their vision of a moral economy into being. Nevertheless, they made time for me.

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TRANSLITERATION

For Romanization of Arabic,[1] this manuscript generally uses the ALA-LC system (shown below). The exceptions are:

- Words that are so common in English-language media that I consider them part of the English language (hence "shariah" instead of *sharīʿah*, "fatwa" instead of *fatwá*), including Islamic-finance terms (e.g. "murabaha" instead of *murābaḥah*). In such cases, I choose what appears to be the most common spelling in English-language media.
- Human names for which the individuals in question demonstrate a preferred English-language spelling (e.g. on a personal website) or that are widely published in English-language media (e.g. "Nizam Yaquby" instead of "Niẓām Yaʿqūbī")

The ALA-LC system for Arabic[2]

Arabic	Romanization		Arabic	Romanization		Arabic	Romanization		Arabic	Romanization
أ	a / u		ذ	dh		ع	ʿ (ʿayn)		و	w / ū
إ	i		ر	r		غ	gh		ي	y
ب	b		ز	z		ف	f		ى	á
ت	t		س	s		ق	q		◌َ	a
ث	th		ش	sh		ك	capital		◌ُ	u
ج	j		ص	ṣ		ل	l		◌ِ	i
ح	ḥ		ض	ḍ		م	m		ء	’
خ	kh		ط	ṭ		ن	n			
د	d		ظ	ẓ		ه / ة	h			

[1] The reader should note that words of Arabic origin that are now part of Bahasa Malaysia or Bahasa Indonesia are often Romanized differently than they are under ALA-LC or conventionally in English. For example, the sound that "sh" represents in English (represented in Arabic by the letter *shīn*) is typically Romanized as an "sy" in Bahasa Malaysia and Bahasa Indonesia. Hence "shariah" in English and *sharīʿah* in ALA-LC but "syariah" in Bahasa Malaysia and Bahasa Indonesia.

[2] Further ALA-LC romanization rules are available at http://www.loc.gov/catdir/cpso/romanization/arabic.pdf (Accessed August 15, 2014).

INTRODUCTION

> We had a meeting in Doha, back when this idea of an Islamic hedge fund was very new. Before the shareholder meeting, I explained the idea to one of the shariah scholars. "*Yā akhī* [*my brother*]," he said, "this is wonderful! We would approve it!" I hadn't even translated the documents into Arabic yet, but he was already thrilled. I was surprised.
>
> Later, we met with the rest of the shariah board. He pointed to me and announced: "Everyone, we have some good news. Our brother here has come up with a new hajj fund!" It took me two hours to explain what we were actually doing.
>
> *Specialist in Islamic financial engineering, United Kingdom, July 2013*

The history of modern Islamic finance is a story of astonishing growth. The first commercial Islamic bank — Dubai Islamic Bank — was only launched in 1975. Today, Islamic finance is a $1.6 trillion global industry growing at 20% per year (Grewal 2013). From humble roots, the industry has also grown technically sophisticated: Islamic financial products ranging from hajj (pilgrimage) funds to hedge funds are now available, as the quote above shows.

This manuscript tells the story of how Islamic finance mushroomed into the industry it is today. To that end, it poses a few simple questions.

First of all, why is there a thriving *Islamic*-finance industry today, yet no other large-scale form of religious finance? Why is there an Islamic-finance industry, but no Christian-finance industry, Hindu-finance industry, or Jewish-finance industry?

Second, why has Islamic finance grown so fast, especially since the year 2000? In the past decade and a half, it has gone from being an niche industry — successful only in a few domestic markets and having a weak transnational dimension — to being a mushrooming segment of the global financial universe, complete with its own transnational markets (most notably the market in *sukuk*, or "Islamic bonds"[3]).

Finally, why does Islamic finance look so much like conventional finance? Today's Islamic financial institutions offer a range of financial products that are "Islamized" versions of conventional financial products: Islamic savings accounts, Islamic credit cards, Islamic auto financing, Islamic bonds, Islamic mutual funds, and even Islamic derivatives, for example.

The manuscript is based on 18 months of fieldwork and 77 in-depth interviews I conducted mostly between 2009 and 2014 — primarily in Dubai, Kuala Lumpur, and

[3] I put "Islamic bonds" in quotation marks because sukuk are technically not bonds, but rather fixed-income asset-backed securities. However, they are engineered to function like bonds from an investor's perspective.

London, and secondarily in Qatar, Kuwait, and Yemen. It also draws on primary and secondary literature on Islamic finance, Islamic jurisprudence, and the comparative history of religion and the economy in the three Abrahamic traditions.

The remainder of this introduction first briefly describes the history and current state of modern Islamic finance. It then previews the manuscript's argument and chapter structure.

Islamic finance since 1975

ISLAMIC FINANCE IS A BOOMING GLOBAL INDUSTRY…

Today, Islamic finance is a booming global industry representing US$1.6 trillion in assets (Grewal 2013). While this is only 0.7% of global financial assets (Lund et al. 2013), Islamic finance's growth has been exponential (see Figure 1). One estimate predicts that the Islamic-finance sector will grow at a compound annual growth rate of 20% a year over 2011–2015, roughly doubling during that period (Standard & Poor's 2012). Demand has been so strong that Islamic banking assets in major markets continued to grow in 2009–2010, in the wake of global financial crisis.

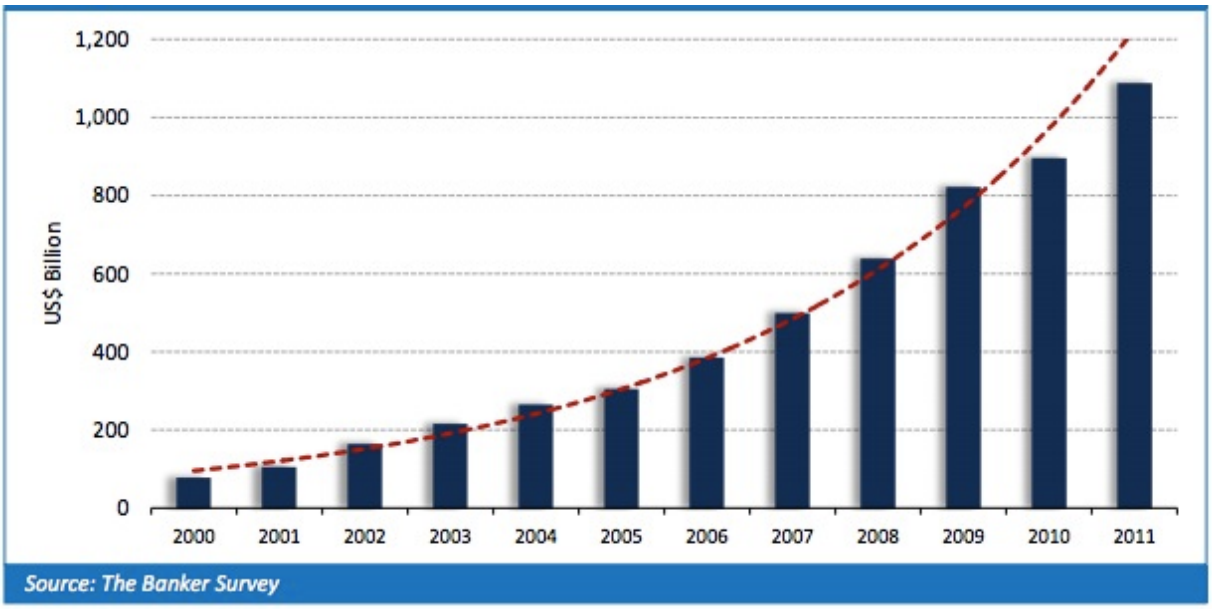

FIGURE 1: GLOBAL ASSETS OF THE ISLAMIC-FINANCE INDUSTRY (OIC SESRIC 2012: 3)

Islamic finance is not only growing fast, but internationalizing fast. While Islamic finance is most popular in the Gulf region and Islamic Southeast Asia, Islamic financial

institutions now exist in 105 countries (Warde 2012). Islamic finance has also extended beyond the Islamic world. Kuala Lumpur, Dubai, and Bahrain are the world's most important Islamic financial hubs today, but London and Singapore are gaining ground. Even governments of countries with virtually no Muslims — such as Japan and South Korea — are drafting legislation, launching government initiatives, and receiving training on Islamic finance.

…that looks increasingly like conventional finance

In addition to growing in dollar terms and spreading around the world since 1975, Islamic finance has grown broader in scope and deeper in technical sophistication — so much that it looks increasingly like conventional finance. Its advocates have also grown less idealistic and more pragmatic. Most no longer think of Islamic finance as a path to a separate and superior Islamic economy, a radically different way of distributing money and capital in society, or a means for reducing poverty and inequality. Some supporters of Islamic finance retain such dreams, to be sure. But those are dreams distant and deferred. Today, its practitioners view Islamic finance as another consumer choice, an alternative flavor of conventional finance, and a novel "value proposition" out of many in the market for financial services. Indeed, Islamic finance has moved so far into the financial mainstream that non-Muslim investors in the United States and Europe are often among the largest buyers of sukuk issuances (Oxford Business Group 2013).

Founded in the 1970s and early 1980s, the first Islamic financial institutions were small and medium-sized banks that focused almost exclusively on retail and commercial banking in their national markets. Next, in the 1980s, came Islamic insurance (known as takaful). Then, in the 1990s and the 2000s, Islamic finance moved into haute finance: Islamic bonds, Islamic mutual funds, and Islamic investment banking appeared. And today, Islamic financial institutions offer nearly the same services that conventional financial institutions do. Even the most exotic animals in the conventional financial bestiary now have Islamic counterparts. Islamic structured finance, Islamic leveraged buyouts, Islamic aircraft leasing, Islamic currency derivatives, and even Islamic hedge funds are now available. Curiously, theorists and practitioners of Islamic finance insisted — as recently as ten years ago — that such sinful and systemically destabilizing instruments would never exist in Islamic finance. Yet these instruments now exist in "shariah-compliant" form.

Its moral critique of Western financial hegemony is softening…

As Islamic finance expands in scope and increasingly replicates conventional financial instruments, its moral critique of conventional finance has softened. In the 1960s, 1970s, and 1980s, supporters of Islamic finance explicitly targeted Western financial hegemony. Their postcolonialism portrayed Western banks in particular as parasites. These true-believers

aimed to launch a moral, spiritual, and social revolution in finance. They sought a third way separate from both the corrupt, untrammeled capitalism of the West and the godless, stifling command economy of the socialist world. This third way was to build a holistic, ethical Islamic economic system that purged the economy of interest and revitalized Islamic economic institutions such as *waqf* (charitable endowment) and *zakat* (the Islamic wealth tax). The early Islamic bankers' critique of interest was not only that the Quran deemed it sinful, but that interest-bearing debt oppressed the poor and discouraged productive investment by placing the burden of risk on the borrower. Therefore, the first Islamic financial institutions aimed to eliminate interest-based debt entirely (Chapra and Ahmad 1985; Al-Najjār 1978; Al-Najjār 1972; Al-Ṣadr 1977; Siddiqi 1972, 1983a, 1985, 2004, 2004). In its place, they introduced equity-based modes of financing in which the owner of capital shared more of the risk. This was a substantively different approach to finance than the conventional model of banking.

…as its imitation of conventional financial practice shows

The postcolonial vision of Islamic finance that prevailed in the 1960s and 1970s gradually eroded from the late 1970s onward as Islamic finance became a commercial endeavor. Faced with competition from conventional banks, the first commercial Islamic bankers found that they had to make compromises. It is easiest to understand these compromises by tracing the development of Islamic financial instruments: between the late 1970s and the 2000s, Islamic financial institutions constructed Islamic versions of the very instruments that the early theorists of Islamic finance criticized.

Consumer lending: In the 1960s, the pioneers of Islamic economics and Islamic finance envisioned an interest-free economy. They condemned consumer loans for ensnaring ordinary people — and especially the poor — in debt. As foes of usury had done for centuries, they saw moneylenders as parasites.

The earliest ventures in Islamic banking were therefore attempts to supplant interest-based lending and replace it with a banking model that was more ethical and substantively different. The first Islamic bank, the Mit Ghamr Savings Bank, opened in rural Egypt in 1963 as a non-profit venture that avoided interest. It extended non-interest-bearing loans to local businesses and invested in them on the basis of profit sharing. Also in 1963, the Tabung Haji Pilgrimage Management Fund opened in Malaysia to help Muslims save money for the *hajj* pilgrimage and invest it according to Islamic principles. Like Mit Ghamr Savings Bank, it provided no interest-bearing consumer loans. A decade later, the Islamic Development Bank, an intergovernmental development organization, was founded with a mandate to avoid interest in all its transactions. Shortly thereafter, the first commercial Islamic bank, Dubai Islamic Bank, opened in 1975 and adopted an equity-based operating model that avoided interest.

Yet by the 1980s, Islamic banks were selling Islamic consumer loans. Today, Islamic banks offer an Islamic version of nearly every consumer-lending product imaginable, from Islamic car loans to Islamic credit cards. Technically, these Islamic instruments avoid charging interest. Instead, they use deferred-payment sales, asset leases, and other stratagems to extract from customers a periodic payment on principal at a pre-established rate. In other words, they perform the same economic function as interest-bearing loans. From the customer's perspective, an Islamic consumer loan is just like a conventional consumer loan — except it is not sinful.

Bonds: In the 1970s and 1980s, theoreticians of Islamic finance disparaged the international bond market. They argued that it entrenches Western economic hegemony, impoverishes the Third World, and destabilizes economies. Bonds, they felt, take the poison of interest and spread it out to borrowers and lenders around the world. Yet by the 1980s, efforts to establish an Islamic bond market were already underway. In 1983, the government of Malaysia issued the first Islamic fixed-income security. And in 1990, Shell MDS issued the first corporate Islamic bond. As of 2013, there were $237 billion of Islamic bonds outstanding worldwide (Thomson Reuters Zawya 2013). Known as sukuk, Islamic bonds are not technically interest-bearing instruments, but asset-backed fixed-income securities. Yet from a functional perspective, they act almost exactly like bonds. Industry analysts expect the sukuk market to continue growing fast, achieving a blistering growth rate of over 25 percent per annum through 2018 (ibid.).[4]

Derivatives: In the 1980s, virtually all theorists of Islamic finance, Islamic economics, and Islamic jurisprudence considered derivatives un-Islamic. Islam, they said, bans the sale of indeterminate things (*gharar*): fish in the sea, birds in the sky, an unborn calf in its mother's womb. Likewise, they argued, Islam bans even the most basic derivatives, such as forward contracts. To them, accepting $300 today in exchange for delivery of a ton of as-yet-unharvested wheat three months from now was akin to accepting $300 today for delivery of an (as-yet-unborn) calf three months from now. And if simple commodities derivatives were un-Islamic, then there could be no question about derivatives with financial underlyings, such as currency derivatives and interest-rate derivatives: they contravened not only the ban on indeterminate sale, but also the ban on interest.

In the 1990s, as the global trade in derivatives boomed, most proponents of Islamic finance still treated derivatives as a red line that Islamic finance should not cross. They argued that derivatives trading is tantamount to gambling (*maysīr*), which Islam prohibits.

[4] The Thomson Reuters Zawya Sukuk Perceptions and Forecast Study 2014 expects the total value of outstanding sukuk worldwide to grow to $749 billion by 2018. From a starting point of $237 billion in 2013, this represents an average annual growth rate of 25.9 percent over the period 2013–2018.

Enron in 2001 (and, later, the sub-prime mortgage crisis in 2008) seemed to make their case neatly. What, they asked, is the global trade in derivatives but a reckless casino-world, untrammeled by moral oversight and systemically destabilizing to boot?

Yet by the mid-2000s, Islamic financial institutions were selling Islamic derivatives. Islamic futures and options came on the market. Today, Islamic banks from Kuala Lumpur to Dubai to London offer not only Islamic commodities derivatives, but all manner of Islamic financial derivatives, including Islamic cross-currency swaps, Islamic foreign-exchange forwards, and Islamic repos.[5] Islamic derivatives have become such a mainstream part of Islamic finance that an international industry organization, the International Islamic Financial Market (IIFM), teamed up with the International Swaps and Derivatives Association (ISDA) to publish global standards for Islamic derivatives in 2010.

How does Islamic finance survive and grow in a world of secular finance?

Both external economic forces and internal transformations within Islamic finance itself help explain how Islamic finance has grown and changed since 1975. Macroeconomic trends have been important: since 2000, high oil prices have again shunted capital to the Gulf region, just as in the 1970s; the fast recovery of the Malaysian economy in the wake of the 1998–1999 economic crisis has boosted Islamic finance there as well. But Islamic finance has also grown and changed because of the expansion of financial markets and financial-services industries worldwide. The evolution of Islamic finance since the 1990s is in many ways a "financialization story." In a world awash in liquidity, where interest rates are low and national barriers to financial entry are falling, Islamic banking has grown as conventional banking sectors have grown; Islamic capital markets have expanded as conventional capital markets have expanded.

An ideological shift accompanied this "financialization of Islamic finance." While the pioneers of Islamic finance in the 1960s and 1970s saw it as a postcolonial project of resistance against Western economic hegemony, by the neoliberal 1990s and 2000s, Islamic finance had been adopted as the precocious, fast-growing little brother of conventional finance. One symbol of this is that the most powerful conventional Western banks — including HSBC, Standard Chartered, Goldman Sachs, Deutsche Bank, and ABN AMRO — today all have Islamic divisions or are otherwise active in Islamic haute finance. Likewise, since the 1990s, many of the largest and most prestigious law firms have launched specializations in Islamic finance.

[5] A repo, or repurchase agreement, is an agreement to sell securities and then buy them back later at a specified price. The repurchase price includes the original sales price plus interest. Because the market price of the security may change, a repo is equivalent to a spot sale (which is not a derivative) combined with a forward contract (which is a derivative). The duration of a repo is usually short: a few days or weeks, or even overnight. The underlying securities are typically short-term government securities.

So how did this happen? How did the project of modern Islamic finance, whose core tenets seem to clash with the modus operandi of conventional financial markets, become grafted onto those markets? After all, the DNA of Islamic finance seems completely at odds with the DNA of neoliberal conventional finance. Nearly every textbook of Islamic finance published in the last decade says that Islamic finance bans interest, speculation, trading in debt,[6] and trading in risk. According to this logic, Islamic finance grounds all financial transactions in real economic activity and in the movement of real assets. How can such principles be reconciled with modern financial markets — the apotheosis of the free, unencumbered, and digitally instantaneous trade of money, debt, and risk, blissfully unmoored from real economic activity? How can Islamic finance work in a neoliberal financial universe?

I argue that since the 1980s, industry participants have overcome this clash between Islamic economic principles and neoliberal finance by building what I call an *ethical-consumption certification apparatus*. An ethical-certification apparatus is a system for formally classifying and certifying market-produced goods and services according to ethical standards. Ethical-certification apparatuses are not unique to Islamic finance: the budding fair-trade sector, which certifies coffee, tea, bananas, and other consumer goods with various proprietary fair-trade labels, is another example.[7]

The ethical-certification apparatus of Islamic finance, which I call the "shariah-compliance apparatus," is what makes possible the marriage between classical Islamic jurisprudence and neoliberal finance. It is a dense jungle of formal rules and certifications, calculative technologies, industry terminology, and institutions. Its institutional ecology includes Islamic jurists, bankers, secular lawyers, government regulators, auditors, accountants, standard-setting industry boards, and academic institutions. The entire apparatus is oriented toward the formal classification and certification of financial products as "shariah-compliant" or "not shariah-compliant." It was into this dense jungle that I dove to conduct research. My fieldwork included 18 months of interviews with many of the leading figures in the international Islamic-finance industry — conducted primarily in Kuala Lumpur, Dubai, and London — as well as two months of participant observation at a Malaysian corporate shariah consultancy and participation in many industry trainings and conferences.

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[6] While shariah scholars involved in Islamic finance in most of the world consider trading in debt to contravene Islamic law, many shariah scholars of the Shāfiʿī juristic school — which prevails in Southeast Asia — consider the trading of debt to be acceptable.

[7] Other examples — to name a few — include socially responsible investing, the environmental certification of buildings and homes (as with the U.S. Green Building Council's LEED certification), and the screening and certification of charities for accountability and efficiency. I discuss ethical-consumption certification apparatuses in Chapter Three.

Dissertation structure

This manuscript has an Introduction, five chapters, a Conclusion, and a Postface. They tell the story of how Islamic finance came to be the industry it is today. Below, I preview the chapters and Postface.

CHAPTER ONE

God's technical experts: Religious jurists and the usury ban in Judaism, Christianity, and Islam

The most important feature distinguishing Islamic finance from conventional finance is its avoidance of interest. But why does Islam — and among the major 21st-century religions, only Islam — still ban interest? Chapter 1 compares the history of the three Abrahamic usury bans between the 2nd century CE and the 20th century CE. Different scholars have argued that different variables determine the survival of interest bans in a religion: general economic development, the rational economic incentives of individual institutions such as the medieval Church, or political relations between religious authorities and secular rulers, for example.

In contrast, I offer a deeply sociological theory: that religious jurists — halachists in Judaism, canonists in medieval Christianity, and *fuqahā'* in Islam — acted as *carriers* of the usury ban. My thesis is that the social position of religious jurists determined the survival of the usury ban. This is because a systematic, legalistic usury ban can only survive as long as a distinct social group of religious jurists survives to carry it through history. The jurists keep the usury ban alive by (1) adapting it to changing economic needs while (2) retaining its symbolic and intellectual link to the prestigious tradition of religious law. I argue that when religious jurists lose prominence and disappear, formal religious law quickly ceases to govern the economy, and the religious usury ban disappears. In conclusion, the usury ban survived in Islam because religious jurists survived as a distinct and respected social group into the 20th and 21st centuries. However, in Christianity and (with the exception of some Orthodox communities) in Judaism, the jurists did not survive.

CHAPTER TWO

From communitarian experiments to shariah formalism: The birth and growth of Islamic finance, 1963–1999

This chapter focuses on the birth and development of modern Islamic finance through the second half of the 20th century. During this period, Islamic finance transformed from a geographically dispersed social movement into a fast-growing for-profit industry.

The chapter's first half focuses on 1963–1975: the period from the launch of the first modern Islamic financial institutions, which were non-profits, to the launch of the Islamic Development Bank in 1973 and Dubai Islamic Bank, the first for-profit Islamic bank, in 1975. Four international-level factors contributed to these developments: (1) the "Arab Cold War" from the 1950s onward; (2) the spread of Islamic conservatism and the expansion of political Islam from the 1970s onward; (3) the oil boom of the 1970s; and (4) the rise of global finance from the 1970s to the present. These forces gave rise to two very different forms of Islamic finance. Out of the marriage of social welfarism and Islamic revival appeared non-profit communitarian experiments in Islamic finance in the 1960s. Out of the marriage of market liberalism and Islamic revival appeared liberal Islamic finance in the 1970s and 1980s. Liberal Islamic finance is the dominant paradigm in Islamic finance today; communitarian projects are marginal.

The chapter's second half focuses on 1975–1999. Since the 1970s, liberal Islamic finance has turned economic piety into a question of adherence to *formal rules* of Islamic law rather than to *substantive economic principles*. Why has this shift taken place? I posit a cycle of formal rationalization triggered by the fact that Islamic banks compete in markets dominated by conventional banks. They therefore face a choice between less profitable solutions that advance a substantive agenda and more profitable ones that merely comply with shariah's formal requirements. A case study of the Islamic financial practice of *murabaha* illustrates this cycle.

CHAPTER THREE

"Capitalism with a human face": Ethical-consumption certification apparatuses

A central argument of this book is that Islamic finance has spread so prolifically because it has transformed into an ethical-consumption certification apparatus (ECCA) that I call the "shariah-compliance apparatus." An ECCA is a regime of rules, organizational forms, monitoring technologies, experts, and forms of expertise that defines and certifies consumer products as either ethical or not.

In this chapter, I introduce the concept of ECCA and describe two other examples: fair trade and socially responsible investing. Both fair trade and socially responsible investing began as social movements of sorts in the 1960s and 1970s, but both evolved into ECCAs by the 1990s and 2000s. Markets were the most powerful engine of this change, driving the movements' formal and instrumental rationalization. This evolution has brought commercial success and visibility, but has also raised new ethical quandaries. Islamic finance followed a very similar trajectory between the 1960s and the 2000s. This suggests that the ECCA is a formation uniquely congruent with certain features of late-twentieth and early-twenty-first century capitalism, and can therefore serve to elucidate those features.

CHAPTER FOUR

Shariah scholars

Shariah scholars are experts in Islamic jurisprudence who serve as the official ethical arbiters of Islamic finance. They are central to the Islamic-finance industry, for it is their job to certify whether financial products are shariah-compliant — a function without which the industry, at least in its current form, would cease to exist.

But how do religious jurists accommodate profit motives — including, today, those of large financial corporations — without looking like hired guns who are "selling out" their religion?

As we will see in this chapter and the next, the answer today — as it has always been — is for religious jurists to become *technical experts*. They succeed in reconciling their ethical obligations with the interests of capital by interpreting religious law as much as possible as a set of *impersonal formal rules*. Formally rational law requires technical experts, and technical experts can elide many of the most challenging questions about the social and ethical balance-sheet of Islamic finance. This approach to shariah is not so much a deliberate tactic to formalize Islamic finance as it is a deeply embedded part of the scholars' Weltanschauung. Because they are so important to the banks and other firms whose products they certify, the scholars' formal-technical approach to Islamic economic ethics now pervades the entire Islamic-finance industry.

CHAPTER FIVE

Ethical contests

Virtually all Islamic financial products today, from Islamic car loans to Islamic credit cards to Islamic bonds to Islamic derivatives, are replicas of conventional products. Most of them use legal stratagems to mimic the economic effects of interest. Yet some are uncontroversial, while others are hotly debated and often criticized. What makes some more ethically sound than others in the eyes of shariah scholars and industry practitioners? In other words, what is the new calculus of Islamic financial virtue? How does this new calculus reflect the needs and demands of capital? And what are its consequences?

To answer such questions, this chapter examines two of the biggest controversies in Islamic finance today. It is in these controversies that the new Islamic economic ethics are being hammered out. I focus on two practices that Islamic banks use to generate cash-in-hand loans: *bayʿ al-ʿīnah*, which is strictly prohibited in the Middle East but has been accepted in Malaysia until very recently; and *tawarruq*, which is controversial yet widespread around the world. The story of these instruments shows how the boundaries of what Islamic law allows and disallows are formed through contestation, negotiation, and compromise. Digging beyond what may appear to the outsider to be casuistic and legalistic

hair-splitting, this chapter excavates the evolving ethical logics behind these practices. I conclude that in Islamic finance, Islamic law (as interpreted by shariah scholars), state regulation, and capitalist interests do not have straightforward and unchanging ethical stances, but in fact co-produce one another in a never-ending dance of negotiation and re-negotiation.

POSTFACE

Shariah-compliant or shariah-based? The changing discourse of Islamic finance

The Postface examines discourse within the Islamic-finance industry. Specifically, it investigates a shift in the vocabulary industry practitioners use to describe what makes Islamic finance "Islamic." Today, practitioners use the terms "shariah-compliant" and "shariah-based." "Shariah-compliant" refers to instruments that meet a minimum standard of adherence to Islamic rules, whereas "shariah-based" describes a higher level of "Islamicness" that contributes — at least in theory — to higher-order goals such as the construction of an equity-based economy that eliminates the cancer of debt.

I discuss the origins of these terms and their early uses, concluding that the popularity of the call for shariah-based finance is an artefact of the 2000s and especially the post-2008 period, when systemic stability and product transparency have become pressing concerns in both Islamic finance and conventional finance. I then ask: What exactly do people mean by "shariah-based"? At present, many definitions circulate. I distill them into three categories: those that stress separation from conventional finance, those that stress authenticity, and those that stress welfare. I conclude by noting that the multiplicity of definitions is a sign of Islamic finance's growing maturity as an ethical project.

CHAPTER ONE

God's technical experts:
Religious jurists and the usury ban in Judaism, Christianity, and Islam

Introduction

Why is there an *Islamic* finance today — but no other "religious finance"?

At the heart of Islamic finance is its ban on interest. Islamic finance has other core principles, including avoidance of *maysīr* (speculation or gambling), avoidance of *gharar* (transacting in items whose characteristics are uncertain), and avoidance of investment in sectors such as alcohol, pork, cigarettes, and arms. But more than anything else, it is the ban on interest that necessitates and justifies a different way of doing finance. After all, interest is ubiquitous. If one wants to avoid it while still engaging in modern financial transactions, a different financial system becomes necessary.

So why is there an *Islamic* ban on interest today — but no surviving interest ban in any other religious tradition? This chapter seeks to answer that question. For over a millennium, Judaism and Christianity banned interest. In times past, other faiths have had rules governing financial activity as well. Yet today, it is only in Islam that a substantial portion of believers consider interest to be impious. Why is Islam different, and what happened to the other religions' rules about interest?

This article first reviews existing hypotheses about the survival and demise of religious usury bans. It then presents an alternative hypothesis that focuses on a particular social group: the religious jurists. My argument is that in any religion, the fate of a systematic interest ban is closely tied to the fate of the religious jurists. When religious jurists do not exist, no systematic interest ban emerges. When religious jurists emerge and cohere as a professional group, a systematic interest ban emerges. While religious jurists thrive and remain autonomous from heavy political interference, the interest ban survives. And when religious jurists come under attack or lose their traditional prestige or role in society, the interest ban weakens and dies. I review evidence from the history of the three Abrahamic religions — Judaism, Christianity, and Islam — to support this argument. I conclude by considering implications of this argument for the future of contemporary Islamic finance, and particularly for efforts to harmonize shariah standards across institutions and borders by establishing national and global-level shariah boards.

Hypotheses

Below, I first discuss two types of explanations for why religious restrictions on usury and interest appear, persist, and disappear in different religious traditions: "economic" and "cultural and political" hypotheses.[8]

Economic hypotheses stress economic forces and incentives.[9] Some emphasize macro-level economic trends, while others focus on the microeconomic interests of relevant actors (such as the medieval Church). Key variables include social structure, demographic pressures, trade patterns, commercial expansion or contraction, the relative weight of urban and rural production, changes in specie supply and money supply, and the economic needs and strategies of religious and secular authorities.

Cultural and political hypotheses focus on extra-economic forces and incentives. Key variables include statements in holy texts; modes of social interaction; religious conceptions of caste, or of preterite and elect; general religious "worldview" (if such a thing can be identified); and the relationship between religious authorities and secular political authorities.

After presenting the hypotheses of others, I present my own hypothesis: that the emergence, survival, and decline of systematic religious usury bans depends on the emergence, survival, and decline of religious jurists as a social group. My hypothesis is not necessarily at odds with most existing hypotheses. Rather, it specifies the *mechanism* by which economic pressures external to the religious sphere and doctrinal developments

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[8] Two notes are in order. First: Segregating explanations for usury restrictions into "economic" and "political and cultural" types is arguably a fool's errand. This is because the distinctions among what Weber calls "value spheres" (religious, economic, political, aesthetic, erotic, intellectual) were less distinct in earlier societies than they are in modern ones, before the taking-hold of *Eigengesetzlichkeit* — the autonomization of value spheres and institutional spheres via an intrinsic working-out, rationalization, and systematization of ethics and worldviews (Weber 1946a, 1946b) (Bellah 1999; Brubaker 1984; Habermas 1997; Parsons and Shils 2001; Schluchter 1985; Swedberg and Agevall 2005). So we are dealing with an anachronistic typology, but one analytically fruitful in drawing the contours of relevant literature.

Second: This article treats restrictions on usury and interest as the dependent variable to be explained. There is a good deal of social-science research that treats religious interest restrictions as an independent variable, usually in trying to explain patterns of economic development. This approach is, for example, a feature of the "divergence" literature that seeks to explain why the Middle East "fell behind" Europe starting in the early modern period, or why the Islamic world fell behind the Christian. See, inter alia, (Greif 1993; Inalcik 1970; Jones 2003; Kuran 1997, 2009, 2010; Lerner 1965; Lewis 2001, 2002; Rodinson 1974; Weber 1978). I touch on some of this scholarship below — but always with the aim of understanding why usury restrictions evolved as they did. (That said, it is often difficult to determine the direction of causality between economic change and the evolution of usury restrictions.)

[9] We could also call these "materialist" explanations. Kuran catalogues theories of civilizations' economic development as "materialist" or "culturalist" (Kuran 2009). But "materalist" can be a confusing label because most of the hypotheses I describe here as "economic" are not particularly Marxian.

internal to it shape the development of religious usury law. That mechanism is the religious jurists.

ECONOMIC HYPOTHESES

Developmental

The "developmental hypothesis" is the most straightforward of the economic hypotheses about the persistence of usury bans. It is so fundamental that versions of it appear not only in the institutional-economics literature, the law-and-economics literature, and economic history, but in sociological literature as well. It asserts that as economies develop, usury bans erode and disappear. This happens because commercial activity increases the collective economic costs of prohibiting or restricting interest-based lending. Merchants and other large users of capital become more powerful over time, increasing pressure on religious authorities or state authorities to eliminate restrictions on interest.

Like most modernization theories and other developmental views of history, the developmental hypothesis of usury presumes that societies journey through history from an economically immature state to a mature one. Credit allocation goes from being socially embedded, with borrowers in need of capital turning to family and neighbors who do not charge interest, to being socially disembedded, with borrowers turning to an anonymous market of interest-charging professional lenders. This correlates with the transition from a rural society and a primitive, agricultural economy to an urban society with a modern commercial or maritime economy.

A crucial corollary of the developmental hypothesis is the "consumption-production axiom." This is the idea that usury restrictions tend to be stricter in economies where most loans finance consumption, and looser in economies where most loans finance production (with "production" construed very loosely to include also investment, trade, and the distribution of goods and services).

In pre-modern economies, people who need consumption loans are typically in woeful situations: they are widows, families facing illness and loss, peasants struck by a bad harvest, and others in suddenly straitened circumstances. They are those without recourse to credit from family or neighbors. In pre-modern economies, it is only the unfortunates who frequent moneylenders. Demanding interest on loans is therefore tantamount to preying on the vulnerable — a transgression against the laws of community, akin to murder or adultery. Interest becomes an ethical problem, as John Kenneth Galbraith explains:[10]

[10] Scholars well before Galbraith have drawn this distinction between loans for consumption and loans for production. Werner Sombart, who argues elsewhere that the medieval prohibition on usury (like other aspects of Catholicism) was actually a boon to the early development of capitalism, notes that

> In such circumstances, interest is not viewed as a production cost but rather as something the more favored charge the less fortunate or the less wise. So like slavery, it raises a problem in ethics — what is right, just and decent in relations between those who are amply supplied with money and the feckless or needy. (Galbraith 1987:12)

When[11] there are vestiges of feudal or semi-feudal production, we may find the same phenomenon even in modern economies. In modern India, for example, some peasants take consumption loans from landlords, remaining perpetually in debt (see the debate over rural Indian feudalism, mode of production, and interlocking markets, with discussion of usury in Bhaduri 1973; and Prasad 1974; for an alternative view, see Bardhan and Rudra 1980). The point is that in economic settings where lending is overwhelmingly for consumption purposes, lenders are often considered predators.

> even [St. Thomas] differentiates between borrowing for unproductive purposes (the simple loan) and borrowing for productive purposes (capital), and goes so far as to say that while to receive payment for the first is wrong, to receive payment for the second is perfectly legitimate. (Sombart 1915: 248)

St. Thomas Aquinas himself would agree with the first part of Sombart's reading of his work, but might dispute the second. Sombart cites the quaestione in the Summa that addresses usury (Aquinas 1981:qq. 78 in the Second Part of Part II, Article 2). However, turning to the original, it is not clear that Aquinas actually says receiving interest on productive loans is legitimate. At the very least, Sombart seems to be splitting hairs; by "to receive payment" he apparently does not exactly mean, "to receive interest." Aquinas does indeed state, "it is lawful to receive interest for money entrusted to a merchant or craftsman" (Article 2, Objection 5). But he later makes clear (Article 2, Reply to Objection 5) that he is not referring to a loan to a merchant or craftsman, but to a partnership investment:

> He who lends money transfers the ownership of the money to the borrower. Hence the borrower holds the money at his own risk and is bound to pay it all back: wherefore the lender must not exact more. On the other hand he that entrusts his money to a merchant or craftsman so as to form a kind of society, does not transfer the ownership of his money to them, for it remains his, so that at his risk the merchant speculates with it, or the craftsman uses it for his craft, and consequently he may lawfully demand as something belonging to him, part of the profits derived from his money. (*Summa Theologica*, qq. 78, a. 2)

[11] John Kenneth Galbraith was one in a long line of economists to write about usury bans. Keynes's "Notes on Mercantilism, the Usury Laws, Stamped Money and the Theories of Under-Consumption" in (Keynes 1965) states his support for usury laws. So does Adam Smith. See Persky (2007:228), who notes that the debate over whether usury restrictions should exist "came to its climax on the eve of the Industrial Revolution, in a well-known interchange between Jeremy Bentham and Adam Smith in the 1780s." In *The Wealth of Nations* Smith, for all his love of free markets, argues for state maximums on interest rates — and quite restrictive ones, of 5% per annum (Persky 2007:228). Smith was an old man at the time of the debate, and Bentham an up-and-comer; Bentham argued vociferously against usury restrictions, but Smith does not seem to have responded to him (Hollander 1999; Persky 2007). Milton Friedman (1970), predictably, took Bentham's stance, penning an article in *Newsweek* in 1970 entitled, like Bentham's essay, "Defense of Usury."

In contrast, when credit flows to production, lenders are more likely to be portrayed as a boon to society, or at least a neutral force. Their loans go to capitalists who can reasonably expect a positive rate of return on their own investments, not to unfortunates staving off perdition.

A core assumption of the consumption-production axiom is that production loans are only common in economies where commercial or industrial activity has reached a certain level. The more capitalist activity there is in an economy, the greater the proportion of credit allocated to production rather than to consumption. This is what gives the hypothesis a "developmental" premise: it asserts that in the course of economic development, credit systems evolve from overwhelmingly consumption-oriented to largely production-oriented.

Promotion of capitalism

Turning the developmental hypothesis on its head, Werner Sombart presents the promotion-of-capitalism hypothesis: that religious figures (in this case, Italian Scholastics in the late Middle Ages) supported a religious usury ban because it *promoted* the development of capitalism (Sombart 1915:247–250). Locked in a long intellectual tussle with Max Weber, Sombart argued that Catholicism — and not Protestantism, as Weber claimed — provided the more fertile ground for the emergence of modern capitalism. With regard to usury, Sombart contends that the later Italian Schoolmen viewed lending money at interest as a way of preventing money from becoming capital, and therefore banned it in the interest of capitalist development. To Sombart, Antonine of Florence (1389–1459) and Bernard of Siena (1380–1444) understood "the essence of capitalism" almost as well as Karl Marx: When money is simply lent, it is barren, possessing "merely the character of money or a commodity"; but when it is invested as capital, "it is productive… possessing… the power of creation" (Sombart 1915:248). There was a moral component to this view as well: "The Schoolmen hated nothing so much as idleness," and "if a man lends out money without being an undertaker of some sort, he is an idler," not to mention a greedy one (Sombart 1915:249–250). This view has echoes in Islamic theories of *ribā* and moneylending as well.

Rent-seeking

A third economic hypothesis is that powerful borrowers create, enforce, and sustain restrictions on usury and interest to keep their own costs of borrowing low. This is the "rent-seeking hypothesis." In "An Economic Model of the Medieval Church: Usury as a Form of Rent Seeking," Ekelund, Hébert, and Tollison (1989) portray the medieval church as a thuggish bureaucracy that used administrative coercion and the threat of excommunication to fill its own coffers by borrowing at preferential interest rates and

lending[12] at high ones.[13] The medieval church was deeply engaged in both borrowing and lending at interest, despite publicly promulgating a ban on lending at interest and excommunicating members of the church for engaging in it. Examining the activities of the apostolic camera (the Vatican's financial administration) between roughly the eleventh and fifteenth centuries, the authors argue that when the papacy was a borrower, it developed and enforced policies that kept its interest rates down, and when it was a lender, it did the opposite. Consider the Crusades, which were one of the Church's largest expenditures in this period. The authors cite evidence suggesting that the papal treasury enjoyed lower interest rates than other borrowers to finance its military adventures, or sometimes paid no interest at all (Ekelund Jr et al. 1989:324). On the other side of the ledger, the authors cite Vatican documents showing how the apostolic camera maintained an internal lending system at interest. It loaned money to its own clerics via papal bankers, charging sums that "were equivalent to modern interest in all but name" (Lunt 1939:472; in Ekelund Jr et al. 1989:325). The church also borrowed money against its future revenues, raised internal taxes on its own prelates, bishops, and monasteries to cover this, and then either threatened them with excommunication if they failed to pay or encouraged them to turn to high-interest-rate Italian bankers affiliated with the papacy (Ekelund Jr et al. 1989:325–326). In short, the authors treat the pre-Reformation church as a rational-acting monopolistic firm in the salvation industry.

Welfare state

Posner, a scholar of contract law, presents the "welfare-state hypothesis." He begins by asking why limitations on voluntary contracts exist under authorities generally committed to free markets. This development is best understood, he says, if we think from the point of view of a welfare state. When a welfare state provides an income floor or some other form of poor relief, individuals have more incentive to engage in risky behavior. Among other things, they become more likely to take out loans at very high interest rates. Maximum legal interest rates are a way to limit such behavior and thus, in the aggregate, to reduce the state's welfare expenditures (Posner 1995).[14]

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[12] See Noonan (1957), especially pp. 13–14, for a vehement objection to this position.

[13] See Koyama (2010) for a related hypothesis: that the usury prohibition was a barrier to entry that protected monopolists. The monopolists included secular rulers, the Church, and some merchant-bankers.

[14] It is important to note, however, that Posner (a) is talking about interest-rate ceilings in societies where interest in general is legal, not total bans on interest; and (b) that he is describing interest bans imposed by governments (starting with Elizabethan England, and focusing most on the twentieth-century United States), not by religious authorities.

Social insurance

Glaeser and Scheinkman (1998) take a more functionalist position, arguing that usury laws are a primitive form of social insurance. Their "social-insurance hypothesis" argues that usury laws are Pareto-improving (i.e., net-welfare-improving) institutions. Individuals tend to borrow when their income is low and lend when their income is high. This means the marginal utility of income while borrowing is higher than while lending. "Therefore, individuals would ex ante prefer income to be transferred from the state of the world where they are lending to the state of the world where they are borrowing" (Glaeser and Scheinkman 1998:3). Usury laws make this preferred state a reality by keeping interest rates artificially low. Working theoretically from this premise, the authors then show that interest-rate restrictions are likely to be stricter when wealth inequality is greater, income is less predictable, and borrowers are more powerful in society than lenders. The authors show this to have been the case with data on interest-rate ceilings in US states, and also use Christian and Jewish usury restrictions as ancillary examples.

Consumption-smoothing

The "consumption-smoothing hypothesis" likewise asserts that usury restrictions are a functional solution to a collective economic concern: the problem of uneven and unpredictable income in a pre-modern economy (Reed and Bekar 2003). Although real wages were very low in the 13th and early 14th centuries, actual starvation was uncommon and aggregate populations increased. How was this possible? One answer was consumption-smoothing mechanisms: ways of stabilizing, over time, individuals' ability to consume. During medieval crises such as "illness, accidents, premature death of bread-winners, fire, robbery, pillage in war, natural disasters, and bad weather" (Dyer 1989:234; in Reed and Bekar 2003:349), there were several ways individuals could smooth their consumption. These included charity from the Church (e.g., via alms and hospital care), informal pooling among neighbors and family members, and borrowing from moneylenders.

In the model that Reed and Bekar present, the medieval Church's usury ban was a way to optimize the mix of "investors" who participated in pooling and charity. In order for pooling and charity to smooth consumption effectively and sustainably across society, most people — and especially wealthier people — had to participate. If the rich left pooling schemes or did not give alms, the consumption-smoothing system would not work as well. (Though the authors do not mention this, there is an analogy here to the way health insurance and auto insurance work: insurance companies seek ways to keep "desirable" customers in their pools.) However, for wealthy individuals, engaging in moneylending was often a better financial investment that investing in pools. By creating religious usury bans that tied "salvation to pooling and charity while tying damnation to lending at interest" (Reed and Bekar 2003:355), the medieval Church kept as many agents as possible "bought

in" to charity and informal pooling schemes and kept them from defecting to the capital market.[15]

CULTURAL AND POLITICAL HYPOTHESES

Primordialist hypotheses: "Urtexts" and "stagnant conservatism"

The simplest "sociocultural" hypothesis is what I call the "Urtexts hypothesis": the idea that interest is prohibited in certain religious traditions because those religions' originary doctrinal texts prohibit or condemn it. The Urtexts hypothesis appears in some form in most analyses of interest bans in Islam (where believers reference the Quran, especially Al-Baqarah, Al-Imrān, and Al-Nisā'; and selections from various ahadith) and Judaism and Christianity (where key passages come from Exodus, Leviticus, Deuteronomy, and Ezekiel; in the New Testament, Matthew and Luke). In simple, ahistorical accounts, the Urtexts hypothesis sometimes stands alone as an explanation for usury bans. Such accounts offer explanations along the lines of "Islamic finance exists because the Quran bans interest."

However, the presence of references to interest in holy texts is not enough to explain the presence and evolution of religious interest bans. Urtexts alone cannot explain (1) why religious scholars and authorities interpret the texts the way they do at certain times and places (e.g. why Jews and Christians interpreted the same Deuteronomic prohibition completely differently), and (2) why religious or political authorities do or do not enforce a ban.

Tribal brotherhood to universal otherhood

Moving on to more nuanced theses, we come to Benjamin Nelson's "tribal-brotherhood-to-universal-otherhood hypothesis," from his 1949 book *The Idea of Usury*. To Nelson (1949), the history of usury in Christian Europe traces a fundamental shift in Western morality. Nelson focuses on the re-interpretation, between the medieval era and the nineteenth century, of the Deuteronomic prohibition on lending to one's brother: "Thou shalt not lend upon usury to thy brother… unto a stranger thou mayest lend upon usury; but unto thy brother thou shalt not lend upon usury" (Deuteronomy 23:19–20).

To Nelson, the re-interpretation of Deuteronomy reflects a shift from Gemeinschaft to Gesellschaft. According to this view, the Church's usury policy evolved because the

[15] But why did the Church care about its believers' economic welfare in the first place, and about insuring them from financial downturns? It is natural to expect the managers of religious institutions to care about the well-being of their faithful. But Reed and Bekar make an interesting rational-choice argument as well: effective social welfare protected the flock's economic productivity and economic stability while reducing its mortality rate. This increased the Church's size, revenues, and influence while reducing the likelihood of peasant uprisings and famines.

transition from a community of common mores to a society of self-interested individuals led Christians to re-interpret the Old Testament ban. Forged in the "blood brotherhood morality of the Hebrew tribesmen," which "assumed the solidarity of the *mishpaha* (clan) and the exclusion of the *nokri* (the foreigner…) from the privileges and obligations of the fraternity" (Nelson 1949:xv), Deuteronomy 23 was long the primary justification for the Jewish policy of prohibiting lending at interest among Jews but allowing it between Jews and gentiles. However, Deuteronomy left one question open. Christian exegetes, starting in the early centuries (e.g., St. Ambrose of Milan, 340–397) and more insistently during medieval times (e.g., Alexander of Hales, d. 1249; and Aquinas, 1225–1274), struggled to understand why a just God would apply one rule to some of His children (the Jews) and a different rule to the rest. They therefore applied the usury ban to everyone. In medieval times, this evolution led to an increasing number of latitudinarian exemptions: more and more casuistic end-runs around the usury ban.

The Reformation was a decisive turning point, with Calvin the hinge. Nelson summarizes Calvin's viewpoint thus:

> It is absurd to argue that usury is intrinsically evil, since God permitted the Jews to take it from aliens. It is fantastic to imagine that by aliens God meant the enemies of the Jews. It is horrible to suppose that it is lawful to discriminate against an enemy (Nelson 1949:96).

With this philosophy, Calvin opened the door to the acceptability of interest, asserting that interest is not sinful so long as rates remain low and the borrower is not harmed. This is the culmination of the internal ethical systematization and rationalization of Christian theology: a shift from seeing the world as consisting of one's communistic tribe of brothers opposing an outside world of enemies to seeing it as a universalistic world in which the Brother and the Other were assimilated.

Separation of spheres

Nelson's evolutionary account is a variant of what we might call the "separation-of-spheres hypothesis" — the idea that the disappearance of religious usury bans reflects the progressive separation of the religious and the economic spheres in the transition to modernity. Although the idea that modernity entails a separation of spheres is often attributed to Weber, in the case of usury bans in particular, the great economic historian of early modern Europe R. H. Tawney (1963) is the most thorough and eloquent exponent of this view. What accounts for the transition from a world where interest was immoral to one where it was normal? Economic and demographic changes attendant to the rise of early capitalism in late medieval and early modern Europe were crucial in increasing both the demand for credit

and the accumulation of surplus capital. (The importance of economic forces here shows how difficult it can be to separate economic hypotheses from cultural and political ones.) From the twelfth century to the sixteenth, these changes included the rise of towns, the growth of trading circuits and trade fairs, the emergence of proto-industrial production, and the ascendance of larger states with ever-increasing financing needs (especially for military expenditures) (Anderson 2013; Mann 2012; Tilly 1992). However, these economic and demographic changes are not, in themselves, a sufficient explanation for the disappearance of religious usury bans. Concomitant with them were transformations in attitudes: specifically, a disruption of the taken-for-granted assumption that the Church's pronouncements on individual economic behavior are worth listening to. Like Nelson after him and Weber (1978) before him,[18] Tawney understands both the expansion of capitalist credit markets and the rationalization of theology to be part of the birth of Western modernity. The move into modernity involves a separation of the religious and economic spheres: the birth of a world in which "trade is one thing, religion is another" (Tawney 1963: 4).[19]

Weber's responses to economic hypotheses

Among sociocultural explanations of the evolution of usury restrictions, Max Weber's is one of the most ambitious in setting a theoretical frame. This is not to say that Weber neglected economic factors in discussing usury. Rather, he was critiquing others who, he felt, took too materialist a stance.

A central theme of Weber's early writings on usury is that the disappearance or relaxation of usury bans is not simply a function of economic growth and the development of a market economy. In his doctoral dissertation in law, "Development of the Principle of Joint Liability and the Separate Fund in the Public Trading Company out of Household and Trade Communities in Italian Cities" (1889), Weber was responding to figures like Sombart, who portrayed religious attitudes toward usury as somewhat epiphenomenal to the transition from a feudal economy to a capitalist one (Kaelber 2003, 2004:52–53, 2007; Weber 2003). Weber argued that increasing economic activity did not necessarily correlate

[18] *The Idea of Usury* began as Nelson's doctoral dissertation, which he wrote before encountering Weber's ideas on usury and the evolution of religious involvement in the economic sphere. The text therefore contains few internal references to Weber, though Nelson acknowledges Weber in a prologue written later.

[19] But are certain religions (or societies in which certain religions are dominant) more likely to undergo the separation of the religious and the economic spheres than others? Conversely, are there faiths in which rules about economic behavior are more likely to persist than in others? The "religious-typology hypothesis" says yes. In *The Sociology of Religion*, Weber categorizes religions along two dimensions with regard to their attitude toward the world, creating a 2x2 typology. See also Lubetsky (2010) on "financial alchemy." Lubetsky argues, "a legal tradition's fundamental attitudes toward law affect its interest-avoiding transactions. He contends that in contrast with other legal normative orders, Islamic law has developed a conspicuously tolerant attitude toward interest-avoiding transactions due to (a) its formalist approach to legal interpretation, and (b) its understanding of law as "ordering rather than actualizing."

with decreasing restrictions on usury.[20] Citing historical records on commerce in late medieval Italy, Weber (2003) said the opposite was true. Likewise, against Wilhelm Endemann, a contemporary who asserted that medieval investment partnerships developed purely in order to circumvent the church's ban on usury (Endemann 1874 in Kaelber 2004), Weber offered evidence that medieval partnership structures such as the commenda fulfilled independent economic needs of medieval trade, and were not merely ways to work around the usury ban. In short, Weber rejected economically deterministic theories of the usury ban's evolution.

In *The Sociology of Religion*, Weber again dismisses economic theories of usury. He stresses first that the most strenuous usury bans appeared just as capitalist development was accelerating in Europe. As an alternative, he proposes that rationalization processes within the economic and religious value-spheres explain the evolution of usury prohibitions. As internal rationalization intensified, the fundamental tension between the economic ethos of profit maximization and the religious ethos of caritas became starker, leading to the separation of spheres in modern life.

> It is striking that the ecclesiastical persecution of usurious lending arose and became ever more intense virtually as a concomitant of the incipient development of actual capitalist instruments and particularly of acquisitive capital in overseas trade. What is involved, therefore, is a struggle in principle between ethical rationalization and the process of rationalization in the domain of economics. As we have seen, only in the nineteenth century was the church obliged, under the pressure of certain unalterable facts, to remove the prohibition in the manner we have described previously.
>
> The real reason for religious hostility toward usury lies deeper and is connected with the attitude of religious ethics toward the imperatives of rational profitmaking. In early religions, even those which otherwise placed a high positive value on the possession of wealth, purely commercial enterprises were practically always the objects of adverse judgment. Nor is this attitude confined to predominantly agrarian economies under the influences of warrior nobilities. This criticism is usually found when commercial transactions are already relatively advanced, and indeed it arose in conscious protest against them (Weber 1978:584).[21]

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[20] The Weber-Sombart rivalry would soon become one of the great intellectual contests of its day, with Sombart arguing that Catholicism was fertile ground for the development of capitalism and Weber arguing that it was not. The debate's sectarian undertones made it all the more acrimonious.

[21] Focusing on medieval and early modern Catholic theologians, John T. Noonan, Jr. makes a comparable argument in *The Scholastic Analysis of Usury* (1957): that the evolution of the scholastic analysis of usury depended more on the inertia of prior ecclesiastical teaching than on economic pressures.[1] But Noonan diverges from Weber somewhat. He suggests that in some ages, economic pressures have less effect on religious doctrine and thought than in others. In the medieval period, he says, economic pressures mattered less than in the early modern period. A Weberian reading of Noonan might portray this evolution as an internal rationalization process within Christian theology.

Dependent political authorities

Jared Rubin is one of very few scholars who have conducted a rigorous historical comparison of interest bans in Christianity and Islam. Why, asks Rubin, did a prohibition on interest that was relatively strict until the fifteenth century in both faiths persist in Islam but disappear in Christianity? Rubin asserts that the key independent variable is the degree to which political authorities depended on religious authorities for legitimacy. What I call his "dependent-authorities hypothesis" is that the greater this dependence, the longer economically inhibitive laws — such as interest bans — are likely to persist (Rubin 2010, 2011).

Rubin therefore sets out to show that political authorities' reliance on religious authorities for legitimacy was historically greater in the Islamic world than in Christendom, particularly at crucial historical moments when commerce was expanding and interest restrictions limited economic growth. This is a tall order, and he admits, "in both regions, religious legitimisation has historically been extremely important to political authorities" (though what he means by "regions" is unclear — he seems to be referring to entire religious traditions as regions) (Rubin 2011:1316).

Rubin argues that Islamic religious law stifled financial development more than Christian religious law did. Most of the argument consists of a stylized mathemical proof. Rubin's brief historical analysis starts with the observation that early Christians, because they lived under Roman rule, neither needed nor were able to construct their own religiously inclined legal system. In contrast, among the first Muslims, "Islamic ideals became those of the state" (Rubin 2011:1317). This comparative conclusion is relatively uncontroversial. Rubin then treats this difference as an exogeneity that would have path-dependent future effects: while admitting that the medieval papacy had "a significant degree of power over lay rulers between the eleventh and thirteenth centuries," he asserts that in Islam, creating political institutions separate from the organization of Islam was "hardly conceivable" (Rubin 2011:1317). At the crucial moment of the growth of commerce — the late tenth century to the thirteenth in the Christian world, the first few hijri centuries in the Islamic — Rubin finds "a flurry of secularly approved but religiously prohibited innovations of commercial instruments" in Christendom such as bills of exchange, rentes for public finance, and the sea-loan; but in the Islamic world, "stagnant" and "restrictive" religious regulation of commercial instruments (Rubin 2011:1329). On the Islamic side, he attributes this to the "independent legitimising force" of muftis in both conducting legal interpretation and legitimizing the rule of early Islamic leaders.[22]

[22] Although Rubin deserves credit for taking on the Islam-Christianity comparison directly and for bridging economic theory and social-political analysis, his dependent-authorities hypothesis suffers from several flaws.

AN ALTERNATIVE HYPOTHESIS: SURVIVAL OF THE JURISTS

The argument of this chapter is that in each of the three Abrahamic religions, the fate of the usury ban in religious law depends on the fate of religious jurists. The two emerge together, persist together, and decline together (see Figure 2). First, when religious jurists initially appear, usury goes from being merely a *sin* to being a systematically defined *crime* against religious law. Then, as long as religious jurists remain important in society, the usury ban survives. Finally, when religious jurists disappear from a religious system — whether suddenly or gradually — the usury ban dies with it. Below, I describe the involvement of religious jurists at these three phases in the evolution of religious usury bans: birth, life, and death.

First, however, I explain who religious jurists are and what they do.

First, Rubin does not prove his main assertion: that political authorities in Christendom relied less on religious authorities for legitimacy than did political authorities in the Islamic world. This is not his fault: it is practically impossible to prove such a sweeping claim, at least without specifying further which states and centuries one is talking about. But Rubin does not even tell us what metrics he would use to measure political authorities' dependency on religious legitimation. How do we operationalize dependency? Should we examine whether religious authorities helped select political leaders in a particular society? The extent to which political authorities contributed to building of mosques and churches? The extent to which religious endowments were taxed by the state? Rubin does not say.

Second, Rubin's assertion that medieval Christians circumvented or ignored the usury ban while medieval Muslims were hampered by it is, at best, very debatable. I will argue below, in the sections on Christianity and Islam, that pre-modern Muslim merchants and financiers regularly found ways to circumvent the ban on interest, or flouted it outright. It is likewise worth noting that there is virtually no evidence of Muslim courts ever prosecuting anyone for engaging in usury.

Third, Rubin uses the terms "Middle Eastern" and "Islamic" almost interchangeably without acknowledging that the Islamic world encompassed also large parts of Southeast Asia, the Subcontinent, Central Asia, Africa, and Europe — and included societies with a wide range of different relationships between political and religious authorities. Finally, Rubin does not examine the reasons offered by both religious authorities and political authorities themselves for advocating the maintenance or change of interest bans. This is important because even if he were to show correlation between (a) the strength of political-religious dependency and (b) the strength of interest prohibitions, he would still have to show causation. Alternative explanations could abound: it could be that both (a) and (b) are endogenous to some other variable — such as external pressures brought on by macro-level changes in the world economy, demographic shifts, or so forth.

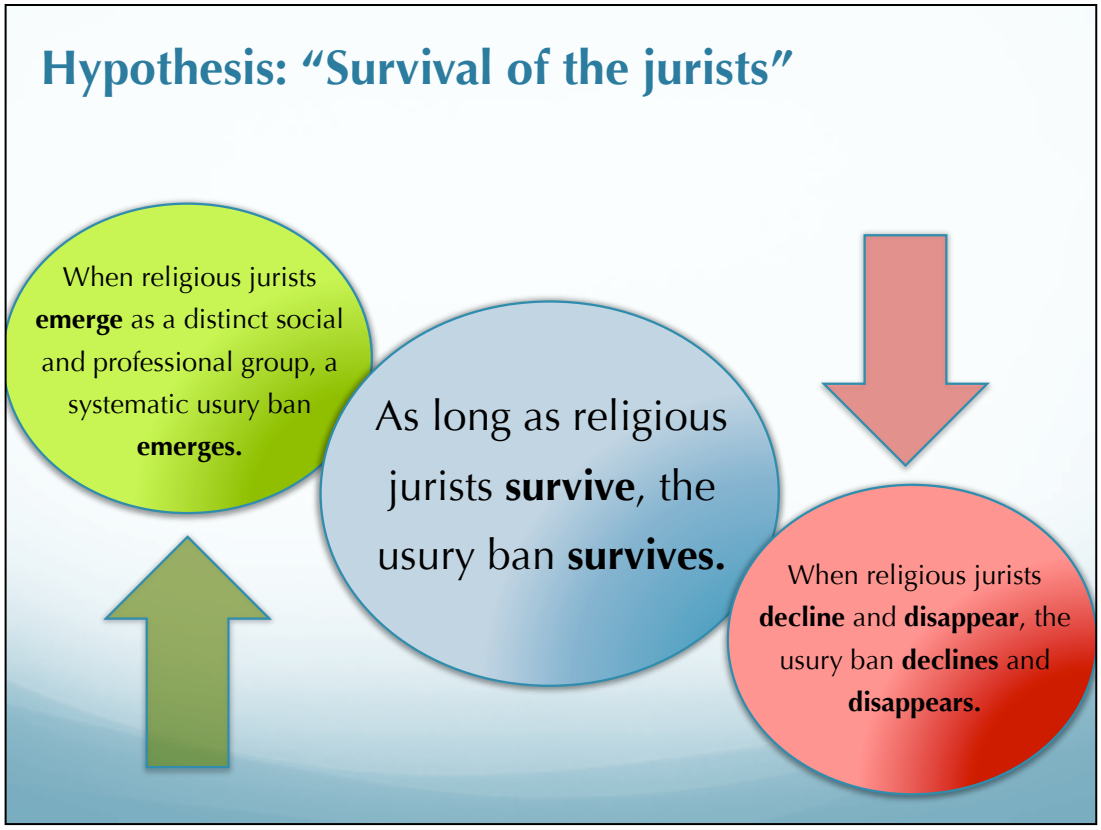

FIGURE 2: THIS CHAPTER'S HYPOTHESIS

Who are religious jurists?

Generically, religious jurists are experts in religious jurisprudence — the science and philosophy of religious law. In Judaism, they are the halakhists: sages and scholars versed in the Torah, the Talmud, and other sources of Jewish law (*halakhah*). In Christianity, they are the canonists (i.e. specialists in canon law), and specifically, in the medieval era, scholastic jurists and often also theologians. In Islam, they are the *fuqahā'* (singular *faqīh*): experts in *fiqh*, or Islamic jurisprudence.[23]

[23] I use the words *faqīh* and *fuqahā'* to refer generally to experts in *fiqh*. However, two caveats are in order.

First, there are always others — such as judges (*quḍāh*, singular *qāḍī*) and lawyers — who have significant knowledge of Islamic law (shariah) and jurisprudence but who may not have the credentials requisite for qualification as a faqīh. Second, there are multiple terms used to refer to experts in Islamic law and jurisprudence. A faqīh is an expert in *fiqh* (jurisprudence), whereas a *muftī* is a legal expert capable of *iftā'* (the issuance of *fatāwá* (singular *fatwá*), i.e. Islamic legal opinions). In many historical settings, there has been overlap between the meanings of the terms faqīh and muftī. Today, the waters are muddied by the fact that some governments appoint state muftis. Also, it is rare today to hear someone call herself or himself a faqīh, but others may use it as a deferential term.

Another still higher qualification is *mujtahid*, which is a religious jurist capable of *ijtihād*, i.e. creative independent judgment in a legal and theological question by application of the *uṣūl al-fiqh*, or principles of jurisprudence (the study of these constitutes a scholarly field in itself). Ijtihād, then, is the establishment of new

Religious jurists perform multiple functions. First, they *form* religious law. This involves (a) exegesis (the close reading and interpretation of religious texts) from fundamental sources such as the Torah, the Talmud, the Bible, the Quran, and the Sunna and (b) the development of guidelines for pious behavior (and in some cases statutes) based on this exegesis and on established principles of religious jurisprudence.[24]

Second, they *teach* religious law. In this regard, religious jurists were historically the equivalent of modern law professors. They trained others to interpret, apply, and reason with the law. Some taught small groups of students informally, while others taught in large universities and academies. Teaching is often a source of income for jurists.

Third, they *advise* on matters of religious law. In all three Abrahamic traditions, this advice-giving has taken the form of *responsa*: written decisions and rulings by jurists in response to questions addressed to them.[25] Religious jurists issue responsa to all kinds of inquirers, from kings to peasants, rich to poor. The responsa can address any question about religious law, but mostly they explain how people should adhere to law in everyday life. Topics range from the mundane and private (such as the validity of certain investment contracts or birth-control practices) to the public (such as the legality of broadcasting sacred texts on the radio) (Umar 2001).

Fourth, they *debate* religious law. Like modern law professors, their opinions and theories vary from individual jurist to jurist and from juristic school to juristic school. They write original works and comment on key texts. In their scholarship, they respond internally to their juristic peers and predecessors and externally to changing social and economic conditions. In this way, they are engines for innovation. Nonetheless, their work is inescapably anchored to the fundamental sacred texts. They thus maintain a symbolic and intellectual link to religious tradition.

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precedent and new legal thought. (The term *muqallid* refers to someone who, in explicit contrast to a mujtahid, adheres to and applies the pre-existing legal traditions of a school of jurisprudence.)

Some in the world of Sunni Islam believe that ijtihād continues today, whereas others feel ijtihād is virtually impossible in the present era because of a lack of sufficiently deep legal knowledge or because the truly precedential and fundamental legal questions have already been answered. (Regardless, as with the term "faqīh," it would be hard to find a scholar who claims the title of mujtahid for herself or himself (even though some might assert that they are engaging in ijtihād), as that could sound arrogant.) In Shi'a Islam, the consensus is that ijtihād continues.

[24] Principles of religious jurisprudence govern matters such as how jurists may use analogical reasoning, how much weight they should grant in legal decision-making to the welfare of the community of believers, and the extent to which they may innovate — among others.

[25] *Responsa* is a Latin term used in the Roman Catholic Church; the corresponding body of Jewish responsa literature is known as she'elot ve-teshuvot (literally "questions and answers"), and in Islam, the analogous body is the *fatwá* literature. Responsa are no longer a major part of Christian practice, but they continue to be relevant to everyday piety in Orthodox Judaism and especially in Islam. One who issues fatwas is a *muftī*; see footnote earlier in this chapter on the distinction between a faqīh and a muftī.

The life cycle of religious usury bans and the role of religious jurists

Religious jurists play crucial roles in the birth, life, and death of religious usury bans.

– BIRTH: When religious jurists emerge, usury changes from a sin to a crime against religious law. Before the appearance of religious jurists in all three Abrahamic faiths, usury is a sin. Bans on usury take the form of social norms and moral exhortations. Systematic laws are absent. But when religious jurists emerge, systematic, detailed usury laws emerge almost immediately. Usury becomes not only a sin, but also a formally defined crime against ecclesiastical law. This process of formal rationalization happens in Judaism in the second century CE, in Islam in the eighth and ninth centuries CE, and in Christianity in the twelfth century CE.

As the midwives of systematic usury law, religious jurists play three roles. First, they *compile* the jumbled mass of existing references to usury. This is a herculean task of collecting manuscripts and oral records, fact-checking them, and editing them. (The compilers do not focus on usury alone, but on the gamut of matters covered by religious commandments.) The result is compendia of source material, such as the Decretum Gratiani (ca. 1150 CE) (Chodorow 1972; Gratian 1993; Hartmann and Pennington 2008; Winroth 2000) and the Ṣaḥīḥ al-Bukhārī (ca. 846 CE) (Al-Bukhari 1987). Second, the jurists *systematize* the references and guidelines in these materials into formal rules. This transforms the tangled, abstruse, and sometimes conflicting set of past references into applicable law. Third, they *extrapolate* the formal rules outward to new areas of economic activity. For example, they take the principles used to identify usury in moneylending and apply them to mortgages, sales on credit, and debt-related activities.

– LIFE: While religious jurists remain important, the systematic usury ban survives. Much like carriers of a gene or a virus, religious jurists are carriers of the usury ban through history. So long as they constitute a distinct social group and continue to play their traditional roles, a systematic usury ban survives. These traditional roles include forming religious law, teaching it, advising on it, and debating it.

An important point here is that as long as religious jurists continue to be socially relevant, economic expansion alone cannot eliminate the usury ban. This is contrary to the developmental thesis. Economic expansion can and often does put pressure on religious usury bans, but the religious jurists' roles in society must be radically curtailed or eliminated if religious usury bans are to disappear entirely.

Religious jurists successfully carry the usury ban for centuries because they are good at adapting it to changing economic circumstances. They do this in two ways. First, they *accommodate* the evolving needs of merchants, investors, states, and other seeking credit. While always stressing that usury is completely sinful and completely illicit, they approve a widening range of financial contracts that serve purposes similar or identical to interest-bearing loans but that stay within the letter of religious law. Over time, they also adjust the

legal definition of what counts as usury. In these ways, they gradually expand the scope of permissible economic activity.

However, such accommodation threatens the legitimacy that jurists enjoy in the eyes of believers — and particularly in the eyes of their fellow jurists, who are often among their harshest and most observant critics. To retain this legitimacy, a jurist cannot merely claim that "business interests required me to change the law," for this is tantamount to claiming that business interests trump divine command. Instead, religious jurists must also develop intellectual and spiritual justification for accommodation to the changing economy — justifications that make sense in light of sacred texts and religious doctrine past and present. In other words, they must *theorize* the usury ban further.

- DEATH: When religious jurists decline and disappear, the religious usury ban dies. Religious jurists embody the idea that religious law should govern everyday behavior. By forming, teaching, advising on, and debating religious law, they stabilize and reproduce two taken-for-granted notions. The first is that religious law is *ubiquitous*. Every venue — from the marketplace to the bedroom to the battlefield — presents opportunities for sin and salvation. The second is that religious law is *rational*, at least from the jumping-off point of God's explicit commandments, which must be taken on faith. In other words, the rules for identifying sacred and profane behavior are accessible to ordinary humans who apply reason and analytical principles to God's commandments. Religious jurists are ordinary[26] humans who have taken on that task through intensive study.

When the hegemony of this view of religious law falters, religious jurists lose authority. Likewise, when religious jurists lose authority, the hegemony of this view suffers too.

The decline of religious jurists and of the religious usury ban can take different forms. It can be sudden (as in the Protestant denominations) or gradual (as in Roman Catholicism). It can also have a range of causes. These causes may be internal to religion, such as powerful reform movements or the branching-off of utopian splinter sects. They may be external political forces, such as colonial rule, secularist regimes, or even Islamist ones. Or the cause may be the gradual migration of issues previously under the purview of religious law and

[26] The word "ordinary" is important here. In all three Abrahamic faiths, religious jurists do not occupy a spiritually advanced plane that puts them closer to God than other believers. They are not, for example, bearers of traditional authority in the manner of priests (unless they also happen to be priests), shamans, or lamas. They are not an elect who guide the preterite. Their authority does not transfer through heredity. They are also not bearers of charismatic authority. A religious jurist cannot count as qualified simply by attracting large crowds. Moreover, they are not mystics: the knowledge that qualifies them to be jurists is not esoteric. Instead, it is the fruit of reason applied to publicly available texts.

In this sense, at least in theory (if not always in practice), the profession of religious jurisprudence has always been a fundamentally meritocratic one. It is theoretically open to any believer (or at least any male believer) who can demonstrate requisite knowledge of religious law and requisite intellectual aptitude. Religious jurists, including ancient and medieval ones, are bearers of legal-rational authority — a quintessentially modern form (Weber 1965:78–79, 1978:212–216).

religious courts to the domain of secular law and secular courts. Regardless, we shall see that once religious jurists lose their traditional role in society, the religious usury ban disappears quickly.

Finally, when religious jurists do not disappear, the usury ban survives. This happened in Islam, for reasons I discuss later. Religious jurists have also persisted (in limited form) in Orthodox Judaism, and indeed, a usury ban persists (in limited form) in Orthodox Judaism.

Evidence

This section compares the birth, life, and death of usury restrictions across the three Abrahamic faiths: Judaism, Christianity, and Islam. In each religion's history, the birth of usury as a legal problem — and not only a moral one — coincides with the emergence of religious jurists as a distinct social group. The maturation and survival of the usury ban — its scholastic elaboration, its enforcement, and at the same time the spread of strategies to accommodate commercial lending in spite of it — coincide with the survival of religious jurists as respected social actors with a strong corporate identity. Finally, the decline and death of the religious usury ban — where it happened (in Christianity and non-Orthodox denominations of Judaism) — coincide with the decline of the jurists from prominence.

JUDAISM

BIRTH

The emergence of rabbinical scholars as a distinct social group

When did rabbinical scholars emerge as a distinct social group? We can take a long-term view or a short-term view.

The long-term view focuses on the gradual rise to power of a stratum in Jewish civilization specializing in legal study. Viewed over a long time horizon, we can point to the Great Assembly — which ostensibly convened during the first few decades of the Second Temple period (circa 530 BCE – circa 70 CE) — as a starting point for this rise. Although historians dispute its specific institutional character, The Great Assembly, also known as the Great Synagogue, was an assembly of elders (allegedly around 120 in number), including scribes,[27] sages, and prophets. According to Tannaitic[28] literature, the Great Assembly was a lawmaking body that canonized existing books of Scripture, instituted prayers and benedictions, and — most importantly for our purposes — began the process of classifying existing Oral Law (Mantel 1967).

Through the lifetime of the Second Temple, sages specializing in religious law became progressively more distinct from other Jewish elites. During the Hellenistic era (323 BCE – 165 BCE) of the Second Temple period, the scribes and sages who were heirs to the legacy of the Great Assembly specialized further in study of the Torah and formed a stratum increasingly opposed to the priests who controlled the Temple and its rituals. The Maccabean Revolt (167 BCE – 160 BCE) put the priests in political power, overthrowing Seleucid rule and establishing the Jewish Hasmonean dynasty led by high priests (who

[27] "The Jewish scribes [in the Hellenistic era] were … more akin to Alexandrian *grammateus* who fixed the text and interpreted the classic literary works" (Mantel 1967:85).

[28] The Tannaitic period was from circa 10 CE to circa 220 CE.

would later become kings). In response, the scribes and sages helped form the Pharisees, a new sect-cum-social movement. Active from the middle of the 2nd century BCE to the destruction of the Second Temple, the Pharisees insisted that all Jews adhere to religious law at all times and places (including purity laws, which the dominant priests enforced only within the Temple itself). The Pharisees resisted Hellenistic assimilation and considered themselves guardians of Jewish tradition.

This brings us to the destruction of the Second Temple: the starting point for a shorter time horizon for the emergence of rabbinical scholars as a distinct group. In 70 CE, Rome crushed a Jewish rebellion, destroyed Jerusalem, and demolished the Temple. This led to dramatic changes in Jewish society, including the enslavement and dispersal into the diaspora of many of the Jews of Judea.

Crucially, the destruction of the Second Temple shifted religious authority from the priests to the rabbis — that is, to the experts in Torah. The ritual authority of the high priests of the Temple was radically diminished. Conversely, the importance of experts in Jewish law increased, for they were able to hold together the fragmented and factious Jewish people.

The Mishnah: The "birth certificate" of systematic rabbinical jurisprudence and a leap in the sophistication of Jewish usury law

The destruction of the Second Temple and the dispersal of many of the Jews of Judea into exile and slavery was the impetus for the compilation of Jewish oral law, also known as Oral Torah, into written law. In Jewish tradition, the Oral Torah was Jewish law that God transmitted orally to Moses on Mount Sinai together with the written Torah. Generation after generation of teachers and students then transmitted the Oral Torah by memorization. Writing down the Oral Torah was forbidden. However, in the century and a half following the destruction of the Second Temple, Jews faced Roman persecution or the trials (and frequently the persecutions) of life in exile. Fearing that the Oral Law would be lost, Rabbi Yehudah haNasi (also known as Judah the Prince) redacted and edited the Oral Law, producing a legal code of 63 books known as the Mishnah.

It is with the Mishnah that systematic Jewish jurisprudence begins. The Mishnah comprises records of debates among rabbinic sages who were known as the Tannaim. These debates transpired between the late 1st century BCE and the 2nd century CE.[29] The Mishnah elaborates the laws and principles of the Oral Torah by recording these debates — many of which were lively, and some of which did not end in agreement among the sages involved. Subsequently, the Amoraim (ca. 200 CE – ca. 500 CE), sages who lived in Palestine and Babylon (the two great centers of Jewish thought of that age), produced further debates and commentaries on the Mishnah. These debates form the Gemara. Together, the Mishnah and

[29] The period in Jewish history between ca. 10 CE and ca. 220 CE is known as the age of the Tannaim. It is also known as the Mishnaic period.

the Gemara form the Talmud, which is the defining text of Rabbinic Judaism (second only to the Torah in authoritativeness) and hence of Jewish jurisprudence in general.[30]

The references to usury in the Torah condemn usury between one Jew and another, but do not elaborate at any length on the definition and nature of such usury. These references include:

> Exodus 22:24: If thou lend money to any of My people, even to the poor with thee, thou shalt not be to him as a creditor; neither shall ye lay upon him interest.
>
> Leviticus 25:35–37: And if thy brother be waxen poor, and his means fail with thee; then thou shalt uphold him: as a stranger and a settler shall he live with thee. Take thou no interest of him or increase; but fear thy G-d; that thy brother may live with thee. Thou shalt not give him thy money upon interest, nor give him thy victuals for increase.
>
> Deuteronomy 23:20–21: Thou shalt not lend upon interest to thy brother: interest of money, interest of victuals, interest of any thing that is lent upon interest. Unto a foreigner thou mayest lend upon interest; but unto thy brother thou shalt not lend upon interest; that HaShem thy G-d may bless thee in all that thou puttest thy hand unto, in the land whither thou goest in to possess it.
>
> (JPS 1917 translation)

Despite these powerful injunctions against usury, lending at interest continued to occur between Jew and Jew. Between the formulation of the Deuteronomic Code (in the last of the five books of the Torah) in the late 7th century BCE and the compilation of the Mishnah, a number of the (albeit limited) historical records mentioning ancient Jewish financial arrangements suggest that the ban on usury between Jews was often flouted. For example, in the *Book of Nehemiah*, the 5th-century BCE Jewish leader Nehemiah (who rebuilt Jerusalem) rebuked the city's Jewish nobles for exacting usury from the Jewish poor, even to the point of enslaving those who could not pay their debts (Nehemiah 5:1–11). Egyptian papyri of the 5th century BCE[31] and the 2nd century BCE[32] show clearly that Jews lent at interest to Jews. A papyrus from pre-70 CE Roman Judaea (that is, from sometime between 63 BCE and 70 CE) acknowledges that even on an interest-free loan, a defaulting borrower will pay a 20 percent fine. This will be true even if the sabbatical year intervenes (Schwartz 2009: 68–9). Economic expediency was no doubt the motivation for such arrangements, but

[30] The version of the Talmud produced by the Palestinian sages is known as the Jerusalem Talmud (*Talmud Yerushalmi*), and that produced by the Babylonian sages is known as the Babylonian Talmud (*Talmud Bavli*).

[31] The Aramaic Elephantine Papyri of Upper Egypt.

[32] The Tebtunis Papyri of 182 BCE and 174 BCE.

the lack of legal clarity about inter-Jewish usury (Stein 1953:6–7) and the tendency to pursue local Gentile custom in the absence of clear, economically nuanced Jewish law was also a problem (Schwartz 2009:69).

Once Yehudah haNasi had redacted the Mishnah ca. 220 CE, rabbinical scholars enjoyed a much more economically nuanced document that they could use as a base for (1) determining the legality of lending transactions on a case-by-case basis and (2) developing future usury law through debates and commentaries on the Mishnah.[33] A short excerpt from the Mishnah, and from the Gemara (published 350 CE – 500 CE), which comments on the Mishnah, shows that Jewish usury law after 220 CE represents a quantum leap in sophistication relative to the broadly worded injunctions of the Pentateuch. I excerpt this passage not to refer to its legal content, but to show the level of complexity of usury law that now appears in Jewish jurisprudence with the Mishnah. Also noteworthy are (1) the back-and-forth disputation among scholars, which demonstrates the fecundity of rabbinical debate even at this early stage, and (2) the scholars' desire to isolate general rules and abstract concepts about the definition of usury:

> R. Safra said: Wherever by their law [i.e., non-Jewish law] exaction is made from the debtor for the creditor, restoration is made by our law from the creditor to the debtor; wherever by their law there is no exaction from the debtor to the creditor, there is no restoration by our law from the creditor to the debtor.
>
> Said Abaye to R. Joseph: Now, is this a general rule? Behold, there is the case of a se'ah [lent] for a se'ah which, by their law, the debtor is forced to repay the creditor, yet by ours it is not returnable from the creditor to the debtor! He replied, They [regard it] as having come into his possession merely as a trust.
>
> Rabina said to R. Ashi: But mortgages without deduction, which by their law is exacted from the debtor for the creditor, yet by our law is not restored from the creditor to the debtor? — He replied: They [regard it] as having come into his hand by the law of purchase. Then, when R. Safra said, 'Wherever by their law, etc.,' what did he mean to tell us? — [This]: 'Wherever by their law exaction is made from the debtor for the creditor, restoration is made by our law from the creditor to the debtor;' this refers to direct interest, and in accordance with R. Eleazar. 'Wherever by their law there is no exaction from the debtor to the creditor, there is by our law no restoration from the creditor to the debtor;' this refers to prepaid and postpaid interest. (Talmud Bavli (Babylonian Talmud) online n.d.:62a–62b)

[33] Such commentaries appeared in, for example, the Gemara, and in the commentaries of the Geonim developed at the two great Babylonian Talmudic of Sura and Pumbedit, ca. 589 CE – 1038 CE. Indeed, this line of commentary on the Mishnah has continued throughout the entire history of Jewish law.

This is only a very small portion of the usury law discussed in the Baba Mezi'a. The amount of law applied to special cases of potential usury is staggering. Yet the back-and-forth of the debate is exciting; the books of law were not afraid to show rabbis in disputation.

Professionalization of the jurists and relaxation of the ban on rabbinical compensation

A longstanding ban had existed up to Talmudic times on scholars of Jewish law receiving material compensation — or even glorification and acclaim — via their knowledge of the law. Rabbi Zadok, a leading Tanna who lived in the first century CE, famously said that rabbis must not use the Torah "as a crown for self-glorification nor as a spade for digging" (Avot 4:5). The sages could not work *professionally* as legal scholars, teachers, and judges, so they also worked in a range of other occupations to earn a living: "as farmers, woodchoppers, tanners, laundrymen, sandal-makers, carpenters, wine-tasters, water-carriers, and tailors" (Roth 1997:571). And yet the injunction against compensation for scholars caused social problems, not least because it made it easier for wealthy Jews than poor Jews to become legal scholars, undermining the meritocratic ideal of Talmudic scholarship.

Over the course of the centuries after the publication of the Mishnah, jurists therefore developed ways to circumvent this prohibition without violating the letter of the law. Common methods included receiving tax exemptions and being allowed to set up shop in the marketplace before anyone else. Eventually, rabbinical acceptance of fees and donations became commonplace — an important step in the transition to professionalization of rabbinical jurisprudence. By the time of Moses Maimonides (1135–1204), outright acceptance of fees and donations was the majority practice among rabbinical scholars, though one that the scrupulous Maimonides denounced (while still accepting the right of scholars to tax exemptions, marketplace privilege, and the like) (Roth 2006).

LIFE

From farmers to merchants: The evolution of Jewish occupational specialization in the first millennium CE

Primarily an agricultural people in the age of the Amoraim (ca. 200 CE – ca. 500 CE), Jews urbanized in large numbers after the Islamic conquest of the Middle East and entered commercial occupations. Many religious scholars were themselves also merchants. This contributed to ongoing accommodation and innovation by rabbinical scholars who sought to devise credit instruments that did not violate halakhic regulations.

The early post-Mishnaic evolution of Jewish usury law: Elaboration and expansion

The Tannaim and the Amoraim expanded the Jewish usury ban's sphere of application and extended its logic to various types of loans and credit-related behavior that were not relevant at the time the original laws of the Hebrew Bible were codified. In the Pentateuch, we find that with regard to the interest ban, Exodus mentions merely simple money loans. Leviticus mentions money and food, and Deuteronomy applies the ban rather ambiguously to "anything that is lent for interest." Faced with the need to manage a sophisticated and diversified economy full of farmers, traders, and shopkeepers, however, the Tannaim sought to specify how the Deuteronomic prohibition applied to the transactions of a commercial economy: sales on credit, mortgages, the borrowing of produce, various types of partnership and investment, and advance payment for goods (such as grain paid for before the harvest, wool before the shearing, and wine before the grape-picking) (Gamoran 2008:15–24).

These were all transactions into which interest could creep implicitly, but that the Bible did not address explicitly, so the Tannaic sages had to develop their own opinions. For example, is it acceptable to insist on a higher price for a product if it is sold on credit? No, according to the Mishnah, because the transaction effectively becomes a sale plus an interest-based loan. If an object or a plot of land is pawned as security for a loan, can the lender derive profitable use from the pawned object or land (i.e., does the lender have usufruct rights) — or would this count as interest? Again, the Tannaim ruled that usufruct from pawned property counts as interest, making the practice illegal. And what if someone borrows a unit of wheat when its market price is 25 dinars and returns it when the price has risen to 30 dinars — is this a form of interest? The Tannaim unanimously said yes: the borrower was returning something of greater worth than what was originally borrowed. Therefore, they ruled lending produce for produce illegal (Gamoran 2008:15–16). In such ways, the sages of the first and second centuries expanded the scope of the interest ban, applying it to more and more areas of economic activity. As the ban's scope expanded, the relevant law became more complex and situation-specific.

Further evolution of Jewish usury law: Accommodation to capitalist needs

In all three Abrahamic religions, the emergence of religious jurists has a curious effect on usury law. In that initial burst of activity during which they apply their intellectual powers, methodological principles, and accumulated knowledge to the problem of usury, the religious jurists simultaneously (1) expand the usury ban's scope (as discussed above) while also (2) starting to allow loopholes in it that accommodate increasingly sophisticated commercial activity. The jurists build a far wider, far stronger net than existed before — but only shortly thereafter, they start to cut holes in the net. They set aside as legally acceptable certain transactions that they consider morally justifiable, economically necessary, or simply adherent to the letter of the law (if perhaps not to its spirit).

Consider, for example, the wheat loan above. Although they considered lending produce for produce generally unacceptable, they devised an exception: if the borrower already had in his possession the same goods (i.e. goods of the same type, quality, and quantity) that he wanted to borrow, then the loan was possible. This is rather counterintuitive. Why would someone borrow goods identical to those he already owned? The Tannaic sages ventured that "the goods may have been temporarily inaccessible — the key to the storehouse had been lost or the borrower's son had the key and would soon return with it" (Gamoran 2008:16). The new legal justification for produce lending was that "if the borrower possessed the goods at the time of the loan, those goods became the property of the lender, and if they appreciated in value before the loan was repaid, they were the lender's own goods that appreciated and, consequently, there was no interest." In other words, the loan was actually a trade. Slippery logic indeed — designed merely to circumvent the ban on produce loans, which was a corollary of the interest ban. The Tannaim engaged in similar casuistic gymnastics to construct loopholes in the various prohibitions concerning credit sales, mortgages, payment for future delivery of goods, and forms of investment and partnership.

The Tannaitic period in Jewish legal history (70 CE – 200 CE) set the pattern for the future evolution of rabbinical law on interest: expansion of scope on the one hand, establishment of loopholes on the other. Rabbinical commentaries on interest continued to be voluminous over the years; interest was long one of the sages' favorite topics of debate. And over the next 18 centuries, generations of rabbis also made room for more and more loopholes — while scrupulously avoiding the question of whether the Biblical prohibition on interest was intended only for the poor (Gamoran 2008:176–177).

These loopholes grew over time, accommodating ever-wider ranges of commercial activity. One Tannaitic loophole was that if the borrower already possessed the same goods (in quantity, quality, and type) that he wanted to borrow, then the loan was acceptable. By the age of the Amoraim (200–500 CE), we find this loophole expanding further. In the third century CE, a Rabbi Isaac ruled that the borrower did not need to have as much of the produce as he wanted to borrow: "even if he had only one seah of wheat, he could borrow many kors of wheat against it" (Gamoran 2008:25).[34] This made lending produce easier. But what if the borrower had not even a little bit of the desired type of produce in his possession? Writing in the first half of the eighth century, Rabbi Aḥai Gaon of the great Babylonian Talmudic academy at Pumbedita ruled in his She'iltot — the first post-Talmudic book of law — that even if the borrower possessed none at all, he could borrow as much as he wanted so long as it was also available for purchase on the open market at a known price. In other words, so long as price information was available, produce lending was acceptable. This made produce lending easier still — a change that occurred as commodities markets were growing and Jews were increasingly involved in commodities trading, during the age

[34] The se'ah (סאה) and the kor (כור) are Talmudic units of dry measure. There are 30 se'ah in one kor.

of the Geonim (ca. 650–1000), when Jews from Baghdad to Jerusalem to Cairo lived under Islamic rule, migrating from the farms to the cities in the face of land taxes and engaging actively in international trade (Gamoran 2008: 39–42). Then, in the sixteenth century, Rabbi Joseph Karo of Turkey and Palestine went still further. What if the borrower possessed none of the desired good and the market price was undiscoverable? Rabbi Karo ruled that the lender could give the borrower a small amount of the desired product, or could even lend him a small amount, just to facilitate the loan. With this new loophole, produce lending effectively became possible under virtually any circumstance.

Thus, between the second century CE and the sixteenth, the bans on lending produce went step by step from having real teeth to being functionally meaningless. Yet over the course of this evolution, the rabbis always insisted that the ban itself was sacred. Consider the great Moses Maimonides (1135–1204), the most celebrated medieval Jewish philosopher and Torah scholar. Like his contemporaries, Maimonides upheld the loophole stating that produce lending was allowed so long as both borrower and lender knew the market price (Gamoran 2008:47). Yet he also condemned interest in the goriest terms: "Why is [interest] called neshekh? Because [the lender] bites and afflicts his neighbor and eats his flesh." In other words, we find an insistence that interest is evil together with a willingness to use loopholes to circumvent it. Economic transactions can be fundamentally moral or immoral actions, but this morality is rooted in the form of the transaction, not the substance, consequence, or intent. This is a juristic rationality at work.

The same was true of those other commercial transactions besides produce lending that have the potential to be usurious (or, as the rabbis put it, constituted avak ribbit, "the dust of interest" (Perlman 1997): through the history of rabbinical law, between the beginning of the first millennium and modern times, the laws developed in ever-greater complexity yet became amenable to more and more loopholes, eventually evolving into mere formalities. Such transactions include advance payment for goods, credit sales at a higher price than the cash price, mortgages, and investment forms where the investor's return is partly or whole guaranteed (Gamoran 2008). In the case of credit sales, for example, the Mishnah[35] states unambiguously, "one may not increase the price [when one sells on credit]." Between the seventh and eleventh centuries, the Geonim stuck officially with this line, telling merchants that "all profit for waiting is forbidden." But by the eighth century, some rabbis allowed merchants to get around this by simply giving a discount for spot payment while charging the "regular" price for deferred payment (Gamoran 2008:62–64). And in the eleventh century, the French Jewish jurist Rashi created yet another loophole, ruling that credit sale at some future price (presumably higher than the current market price) was acceptable so long as the transacting parties did not actually establish a (presumably lower) spot price — the "wink-and-a-nod" approach. This became a leading position for centuries, although debate

[35] The first major book of rabbinical law, the Mishnah emerged from the debates of the Tannaim in approximately the first two centuries CE.

on the question did continue into the eighteenth and nineteenth centuries, with some rabbis in Russia, Poland, and Hungary taking the old hard line. By the twentieth century, we find the Rabbi Mordecai Breish of Poland and Switzerland arguing that taking a lower price for early payment is acceptable for sales — according to the logic that it is also acceptable for rentals. Rabbi Breish's reasoning is less important than the context he provides: he continually cites "the custom of merchants" of his day. This shows that the progression of market customs shaped the evolution of rabbinical opinion.

In other words, rabbis debated questions about interest at great length for centuries, and sanctioned different practices from place to place and rabbi to rabbi — and yet in general, the trend over time was toward increasing accommodation of commercial needs through the creation of more loopholes.

Accommodations out of political necessity: The diasporic condition, medieval European persecution of Jews, decentralization of rabbinical scholarship, and the further relaxation of usury restrictions

The diasporic condition of the Jewish people had several effects on Jewish jurisprudence and the usury ban. First, from the destruction of the Second Temple onward, there was no single centralized bureaucratic religious authority in Judaism (as existed in medieval Christianity, for example). This decentralization allowed individual rabbinical scholars in far-flung locations to accommodate the economic needs of their communities in line with the dictates of their learning and their consciences without strong pressure to adhere to a centralized "line." Second, after the dispersal of the three great yeshivot of Jerusalem, Sura, and Pumbedita owing to Seljuq and Mongol invasion between the 11th and 13th centuries, education in Jewish jurisprudence was also increasingly decentralized and autonomized to smaller yeshivot and to the tutelage of one scholar to a few students at a time (which had always been a common form anyhow). Finally, the severe persecution that Jewish diasporic communities suffered during medieval and modern times — particularly in Europe — led local rabbis to accommodate to economic circumstance. Unlike in Christianity and Islam, many rabbinical scholars were also community leaders. As such, they held greater responsibility to accommodate the economic needs of local Jews, particularly when allowing or disallowing certain forms of moneylending might mean the difference between sustenance or impoverishment.[36]

[36] See Soloveitchik (1970) on pawnbroking in exile.

The heter iska contract: A 16th-century loophole thenceforth widely adopted

The *heter iska* is a partnership structure that effectively replicates an interest-bearing money loan. It emerged in Poland in the late sixteenth century and was perfected over the course of the seventeenth, taking on a template format amenable to merchants and rabbis alike and becoming "an integral part of business dealings within the Jewish community" (Gamoran 2008:159–167).

A heter iska is acceptable according to halakha because it is technically an investment transaction, not a loan transaction. The "lender" is technically a silent investment partner who contributes capital in exchange for shares in the venture, and the "borrower" is the active partner, who is to contribute "labor." The active partner receives a nominal "salary" (one dollar, for example) from the silent partner.[37]

Eventually, the heter iska became so formalized and perfunctory that parties could simply sign a piece of paper attesting that they were entering into one. If the signatory represented a financial institution such as a bank, this would make halakhically valid (at least according to some rabbis) any subsequent interest-based transactions into which the financial institution entered.

DECLINE (BUT NOT QUITE DEATH)

The Haskalah (Jewish Enlightenment) of the 18th and 19th centuries: Integration into Jewish society and battles for Jewish emancipation

Transformations and denominational splits in modern Judaism eventually led to a condition today in which only a minority of contemporary Jews feel that the details of daily life outside of spiritual activity, family life, and diet should be regulated intensively by halakhah.

An initial step in this direction came with the Haskalah (Jewish Enlightenment) of the late eighteenth and nineteenth centuries. In the Haskalah, Moses Mendelssohn (1729–1786)

[37] How a heter iska works: The catch is that the active partner effectively guarantees the return of the investment principal, plus an "expected" rate of profit (say 5%), to the silent partner. While an actual guaranteed return would be unacceptable under rabbinical law because it would constitute the "dust of interest," in a heter iska, the managing partner merely states in advance that he expects the partnership to earn a 5% return. However, the heter iska agreement makes it very difficult for the active partner to claim a loss or any profit less than 5%: to do so, he must "present complete documentation and halachically valid witnesses" — a standard he is unlikely to be able to meet (Orlian 2009). But what if the investment earns more than a 5% return? The parties also agree in advance that so long as the active partner pays the expected 5% return, the silent partner waives any further claim against him. Thus, the return of principal plus 5% "profit" is effectively guaranteed, replicating a conventional loan.

and other reformers advocated Jewish adoption of secular learning and culture and integration into mainstream European society.[38]

The Jewish Reform movement of Jacobson and Zunz: Toward a rejection of legalism

The Haskalah, together with Jewish Emancipation, led to the inception of the Reform movement in Judaism in nineteenth-century Europe. Reformers in Germany, Austria, Hungary, Denmark, the United Kingdom, the United States, and elsewhere increasingly advocated changes such as relaxation or elimination of kashrut (Jewish dietary laws), sidelining of kabbalah (Jewish mysticism), and more relaxed congregational structure.

The irrelevance of usury law in contemporary Conservative and Reform congregations

This movement eventually gave rise to the Reform and Liberal denominations worldwide, and to Conservative (Masorti) Judaism, which adopted a middle path between Reform and Orthodox Judaism.

Both Reform and Conservative/Masorti congregations today have essentially no place for a usury ban — or other regulation of marketplace activity — in their systems of belief. Some members of Reform congregations consider Reform Judaism to be entirely "post-halakhic." Others feel that halakhah may have a place in Judaism, but one that is extremely fluid, demoored from the teachings of the jurists of antiquity, and entirely separate from civil and criminal law. Most leading figures in the contemporary Conservative/Masorti movement, on the other hand, do strongly consider theirs to be a halakhic denomination. For example, a significant number of Conservative/Masorti Jews observe kosher laws assiduously and avoid driving and using electronics on Shabbat. Some Conservative/Masorti temples give precedence to Kohanim (patrilineal descendants of Aaron, and thus members of the priestly community) in congregational Torah reading and other priestly functions. However, concern with the Bava Metzia — the Talmudic tractate that discusses civil matters such as property law and usury — is essentially absent in Reform and Conservative congregations.

The evolution of the heter iska in modern Orthodox Judaism

Instead of neglecting the usury ban, some Orthodox rabbinical scholars of the 19th and 20th centuries focused on finding a way to make the heter iska amenable to modern banking.

A crucial step on the road to accommodation was a tract on the "general heter iska" published in 1922 by Ezriel Eiger (1873–1941), grand rabbi of Lublin, Poland (Leiner 2003).

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[38] Mendelssohn translated the Torah into German, stressed rational and modern aspects of Jewish philosophy and belief, sought to revive the Hebrew language, and became an example of how Jews could assimilate and achieve success as public intellectuals in Europe while celebrating their Jewish identity.

Some rabbis of Eiger's era contested the validity of a general heter iska when applied to individuals because a heter iska (like any financial transaction) has two parties, suggesting that the active consent of both parties is necessary to make the transaction valid. However, even skeptical rabbis came to accept the general heter iska when applied to entire institutions, under the logic that anyone who walks into a bank (or other financial institution) necessarily agrees to abide by its previously established terms and conditions (Leiner 2003).

While this may seem a minor point, it is actually quite important: the validity of a general heter iska makes it unnecessary to create a separate class of "Judaically correct" financial products. Establishing a separate set of financial institutions devoted to selling only those types of products becomes unnecessary; a single document once signed for each financial institution will do.

The usury ban in Orthodox Judaism today: Despite radical accommodations, it remains alive to rabbinical scholars and to banks in Israel (and one in New Jersey)

In practice today, it is only Orthodox Jews — and indeed, only a subset of them — who rely on halakhic oversight of their economic affairs.

The practice of heter iska persists today, and is widespread enough that one could make the case that its use does indeed constitute a form of "Jewish finance." Today, all banks in Israel operate with a signed document (sometimes displayed on the wall, with rabbinical authorization) stating that the bank's "loan" transactions are technically heter iska partnerships. This is a "general heter iska" — that is, one binding on all future transactions entered into by a signatory, such as a bank or an individual, as opposed to a separate heter iska that is signed for each transaction.

While the Jewish usury ban is now accommodated to the point of circumvention merely by a piece of paper on the walls of a bank, it nonetheless represents an ongoing belief in the relevance of rabbinical jurisprudence to financial life. It is a symbolic link between religion and the economy. Moreover, with the growth and spread of Orthodox congregations worldwide, it shows no sign of disappearing. The heter iska is primarily only a matter of concern within Israel because the Jewish usury ban applies only when both the lender and the borrower are Jewish. However, it has recently made an appearance in the United States. In 2011, the Lakewood, New Jersey branch of First Commerce Bank — which has a Jewish president and CEO, a Jewish chairman, and two rabbis on its board (one an attorney and the other a certified public accountant) — "has inserted a heter iska into the charter of the bank and in the applications with state regulators and the FDIC, becoming the only bank [in the

United States] that has done so to date" (Schneider 2011).[39] The Jewish usury ban, while certainly attenuated, is still alive.

CHRISTIANITY

BIRTH

The New Testament says nothing about interest

The New Testament shows no interest in interest. The term "usury" (Greek τόκος) appears only twice in the New Testament. These passages (Matthew 25:27 and Luke 19:23) summarize the Parable of the Talents and therefore, at least by conventional Christian readings, do not focus on financial ethics (Jones 2004:25; McGaughy 1975). At best, the parable is morally neutral about interest, incorporating it into the narrative without remark (Maloney 1973:241–242). Viewed in an unorthodox way, the parable could even be interpreted as divine sanction of interest, for the servant who does not bring his lord's money to the banker to earn interest suffers his lord's anger, while the servants who do so earn approval (Moser 2000:32).

Paul's Epistle to the Galatians: Does Mosaic law apply to Christians?

Must Christians adhere to Jewish law? The apostle Paul addressed this question in his "Epistle to the Galatians" (composed ca. 50 CE – 60 CE). Simply put, his answer is no: Christianity is a religion of faith and love, not one of adherence to laws. (This argument would become important again with the Protestant Reformation a millennium and a half later.)

Abstract norms and unsystematic edicts: Usury in Christianity's first millennium

Despite *Galatians*, the early Church Fathers and other early medieval Christian thinkers roundly condemned usury. This condemnation borrowed in part from the thought of prominent philosophers in the Mediterranean basin, such as the Hellenistic Jewish philosopher Philo (20 BCE – 50 CE).

Yet for the first 1000 years of Christianity, Christian writings and decrees on usury took the form of relatively simple moral arguments: usury was a sin against justice, generosity, or

[39] Lakewood has a large Orthodox Jewish community: of its total population of 93,000 people, 18,000 are yeshiva students.

brotherhood. They did not focus on developing a systematic analytical theory of usury, based on abstract concepts and principles that could be applied to determine the legality of complex individual cases.

It did not take long before the early Church Fathers began condemning usury. This is not surprising given the explicit references to usury in the Old Testament (see above) and the importance of usury to influential contemporary thinkers such as the Jewish Philo of Alexandria (20 BCE – 50 CE), who opposed it staunchly, and others in the classical world with similar views. The list of early Church Fathers who condemned usury is long.[40]

The early Church Fathers' reasoning for the ban on interest was relatively straightforward, especially compared with the complex justifications the scholastics would offer in late medieval times. Two main arguments against interest appeared in the first four centuries CE: (1) that the Hebrew scriptures prohibited it, and (2) that it clashed with the ethos of charity in the name of Christian love. Looking more closely at the logic behind these arguments, however, we find (starting in the early fourth century with Lactantius, and again in the mid-fourth century with Hilary of Poitiers) increasing resort to rationalist positions (Moser 2000). Some were arguments condemning the motives behind interest, arguing that creditors' attempts to profit from the need of borrowers are unjust. Others were arguments against the effects of interest, asserting that it causes evil and suffering in society. Still others were arguments against the nature of interest, reviving the Aristotelian position that interest is the multiplication of something (money) that is inherently barren. These rationalist positions were ensconced within broader invocations of brotherly love and Christian compassion.

Gratian's Decretum and the birth of Christian jurisprudence

The emergence of truly systematic Christian usury law began in the 12th century as part of the systematization of canon law and the initial development of Christian jurisprudence in the Western church.

Gratian's *Decretum* (Gratian 1993), completed circa 1140, is a turning point in the history of canon law. Gratian was a Bolognese monk and an early Scholastic. His *Concordia Discordantium Canonum* (the *Decretum* for short) effectively established the science of Christian jurisprudence.

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[40] The list includes Clement of Alexandria (c. 150–215), Tertullian (c. 155–c. 220), Cyprian (c. 200–258), Commodianus, Lactantius, Athanasius (c. 295–373), Hilary of Poitiers (c. 315–c. 367), Cyril of Jerusalem (c. 315–387), Basil the Great (330–79), Gregory of Nyssa (335–394), Gregory Nanzianzen (330–389), most voluminously St. Ambrose (339–397), St. John Chrysostom (344?–407), St. Jerome (344–420), St. Augustine (350–430), and Pope Leo I (Leo the Great, 390?–461), whose work was the basis for the Hadriana's passages on usury (see below) (for an exhaustive account of all of their positions, see Maloney 1973).

Gratian's work was a crucial *rationalization* of the study of canon law. With Gratian, it became possible to study canon law as a *science*, and not merely by poring over text after text without a concrete comparative and analytical methodology.

Gratian's *Decretum* was foundational for the development of a Christian jurisprudence in a number of ways. First, it *compiled* existing canon law more exhaustively than any predecessor's work. Second, it applied a more *rational system of ordering and categorization* to the jumble of papal decretals and Church Fathers' writings. Third, it focused on extracting *abstract principles and juridical concepts* from past law. This contrasted with past collections of canon law, which had tended only to summarize individual arguments. Indeed, until Gratian, the history of canon law had merely been a history of collections. Fourth, Gratian integrated Roman law — which was just recently being revived in Western Europe thanks to newly uncovered documents — into Christian jurisprudence. Fifth, Gratian (and others writing around the same time as he) took important steps to separate the study of canon law from theology.

Universities, monasteries, and the birth of the legal profession in the 12th and 13th centuries

Thanks in no small part to Gratian, canonical jurisprudence blossomed in the 12th and 13th centuries. The establishment of early universities at Bologna, Paris, Oxford, and Cambridge supported this. Legal scholarship also developed in the burgeoning system of monastic orders emerging at the time. This rapidly developing academic infrastructure provided not only a setting for the systematic study of canon law (including usury law), but also provided an environment relatively free from political interference.

Usury law becomes stricter and more seriously enforced in the 12th and 13th centuries

Around 1150, the Church's penalty for usury increased from being denial of communion to exclusion from all church services. In a society where the Church was at the center of social life, this punishment was tantamount to pariah status. In 1179, the Church deemed that any cleric who granted a Christian burial to a usurer, or received donations from a usurer, would be suspended from his office. This penalty was raised to excommunication at the 1207 Council of Paris. Also at the Council of Paris, Innocent III empowered the Church to pursue the prosecution of usurers, putting new teeth behind the usury ban. Until then, ecclesiastical judges would only oversee cases in which a plaintiff alleged usury against a defendant. But after 1207, ecclesiastical judges could prosecute those with a reputation for usury, even in the absence of a plaintiff (Tan 2002:190). In 1311, Church prosecutors were empowered still further: businessmen accused of usury had to turn over their account books to the ecclesiastical courts.

Ivory-tower canonical jurisprudence in the late Middle Ages and the expansion of "interest" as a category

With regard to usury law in particular, academic freedom helped establish a setting in which an "ivory-tower" scholarship of usury could develop. Usury law initially became much more comprehensive, but the ivory-tower approach allowed for further development away from immediate practical concerns in some cases.

The Scholastics, 1200–1500: Condemning usury while expanding interest

Over the next four centuries, legal formalism increased. On one hand, this coincided with a tightening of Church policy against manifest usurers: those who clearly flouted the usury ban by lending at high interest rates. However, at the same time, technical justifications for morally and legally acceptable "interest" increased. "Interest" contrasted with sinful "usury." "Interest" was, in principle, a way of making whole a lender who had made a benevolent loan but had suffered costs while doing so. Usury was immoral excess. Interest was a restitution, a legal technique. Usury was avarice of the basest sort.

The core of the idea of "interest" as conceived during the classical and medieval periods was the notion of making a lender whole by compensating her for financial injury. "Interest" stems from quod interest, "that which is the difference," referring to damages owed because of the nonfulfillment of a contractual obligation. In Roman law, id quod interest was "that what I have lost and would have gained." In other words, when a Roman judge condemned a defendant in quod actoris interest, "the judge had to estimate the claimant's losses and his material situation which would have resulted if the fact for which the defendant was liable had not occurred" (Berger 1953). Likewise, among twelfth-century scholastics, interesse — a term developed by the celebrated Bolognese jurist Azzo — referred to compensation for the party injured by another's failure to live up to contractual obligations. "Interesse," wrote Raymond of Peñafort (ca. 1175–1275), patron saint of lawyers, "id est non lucrum, sed vitatio damni" ("Interesse is not gain, but the avoidance of loss") (Noonan 1957:106).

As both commerce and Scholasticism expanded in Western Europe, the scope of transactions that counted as licit interest and not as illicit usury increased. By the late Middle Ages, lenders were regularly charging interest rates in the range of 10%–15% per annum with ecclesiastical justification. Yet on the other hand, penalties for manifest usurers — usually small-scale moneylenders who charged even higher interest rates — grew even harsher.

Common medieval Christian legal conventions for replicating interest

Poena conventionalis (penalty by agreement) was a penalty for late payment. Stipulated in advance of the loan, it was usually a percentage of the principal. It applied when repayment was delayed past the due date by a predetermined period — much like a modern credit card (Kerridge 2002:7–8) — though the grace period was typically three or six months, sometimes a year. The logic behind poena conventionalis is that while it is not acceptable to make the borrower pay simply for use of money that he returns on time, a lender who is patient with a borrower in default deserves compensation for withholding his legitimate rights to liquidate the borrower's pawned bond or security or to enter into legal proceedings against the borrower.

Damnum emergens (emergent loss) referred to atypical losses the lender suffers that arise from the loan itself. Excluded are the typical transaction costs of moneylending such as the cost of having to get hold of the money or goods being lent, accounting costs, insurance premiums, and broker's fees (Kerridge 2002:9). To claim interest for damnum emergens, a lender must show extraordinary loss: for example, a default by the borrower might force the lender to incur the cost of taking out a loan of his own.

Lucrum cessans (cessant gain) occurred when a lender, because of a borrower's late payment or default, missed an opportunity to invest profitably elsewhere. The forgone investment opportunity could not be in moneylending, but had to be in some other area — typically industry, agriculture, land, construction, trade, an investment in a company, and so on. The borrower incurred a previously stipulated penalty.

Periculum sortis (lot risk)[41] arose when the lender acted as insurer of capital during a risky venture. If the venture fails, then the lender agrees not to hold the borrower responsible for

[41] Barker draws a modern analogy: "Risk does give a man title to special remuneration — we give a higher wage to steeplejacks and aviators" (Barker 1921:102). Moreover, the riskier the venture, the more the lender could charge for periculum sortis. Because a venture's risk could theoretically be infinite, rates for sea voyages could be high: they were typically 30 to 50 percent in early modern England, and could legitimately go as high as 300 percent, though English courts frowned on very high rates (Kerridge 2002:10–12). Lord Bramwell explains this logic: "Suppose you were asked to lend a mutton chop to a ravenous dog, upon what terms would you lend it?" (Kerridge 2002:10–12). But because it bore strong resemblance to the notion of compensation for

the capital (Noonan 1957:129). But the borrower is allowed to charge a premium for this. In a typical scenario, the borrower was a captain undertaking a risky sea voyage who needed a loan to buy cargo. According to the doctrine of periculum sortis, it was legitimate for the lender to impose a charge — like an insurance premium — to compensate for the risk that he would never receive his principal back.

DEATH

Luther: "I shit on the jurists"

The Protestant Reformation gave rise to a divergent series of approaches to usury. At first, the stormy Martin Luther (1483–1546) radically condemned not only usury, but the Church's own endorsement of financial instruments (such as *Zinskauf*, or land rents) that he considered both usurious and exploitative of Germans. Luther combined this reforming zeal with an initial desire to rid Christianity of jurists, and more generally of what he considered to be a cancerous legal formalism:

> I shit on the law of the emperor, and of the pope, and on the law of the jurists as well.
>
> Jurists are bad Christians.
>
> Every jurist is an enemy of Christ.
>
> We theologians have no worse enemies than jurists.
>
> A jurist should not speak until he hears a pig fart [for only then will his words have a proper climate to be appreciated].
>
> – Martin Luther (Witte 2002:119)

Luther wanted to *strengthen* and *simplify* the ban on usury by going back to first religious principles of brotherly love and charity. At first, he despised the jurists' scholasticism, considering it an obstacle to this return to first principles. He was also embroiled in disputes with the University of Wittenberg's law faculty, symptomatic of centuries-old rivalry between teachers of law and of theology (Witte 2002:119). So for both personal and ideological reasons, the jurists' stance on usury was deeply problematic to Luther.

---

the risk of a loan, interest for periculum sortis was highly controversial among medieval and early modern scholastics (Noonan 1957:129). Indeed, the advent of periculum sortis as a legitimate cause for compensation represents the incipient emergence of a more modern way of thinking about risk (Coumet 1970:581).

Unfortunately for Luther, however, a simplified, anti-legalist usury ban did not survive for long. Luther himself changed his stance toward usury within his lifetime (see Chapter Two). Until the German Peasants' War of 1524–1525, he was a populist firebrand, condemning usury in its various forms. He railed especially against the Zinskauf land rent, which was a financial leech on the peasantry. But after the Peasants' War and the rise of the left-wing reformers (including the Anabaptists, socialists before their time), Luther suddenly had to transition from revolutionary to architect of social stability. He tempered his revolutionary positions and accepted five-percent interest rates in his later years.

The Anabaptists: Radical utopianism

The Anabaptists were the "left wing of the Reformation" (Bainton 1941): a radical offshoot that emerged in the 1520s, in large part as a faction that broke away from Zwingli for being too accommodating of the Zurich City Council and not actively supporting measures such as the elimination of infant baptism (which the Anabaptists replace with adult baptism) and the rejection of mass. The movement took hold quickly across disparate parts of the Holy Roman Empire (including modern Switzerland, Germany, Austria, and the Czech Republic) and the Habsburg Netherlands. It is the direct precursor of today's Mennonite and Amish movements.

The Anabaptists' stance on usury was straightforwardly utopian: all lending at interest was sinful and should be abolished. According to Jones (2004), they took this stance for three reasons. First, they rejected (and still reject) things of the majority's culture in preference for an exclusive and separatist brotherhood of the truly pious. Usury was worldly and therefore abominable. Moreover, usury leads to oppressive class divisions, which contravene the Anabaptists' fraternal ethos. Finally, acceptance of usury, in their view, ran afoul of a literalist interpretation of scripture — something the Anabaptists adhered to regardless of current practices in majority culture.

However, the usury ban did not last long among the Anabaptists, falling out of the movement's central doctrine in the space of a century and a half. The Anabaptists, like the early Luther, had rejected the idea of legalism roundly. This removed the crucial role of formalist jurists in retaining a usury ban that made legalistic accommodations in the face of expanding commercial needs.

Calvin: Opening the door to low interest rates

John Calvin (1509–1564), more than any other figure, helped replace the medieval view of the religion-economy nexus with a modern one. He sanctioned usury at low rates so long as it did not harm the borrower.

Calvin altered the moral valence of commercial activity: no longer antithetical to piety, success in commerce became an outward manifestation of grace (Bieler 1964; Tawney 1963; Troeltsch 1958; Weber 2002). This opened the door for Calvin to acknowledge that it is natural for humans to seek profit. He was well aware that the profit-seeker could cause great harm to others, and he therefore upheld the role of Biblical teaching in curbing avarice and protecting the poor. But he did not view profit-seeking as in itself impious. Rather, he believed the test of piety should be in the effects of commercial activity on others. That is why Calvin's break with the medieval morality of religion and economy was so decisive.

Calvinism was also important to the dissipation of the usury ban in Protestantism and in the West more broadly because it provided a cognitive justification for an *individualistic view of economic behavior*. Although early Calvinism was strongly communalist, the Calvinism of the late 17th and early 18th centuries — on which Weber focuses in *The Protestant Ethic and the Spirit of Capitalism* (Weber 2002) — emphasizes the rational pursuit of profit as a deeply individual ascetic endeavor stemming from individual anxieties about predestination. This individualism paved the way for the emergence of *homo economicus*, a rational, self-interested, atomistic individual actor in the marketplace. Homo economicus kept his moral and religious beliefs separate from his economic transactions with others. This impulse was naturally antithetical to religious usury bans.

The changing role of jurists in Protestantism

Once they were faced with the task of building not only a spiritual community but also a political one, the Lutherans also revived the role of religious jurists. Chaos reigned in the 1540s as the lack of clear laws in Protestant lands led to an increase in robbery, prostitution, and indeed usury.

However, a crucial point is that when jurists returned to Lutheranism, they returned not as guardians of legalistic thought who engaged in an ivory-tower Scholastic exercise, but as *lawmakers* whose main goal was to establish a rational means of maintaining order, ascetic morality, and faith in the community of believers. Protestantism stripped away the notion that adherence to sacred law was *in itself* part of the path to salvation. Rather, the job of Protestant jurists was to ensure that believers could focus on living a moral, Christian life — with their morality measured by their *individual* grace and not by their works. Melanchthon's 1531 *Apology of the Augsburg Confession* draws this clear distinction between law (obedience to God's will) and the gospel of grace (the promise of forgiveness of sins in light of the person and work of Jesus) (Pelikan 1985:170–171).

Eastern Christianity in the late Middle Ages: At the moment of the systematization of canon law, religious jurists blend together with secular jurists and the usury ban disappears

In late medieval and early modern Eastern Christianity (including the late Byzantine, Coptic, and Slavic churches), usury was virtually absent as a topic of religious debate and discussion. It appears that the Eastern Churches upheld the views of the early Church Fathers and pre-Schismatic Greek and Latin synods of the first millennium of Christianity, but generally speaking, went no further in developing a sophisticated jurisprudence of usury.

This was not because of a lack of sophisticated canonical jurisprudence in Eastern Christianity, for one certainly existed in late Byzantium. Rather, it appears to have been because of the religious jurists themselves lacked functional and intellectual autonomy from state power. Unlike their Western Christian counterparts, who enjoyed functional and intellectual autonomy to develop a sophisticated ivory-tower theory of usury within the monasteries and universities from the 12th century until the Protestant Reformation (even while secular rulers — and even the Church itself — was lending and borrowing in large-scale credit markets), the jurists of late Byzantium and other Eastern Christian lands operated in an environment in which religious law and secular law were merging. Although the lack of systematic Eastern Christian sources on usury makes it difficult to draw firm conclusions, it appears that the religious jurists' lack of autonomy from political power blocked the development of ivory-tower usury theory.

Fading into obscurity together: Roman Catholic usury doctrine and Roman Catholic jurists, 1600–1900

Despite coming under attack during the Protestant Reformation and its aftermath, both the official usury ban and the scholastic activity of religious jurists continued in the Roman Catholic church. Both died a slow, gradual death. Although the usury ban remained a topic of discussion among Roman Catholic canonists in the 17th and 18th centuries, fewer and fewer Catholics adhered to the ban. With the rise of modern states, religious enforcement of economic laws on the public (as opposed to on the priesthood and on church administrators) essentially ended. The usury ban technically remained a part of canon law until 1917, but by then it was a dead letter. (Indeed, the Apostolic Camera and other Church bureaucracies had long been involved in interest-bearing financial markets through their bankers.)

This decline of the usury ban coincided with a shift in the role and importance of religious jurists in Roman Catholicism. Canon law itself went from being an institution relevant to lay Catholics to one that regulated internal Church personnel and bureaucracy. The canonists, whose complex and nuanced meditations had real consequences in the

medieval and early modern periods for the regulation of usury, lost all impact on the economic behavior of believers.

Unlike in the Orthodox Jewish and Islamic cases, the authority of Roman Catholic jurists to regulate economic behavior did not maintain even a symbolic religious legitimacy in the era of modern capitalism. In order for a religious usury ban to survive into the 20th century, or to be revived in the 20th century, a *symbolic link* to the legitimacy of the traditional policy was necessary. Religious jurists' persistent esteem and prestige within Orthodox Judaism and Islam provided that link. The decline of religious jurists' esteem and visibility in Roman Catholicism precluded this possibility.

Usury as a secular problem of social policy

As religious regulation of usury declined in Western Europe from the 16th century onward, interest rates became a policy concern of secular governments. This process had its origins during the late medieval period, when in many Western European countries secular courts operated alongside ecclesiastical courts, sometimes even handling the same infractions. By the 19th century, regulation of interest rates had become thoroughly a policy concern of national governments, and with the rise of central banking in the 20th century, macro-level interest rates became one of the top policy concerns of governments. Maximum interest rates on retail moneylending, meanwhile, became an instrument of social policy and poverty management.

ISLAM

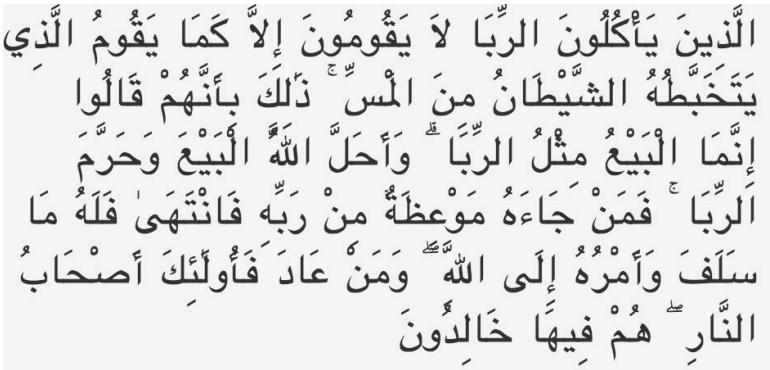
BIRTH

Ribā in the Quran: Clearly condemned but ambiguously defined

Ribā is an Arabic term that means "increase." Specifically, it refers to unlawful increase from an exchange via excess or delay.[42] The term appears eight times in the Quran.[43] One of the passages cited most often is this:

[42] The word *ribā* sits in the semantic field *rā'-bā'*-waw, which denotes increase, growth, and excess.

[43] *Ribā* appears three times in 2:275 and one time each in 2:276, 2:278, 3:130, 4:161, and 30:39.


الَّذِينَ يَأْكُلُونَ الرِّبَا لاَ يَقُومُونَ إِلاَّ كَمَا يَقُومُ الَّذِي
يَتَخَبَّطُهُ الشَّيْطَانُ مِنَ الْمَسِّ ۚ ذَٰلِكَ بِأَنَّهُمْ قَالُوا
إِنَّمَا الْبَيْعُ مِثْلُ الرِّبَا ۗ وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ
الرِّبَا ۚ فَمَنْ جَاءَهُ مَوْعِظَةٌ مِنْ رَبِّهِ فَانْتَهَىٰ فَلَهُ مَا
سَلَفَ وَأَمْرُهُ إِلَى اللَّهِ ۖ وَمَنْ عَادَ فَأُولَٰئِكَ أَصْحَابُ
النَّارِ ۖ هُمْ فِيهَا خَالِدُونَ

> Those who exact usury [ribā] will not stand but like one deranged by the Devil's touch. That is because they say, 'Trade is just like usury.' While Allah has allowed trade and forbidden usury. Whoever, on receiving advice from his Lord, relinquishes [usury], shall keep [the gains of] what is past, and his matter shall rest with Allah. As for those who resume, they shall be the inmates of the Fire and they shall remain in it [forever]. (Quran 2:275, Arberry translation)

There are also numerous references to ribā in the canonical ḥadīth literature. According to a ḥadīth recorded in the *Sunan ibn Mājah*, the Prophet Muhammad declared ribā a sin even worse than a man marrying his own mother (Al Zuhayli 2006:27). Ribā has been a central topic of discussion throughout the history of classical, medieval, and modern Islamic thought as well. Tariq Ramadan calls the prohibition of ribā "the moral axis around which the economic thought of Islam revolves" (Ramadan 2004:188).

But while the Quran prohibits ribā unequivocally, it does not define ribā explicitly. Over the centuries, there has been much debate over what exactly counts as ribā. Contestation over the word's precise meaning began as early as the seventh century CE, among close companions of the Prophet Muhammad himself, shortly after His death. Imam Muḥammad al-Bukhārī, in a ninth-century (CE) commentary on the Quran, writes that ʿUmar ibn al-Khattāb (579–644 CE), a companion of the Prophet Muhammad and the second of the *Rāshidūn* (the four Rightly Guided Caliphs), is quoted to have said that "the last verse revealed to the Prophet was on ribā" and that "He died before we could question Him on the subject" (Çağatay 1970:55). In other words, the Prophet's own companions rued the fact that He had not lived to expound further on ribā, leaving the matter something of a mystery for future generations.

Types of ribā

Many scholars of Islamic law distinguish between two types of ribā: surplus ribā (ribā al-faḍl, literally "ribā of excess") and credit ribā (ribā al-nasī'ah, literally "ribā of deferment" or "ribā of delay"). Some scholars add a third category: pre-Islamic ribā (ribā al-jāhilīyah, literally "ribā of the age of ignorance").

Surplus ribā can be defined as unlawful excess of the countervalues in a hand-to-hand transaction.[1] It occurs during barter, when goods of the same genus and kind are traded in different quantities. The prohibition on surplus ribā is similar to the Biblical prohibition on deriving profit when lending food, which appears in Leviticus 25:37 (Iqbal and Mirakhor 2007:56). The Islamic prohibition appears in a ḥadīth according to which the Prophet said:

> Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt, like for like, equal for equal, and hand-to-hand. If the commodities differ, then you (may) sell as you wish provided that (the exchange) is hand-to-hand.

What does this ḥadīth mean? The rule it sets down seems to be that a commodity now may be exchanged for the same commodity now only if it is exchanged in equal quantities. But this is odd: since exchanging five pieces of gold for the same five pieces of gold is pointless, why have such a rule? Scholars of Islamic law have replied that in banning surplus ribā, "the Prophet was bringing some order into an otherwise chaotic financial market" (Siddiqi 2004:49–50). Money, including gold and silver currencies, were poorly standardized in the Prophet's day, with coins of different weights circulating under the same names, and with coins often adulterated as well. Restricting such exchanges reduced the possibility of trickery and error. A similar argument applies to wheat, barley, dates, and salt, which were likewise used as mediums of exchange in the sixth-century Arabian economy (Ibn Rushd 1988:135; in Siddiqi 2004:51).[44] These commodities, and items analogous to them by extension (including other forms of currency besides gold and silver), came to be known as ribawī substances: that is, substances to which the rules of ribā apply.

More directly germane to the ban on interest is credit ribā, which occurs when two ribawī substances are exchanged: one immediately and the other with a delay. The Quran says:

وَمَا آتَيْتُمْ مِنْ رِبًا لِيَرْبُوَ فِي أَمْوَالِ النَّاسِ فَلَا
يَرْبُو عِنْدَ اللَّهِ ۖ وَمَا آتَيْتُمْ مِنْ زَكَاةٍ تُرِيدُونَ وَجْهَ
اللَّهِ فَأُولَٰئِكَ هُمُ الْمُضْعِفُونَ

[44] Depending on their school, jurists have extended the category of prohibited *ribawī* substances (i.e. substances to which ribā attaches) beyond gold, silver, wheat, barley, dates, and salt. There are differences among the schools (Saleh 1986): Ḥanafīs apply it to all fungible goods that can be weighed or measured, whereas Shāfiʿīs and Mālikīs specifically to currencies and foodstuffs. Ḥanbalīs and Ibāḍīs take a range of positions. Only the Ẓāhirīs take the narrowest position: that ribā of excess applies only to the six goods mentioned in the ḥadīth.

> That which you give in usury [ribā] in order that it may increase people's wealth does not increase with Allah. But what you pay as *zakāt* seeking Allah's pleasure —it is they who will be given a manifold increase. (Quran 30:39, Arberry translation)

This passage refers to a loan of some kind. Interpreting this and other passages in the Quran,[45] as well as various references in the canonical books of ḥadīth, most classical jurists asserted that Islam prohibits lending ribawī substances at interest. Almost all jurists agree that the inclusion of gold and silver as ribawī substances extends to any form of currency.[46]

In other words, for hundreds of years, the "orthodox" position among a majority of Islamic jurists has been that charging interest is a sin. Specifically, these jurists have argued that giving a certain amount now, conditional upon return of a larger amount in the future, is the prohibited credit ribā. One contemporary jurist gives a simple example, and then extends it to modern banking:

> An example … is one's buying a sa' of wheat in the winter for one and a half sa's to be paid in the summer; in this scenario, the extra half sa', which is an increase in the cost, has no counter-value, but is only set against the delay of the debt's collection…
>
> …The process of today's banks, in which money is lent on credit, with annual or monthly interest rates of 7, 5, or 2.5 percent, is likewise the forbidden and unjust consumption of people's wealth… for it is credit ribā… Conventionally, the word "interest" today is only used to indicate the interest on money due to delay in payment, this being the very same credit ribā known by the people of the pre-Islamic period. As for surplus ribā, today it is very rare. (Al Zuhayli, 2006: 34–35).

This position is typical (Khalil 2006:55) of the classical and contemporary orthodoxy. From this perspective, ordinary interest on credit is, unequivocally, ribā.

Pre-Islamic ribā (ribā al-jāhilīyah) is a practice that some scholars designate as a third category but others do not. In pre-Islamic Arabia, when a debt matured, it was allegedly a common practice to ask the debtor whether he would pay the full principal (and no interest) now, or increase the principal and pay later (Saleh 1986:13, 27; Rodinson 1974:14). In other words, ribā al-jāhilīyah "involved adding an amount to the principal against an extension of the maturity of an existing debt due to the debtor's inability to repay on time" (Saeed 1996:23). Unlike in modern-day lending, the borrower and lender did not stipulate the rate of increase in advance. And in some cases, the increase could be a doubling of the principal

[45] See 2:275–281, 3:130.

[46] Only the Ẓāhirī school does not consider other forms of currency to fall under the prohibition, interpreting the relevant Quranic passages literally to refer only to the mentioned ribawī substances.

— a brutal lending practice indeed. The Quran seems to refer to this doubling process:

يَا أَيُّهَا الَّذِينَ آمَنُوا لاَ تَأْكُلُوا الرِّبَا أَضْعَافًا مُضَاعَفَةً ۖ وَاتَّقُوا اللَّهَ لَعَلَّكُمْ تُفْلِحُونَ

وَاتَّقُوا النَّارَ الَّتِي أُعِدَّتْ لِلْكَافِرِينَ

> O believers, devour not usury [ribā], doubled and redoubled, and fear you God; haply so you will prosper.
>
> And beware of the Fire which has been prepared for the faithless. (Arberry translation, 3:130–131)

If the borrower kept failing to pay, his debt would allegedly double and re-double until he found himself enslaved (Warde 2010:53).

LIFE

Islamic usury law in practice: The challenges of enforcement in the medieval era

In some cases, Muslims simply ignored the interest ban and engaged in everyday financial practice that openly involved interest. Rodinson finds evidence of many Muslims lending money at interest all over the Islamic world before the introduction of western banking: in ninth-century Basrah (in what is now southern Iraq), a leading center of early Islamic civilization; he also finds "an everyday practice of violation of the canonical rules regarding *ribā*" in eleventh- and twelfth-century Tunisia among financiers, moneychangers, and the butchers and wholesalers of flax, cotton, and oil they serviced (Rodinson 1974:39). And Jennings finds early-seventeenth-century Ottoman court records from the Anatolian city of Kayseri to be full of accounts of interest charged on credit by and to Muslims — "not just the people of the bazaars but the rural agas, the Ottoman military class, and the ulema as well" (Jennings 1973:169).

Impunity and the gap between jurists' law and judges' law

The fiery punishment in the hereafter for dealing in ribā is fearsome indeed. But what of punishments on earth?

Curiously, there rarely seems to have been legal punishment for dealing in interest — beyond nullification of the contract that involved interest. "When a transaction involving illicit gain comes to court," writes Haim Gerber, "the only thing that actually happens is that

the transaction is made void, and has no legal consequence" (Gerber 1999:129). Gerber's focus is Ottoman legal practice in the seventeenth and eighteenth centuries. But in other legal histories of Islamic civilizations across space and time, it is likewise difficult to find reference anywhere to offenders suffering legal punishment for trucking in ribā, or to those accused of it being prosecuted.

Alternatives to interest-based finance in medieval Islamic economies

Early and medieval Islamic jurists devised and codified many types of contract structures, and merchants dextrously adopted some of these as alternatives to borrowing or lending at interest.

Partnerships: One such contract is the equity partnership. As any investment banker knows, the most straightforward alternative to raising capital through interest-bearing debt is to raise it by distributing equity. Commercial partnerships and other equity arrangements were a crucial means of financing in the medieval world, especially to finance long-distance trade. By the tenth century, partnership law — and commercial law in general — were strikingly advanced in the Islamic world (Kuran 2010:48–62). This was true both in the Middle East (Udovitch 1970) and the trade circuits of the Indian Ocean (Chaudhuri 1985:210–11). There is evidence that the medieval European commenda structure, which was vital to Mediterranean trade, has Islamic origins (Udovitch 1962). Common equity-based forms included the proprietary partnership (sharikat al-milk), the unlimited investment partnership (the Ḥanafī *mufāwadah*), the limited investment partnership (*ʿinān*), and several versions of the commenda[47] (muḍārabah, *qirāḍ*, and *muqāraḍah*) (Udovitch 1970).

Salam: Besides equity partnerships, there were (and still are) other financial structures that incorporate an element of credit but are universally sanctioned by experts in Islamic law. One form of debt financing, the *salam* contract, has played an important role in Islamic economic history through the centuries. In a salam contract, a buyer pays in advance for future delivery of a product. A grain merchant, for example, can pay a farmer in the spring for grain to be delivered in the fall — ensuring that the farmer will have money to buy seed and fertilizer. The advance price can be less than the (indeterminate) future market price, meaning salam is essentially a form of credit.[48] Salam played an important part in financing

[47] As Udovitch explains, "the commenda is an arrangement in which an investor or group of investors entrusts capital or merchandise to an agent-manager, who is to trade with it and then return to the investor(s) the principal and a previously agreed-upon share of the profits. Any loss resulting from the exigencies of travel or from an unsuccessful business venture is borne exclusively by the investor(s); the agent is in no way liable for a loss of this nature, losing only his expended time and effort" (Udovitch 1970:170).

[48] The ban on *ribā* has led some people to assert that Islam does not recognize the time value of money. To rebut this assertion, Islamic economists and people in the Islamic-finance community have pointed to the universally accepted salam contract, which — by being Islamically acceptable — acknowledges prima facie the time value of money.

agricultural and artisanal production for centuries (Doumani 2006; Cuno 2006; Johansen 2006), and has been accepted by jurists through the ages on the basis of ḥadīth statements. Today, some Islamic financial institutions use salam to structure Islamic commodity futures (Kamali 2007, 2010) and other derivatives.[49]

Pawnbroking: Another alternative to borrowing at interest, at least on a small scale, is pawnbroking. An apparent reference to pawning — that is, to holding an item as security against a debt — appears in the Quran:

> O believers, when you contract a debt one upon another for a stated term, write it down, and let a writer write it down between you justly… And if you are upon a journey, and you do not find a writer, then a pledge in hand [shall suffice]. (2:282–283, Arberry translation)

There is also a ḥadīth attributed to Ā'ishah, the Prophet Muhammad's third wife, stating that the Prophet pawned his iron armor when buying some barley from a Jew on credit (Al-Bukhari 1987:3.453). Pawnbroking appears to have been relatively common in some Islamic societies, with many references to it in fatwas and books of fiqh over the centuries (Çağatay 1970:56). Pawnbroking has been a part of everyday financial life in economies that have attained more than a rudimentary level of marketization, especially (though not exclusively) among the poor and the working classes (Becker 1957; Beezley 2008; Bouman and Houtman 1988; Caskey 1991; Tebbutt 1983; Woloson 2007), so it is no surprise that the same was true in the Islamic world.[50]

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[49] Another form of credit was the bill of exchange (suftajah, plural *safātij*). The bill of exchange, however, was used almost entirely for the purpose of moving specie safely and easily in international trade, not as a lending instrument (Ingham 1999; Labib 1969; Ray 1997; Udovitch 1975; Wilson 1991).

[50] However, the fact that pawnbroking was generally allowed in Islamic societies does not explain the persistence of the interest ban because pawnbroking generally serves a relatively narrow economic function (small-scale borrowing, typically for purposes of consumption) and a limited customer demographic (largely the poor, though not entirely (Calder 2009:45–49). Pawnbroking is efficient in poor communities because it solves an information problem: there is no need for the lender to assess the borrower's creditworthiness so long as the pawnbroker can quickly determine the value of the pawned item instead. This approach is efficient for both lender and borrower if the risk of non-payment is high. However, it requires that the borrower be able and willing to produce a liquid, transportable asset of considerable value to pawn. This makes pawnbroking useless to the completely impecuious; only those of limited but non-zero means will turn to a pawnbroker.

A recent Malaysian innovation is Islamic pawnbroking (Abdul Hamid and Abdul Aziz 2003; Abdul-Razak 2011; Appannan and Doris 2011; Bhatt and Sinnakkannu 2008; Muhamat, Rosly, and Jaafar 2011; Othman, Hashim, and Abdullah 2012). Marketed in Malaysia as ar-rahnu (which is Arabic for "pawn" or "mortgage"), it first appeared in the early 1990s in the Malaysian states of Terengganu and Kelantan, which have traditionally been strongholds of Islamic conservatism, receiving support from the state governments there. Islamic pawnbroking was introduced in 1992 by the Council for Islamic Affairs and Malay Customs (Majlis Agama Islam dan Adat Melayu Terengganu) of the government of the Malaysian state of Terengganu. In 1993,

Loans secured by land: An older mode of financing common in rural areas of Islamic Southeast Asia in the pre-colonial and colonial periods involved the use of land as security. A landowner would pledge his land to a lender in exchange for a loan, and then get the land back when he repaid the debt. The usufruct of the land and the right to occupy it transferred to the lender for the duration of the loan, serving as a substitute for interest and thus avoiding the taint of ribā. In Malaysia, this practice was known as *jual janji*,[51] and in Indonesia, *hak gadai*;[52] these were established practices in the adat (customary practice) of the Malay world.[53]

Unfortunately, while offering land as security for a loan may have protected Southeast Asian villagers from the taint of ribā in the eyes of their communities, it often did not protect them from financial predation. In Malaysian jual janji, for example, the value at which the landowner temporarily "sold" his land to the moneylender was typically well below market value. This meant jual janji effectively became a guise for high-rate usury (Gordon 1962; Jomo 1977:247, footnote 3). This was true as late as the 1980s.[54]

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neighboring Kelantan state followed suit. At a moment when political and popular support for Islamic finance was accelerating in Malaysia, Islamic pawnbroking received the support of a public-private consortium that included the Malaysian central bank, the private-sector Bank Rakyat, and the Foundation for Islamic Development Malaysia (Yayasan Pembangunan Ekonomi Islam Malaysia, or YaPEIM).

Islamic pawnbroking is similar to conventional pawnbroking, but seeks to address some of the irregularities that have plagued Malaysia's traditional pawnbroking sector, including high interest rates of 2% to 2.5% per month, undervaluation of the pawned item during appraisal, and illegible receipts and shoddy recordkeeping by unscrupulous lenders. Instead, Islamic pawnbroking in Malaysia accepts as collateral only gold (which is more easily and uniformly appraised than other items), involves the use of loan and safekeeping contracts that are approved by Islamic scholars, and charges a safekeeping fee (typically of less than 0.7% per month) instead of an interest rate (Abdul-Razak 2011, Ch. 5). In short, the emergence of Islamic pawnbroking in Malaysia has been a state-supported rationalization of the pawnbroking sector that has addressed problems facing customers, many of whom were of low income and some of whom were illiterate or had low education levels. Today, over half of Malaysia's pawn shops are Islamic (Abdul-Razak 2011:72).

[51] Literally, a promise of a sale/transfer.

[52] Literally, a right of security/pledge.

[53] The Malaysian and Indonesian practices differed slightly: in jual janji, the borrower technically sold his land to the moneylender, retaining the right to buy it back during a specified period of time according to the Islamic contract of *bayʿ bi-l-wafā'* (sale with repurchase); in hak gadai, the landowner merely pledged his land to the moneylender, reserving the right to recover it when he repaid the loan (Hiscock and Allan 1982:513–14; Yasin 1994:165–66).

[54] In his ethnography of a village in Malaysia's Kedah plain, James C. Scott observed that wealthy local hajis had earned the money to go on the hajj pilgrimage by lending via jual janji, and that many villagers saw this as an ethically dubious way of making money (Scott 2008:19).

Non-Muslim moneylenders in medieval and early modern Islamic societies: Hardly a solution

Some religious minorities in Muslim-majority societies specialized in moneylending or banking. Non-Muslims from the Subcontinent are a prominent example — most famously the Bania (known in western India as the Vani or Vania), a merchant community active in Muslim-majority societies in South Asia, Central Asia, and Persia.[55] Similarly, members of the Khatri community (a caste principally from the Punjab, comprising mostly Hindus and Sikhs), successfully financed trade between India, Afghanistan, Central Asia, and Tibet from the late seventeenth century well into the twentieth (Levi 2002:107). And along the Swahili Coast and elsewhere in East Africa (as well as Southern Africa and West Africa), we find also Hindu and Jains — especially Gujaratis (Alpers 1976) — well-represented in nearly all commercial activities, and in moneylending as well.

In Islamic Southeast Asia (encompassing what is today Indonesia, Malaysia, Brunei, southern Thailand, and the southern Philippines), the ethnic Chinese minority has been successful in moneylending and other financial and commercial activities since the sixteenth century (Chirot and Reid 1997; Gomez and Hsiao 2004; Kumar 1987; Mackie 1991; Tan 1991; Wu 1983; Yeung 2006). Likewise successful in Southeast Asia have been the Chettiar, a community of mercantile castes largely from Tamil Nadu who spread across Southeast Asia. Some of their number grew wealthy as moneylenders and bankers in what is today Singapore, Malaysia, Indonesia, Burma, and Vietnam (Kudaisya 2009; Mahadevan 1978; Markovits 2007; Menon 1985; Sandhu 1993: especially 154, 175 ; Schrader 1992, 1996; Turnell and Vicary 2008).

Jews have participated in banking and professional moneylending in Islamic lands. With regard to lending in particular, and to economic life in general, Jews were on the whole much better integrated into medieval Islamic societies than they were into medieval Christian ones in northern Europe. This was partly due to Islam's more accommodating stance than Christianity's toward trade, in which medieval urban Jews were heavily involved in both medieval Islamic lands and Christendom. Both within the sphere of moneylending

[55] The Bania are Hindu or Jain and hail primarily from northern and western India. They have long been well-represented in commerce in India itself, and Bania moneylenders have wielded considerable economic power at times. In nineteenth-century Sindh (which became part of Pakistan after Partition), Hindu Bania moneylenders wielded great power over Muslim zamindar landholders, for "the Muslims who formed four-fifths of Sind's population had traditionally left all financial affairs to the Hindu minority," at least partly because of the Islamic ban on interest (Cheesman 1982:446). (The four-fifths figure was prior to the sudden and violent population transfers of Partition. According to the 1998 Pakistan census — which, at the time of this writing, is the latest census data available — Sindh is today 91.3% Muslim and 6.5% Hindu.) The Bania have historically also been great diasporic entrepreneurs — successful in long-distance trade, moneylending, and brokering (Levi 2002:105; Markovits 2000). Indian trade caravans and merchant communities had appeared in Kabul, Bukhara, Tashkent, and Samarqand by the sixteenth century (Levi 2002:93–95), and by the mid-seventeenth century in Central Asia and Persia, the term "Bania" had come simply to refer to non-Muslim Indian merchants (Levi 2002:106).

and in economic life in general, the fact that Jews were natives of the Middle East, phenotypically indistinguishable from many of their neighbors, and often engaged in commercial partnerships with gentiles all reinforced "the traversibility of boundaries between Jew and non-Jew" in the medieval Islamic world (Cohen 2002:201).

However, the all-too-common beliefs that most moneylenders in Islamic lands were Jewish, or that most Jews in Islamic lands were moneylenders, are wrong. Gerber writes:

> It is generally assumed that during the Middle Ages and afterwards Jews everywhere were engaged in money-lending as their main occupation. However, this does not appear to have been the case in the Ottoman Empire (Gerber 1981:100).

Goitein remarks acerbically that readers who assume "that the Jews were the Rothschilds of the Islamic world" will be disappointed.[56] This, assumption, he says, stems from an article by the French Orientalist Louis Massignon, "which was based on a few data about Jewish merchants of the ninth century granting loans to various government agencies in Baghdad" (Goitein 1967:229–30).

These accounts of non-Muslim moneylenders in Muslim lands do not, by any means, paint a complete historical picture. But they do suggest strongly that borrowing from non-Muslims was not a generalized, transhistorical "solution" or "work-around" to the problem of the interest ban in Islam. In other words, we cannot attribute the long-term survival of the Islamic interest ban to moneylending by religious minorities in Islamic lands.[57]

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[56] Rather, it is more accurate to say that in the Islamic world, Jews were sometimes moneylenders — but when they were, it was alongside other moneylenders. In some Muslim societies, Jews were active merchants but not bankers or moneylenders, as in the case of the many Persian Jews who settled in the Mughal Empire (a multidenominational empire, but one ruled by Muslims), where those fields were dominated by the native Indians (Fischel 1948). When they did engage in banking and moneylending in Muslim societies, Jews were generally not, as was too often true in medieval Christendom, a pariah group whose presence was only tolerated (often cruelly) because of their economic utility as financiers. Rather, Jewish moneylenders were usually professionals like any other moneylender — no doubt despised sometimes by their borrowers, as all moneylenders are, but generally not hated collectively on the basis of their religion and its association with usury. We find evidence for this in Goitein's meticulous complication of the papers of the Cairo Geniza — a storehouse of Jewish documents, and by far the best primary source on the economic history of Cairo (whether Muslim, Jewish, and Christian) between the ninth and nineteenth centuries CE. The records show that everyone lent to everyone throughout Cairene history (Goitein 1960, 1967). Jews lent to Muslims, yes, but they also lent to Christians and other Jews. Muslims, meanwhile, also lent to Jews, Christians, and their fellow Muslims — see, for example, Goitein (Goitein 1967:257). Economic affairs were largely adjudicated through separate confessional courts — and yet cross-confessional lending occurred regularly, and the courts generally addressed disputes in a workmanlike manner, with few signs of favoritism. For example, in 1239 CE, under the Ayyubid dynasty, we find a Muslim court enforcing a claim for interest on behalf of a Jewish plaintiff (Goitein 1960:38–40).

[57] Moreover, while it was occasionally true (as with the Hindu Bania in nineteenth-century Sindh) that non-Muslim moneylenders succeeded in Islamic lands *because* they were not Muslim, this was more often not the

Ḥiyal: Legal stratagems and their ambiguous status among jurists

Whereas salam has historically been uncontroversial among Islamic jurists, more controversy has surrounded efforts to replicate interest-based lending using double sales and other asset transfers (Ray 1997). These mirror the practices of medieval Christians and Jews who sought to circumvent commonly accepted injunctions concerning interest (Bleich 2010; Cardahi 1955; Gamoran 2008; Kerridge 2002; Noonan 1957; Orlian 2009; Perlman 1997; De Roover 1967; Tawney 1963). Many Islamic religious scholars considered such measures to be *ḥiyal* — legal devices that use lawful means to achieve prohibited ends (Cardahi 1955:531–4; Schacht 1936).[58]

Islamic jurists in the classical and medieval periods had mixed views about the permissibility of ḥiyal in general, and about efforts to circumvent the ban on ribā in particular. Of the four major schools of Sunni jurisprudence,[59] the Ḥanafī were most lenient

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case. As with medieval Jews in Cairo, different minorities' specializations in finance probably owed much more to other factors besides the Islamic ban on ribā: to their status as in-group networks with access to capital and market information, the familiarity with long-distance trade and its financing that is concomitant with diasporic migration experiences, and their diasporic deracination from agriculture.

The case of the Dutch East Indies illustrates this. In Java in the mid-nineteenth century, the Chinese population controlled moneylending — in addition to trade and tax farming. They worked at all levels of the lending business, acting as both itinerant small moneylenders who pedalled by bicycle from village to village and large-scale moneylenders financing feudal elites and the colonial state itself (Schrader 1994b). And yet their proliferation in moneylending seems to have had little to do with their being non-Muslim, because we also find Muslim Arabs among the groups most heavily engaged in moneylending in Java (Schrader 1994a). Indeed, in the Dutch East Indies, Arab moneylenders — mostly from Ḥaḍramawt in what is today Yemen — apparently had poor reputations:

> Quite a number of Arabs functioned as money-lenders, with their reputations on the whole worse than those of their Chinese counterparts. The thriving usury cast a slur on the Arab community. If colonial administration reports are to be believed, in some areas the word Arab was synonymous with such terms as miser and swindler (de Jonge 1993).

While colonial administrators were notorious for their ethnic prejudices, it is at least clear that Ḥaḍramīs — who would go on to become a small but celebrated part of Indonesia's ethnic tapestry — were indeed well represented in moneylending in the nineteenth and twentieth centuries. The upshot: it was not being Muslim or non-Muslim that inclined ethnic groups toward or away from moneylending in colonial Indonesia.

[58] Cardahi (1955) writes: "Bien des <<hiyal >>, des subterfuges, des échappatoires furent dans ce but imaginés pour éluder les préceptes de la loi en cette matière" (531) (1955:531).

[59] There are five major schools of Islamic jurisprudence (*madhāhib*, singular madhhab) — four Sunni (the Ḥanafī, Mālikī, Shāfiʿī, and Ḥanbalī schools) and one Shiʿite (the Jaʿfarī school). They divide the Islamic world roughly by region. The madhāhib are not religious sects, but rather different corpora of juristic precedent and

toward ḥiyal, with great classical Ḥanafī jurists composing works devoted to the topic between the eighth and twelfth centuries CE (Schacht 1936). In the Shāfiʿī school, early figures, including the school's founder Imām Al-Shāfiʿī, often considered ḥiyal to be reprehensible (*makrūḥ*) but not necessarily forbidden (*ḥarām*), and from the eleventh century CE. onward, leading Shāfiʿī scholars began accepting larger numbers of ḥiyal. The same was true of major Mālikī scholars in the medieval period.[60]

Despite the prevalent canonical notion that each of the major juridical schools has a position of its own on ḥiyal, there was also diversity within each school. Because ḥiyal were, by definition, designed to achieve an otherwise prohibited outcome through Islamically lawful means, even Hanafi scholars (who are theoretically the most lenient toward ḥiyal) have sometimes viewed them askance.

Historical records reveal various kinds of ḥiyal used to circumvent the ban on interest. It is often hard to say how economically significant these ḥiyal were at specific times and places (Ray 1997:58). People in Medina — that is, the heartland of Islam's birth — were reportedly using double sales to circumvent the ban on interest as early as the eighth century, and specialists in religious law helped merchants develop complicated ḥiyal to meet their commercial needs (Schacht 1936, 1960:101–102).

Medieval Arab commentators reported the use of the following types of strategems — some of which are now widely used in modern Islamic finance, in similar or identical form, but some of which contemporary jurists deem unacceptable (al-Bāqī Al-Zurqānī 1978; Cardahi 1955:532–534; Al-Khurashī 1975; Ray 1997:58).

1. Sale or lease with the option to rescind,[61] combined with advance payment of the price. For example, "L" (who is effectively the "lender" of money) buys a plot of land from "B" (effectively the "borrower") for $10,000. During the three-month term of the option, "L" enjoys some income from the use of the land — say $500. This takes the place of interest. Then, just before the end of three months, "L" rescinds the

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approaches to legal reasoning and interpretation of sharia that crystallized in the 8th to 10th centuries C.E. and have remained salient ever since.

[60] The ahl al-ḥadīth, however, were staunchly opposed to ḥiyal.
Shariah distinguishes human action not only as lawful (*ḥalāl*) or forbidden (*ḥarām*), but rather evaluates it as obligatory (*wājib*), recommended (*mandūb*), permissible (*mubāḥ*), reprehensible (*makrūḥ*), and forbidden (*ḥarām*). An entire literature exists in classical Islamic jurisprudence on the permissibility of ḥiyal, and stances toward ḥiyal in general vary between different schools of jurisprudence (Horii 2002).

[61] This stipulated option was (and still is) known as khiyār al-sharṭ, or literally "option based on a condition." Being essentially the same as an option contract of the sort used in conventional finance, scholars of Islamic finance have proposed khiyār al-sharṭ as a legal vehicle for engineering Islamic derivatives (Vogel and Hayes 1998:155–156; Smolarski, Schapek, and Tahir 2006; Ariffin, Archer, and Karim 2009; Ayyash 2008; Ghoul 2008; Helliar and Alsahlawi 2011; Obaidullah 2002).

contract, returns the land to "B," gets back the original $10,000, and keeps the $500 in income (Vogel and Hayes 1998:156 fn. 53).

2. Sale with agreement to repurchase. "B" owns an asset, such as a home. "B" sells the home to "L" for $10,000, but they agree that "B" will buy it back later for the same price. "B" continues to live in the home she just sold for three months, paying rent (totaling $500) to "L." After three months, "L" sells the home back to "B" for $10,000 as stipulated.[62]

3. Double sale: "L" sells "B" an object for $10,500 on deferred-payment terms, with the amount payable in three months. "B" immediately sells it back to "L" for $10,000 on spot-payment terms (i.e. cash due on the spot). This practice, usually known today as bayʿ al-ʿīnah, is important in contemporary Malaysian Islamic finance but is generally not accepted in the Middle East and North Africa.[63] It also made its way into medieval Europe as the mohatra contract, which Blaise Pascal criticizes in Lettres Provinciales when skewering casuistic Jesuit practices such as monks temporarily defrocking themselves so they could visit brothels (Pascal 1920; Çağatay 1970:57).

4. Interest-free loan plus sale: "L" grants "B" an interest-free loan (known as a qarḍ ḥasan, which is legally valid) for $10,000, payable in three months. "L" also sells "B" an item of merely nominal value, such as a pen, for $500 as a substitute for interest.

5. Sale by agent, with commission: This is an arrangement designed to finance a purchase. "L," acting as the agent of "B," buys a car for $10,000, with the agreement that "B" will buy the car from "L" three months later for $10,000 plus a commission of $500.

NEAR-DEATH AND REVIVAL

Diminished but not degraded: The social role of the fuqahā' under colonial rule

The significance of the ulama as an independent, respected social group waned in the nineteenth and twentieth centuries — but never ceased completely. In British India, British

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[62] This is very similar to the ijārah (lease) contract used in many ṣukūk (Islamic bonds) and other contemporary Islamic-finance instruments today.

[63] The main reason why bayʿ al-ʿīnah is common today in Southeast Asian Islamic finance (especially Malaysia) but very rare elsewhere is that scholars of the Shāfiʿī school of jurisprudence, which prevails in Southeast Asia, generally consider the contract lawful, whereas scholars of the other major schools do not. The basic reasoning here is that the intention of the parties to a contract is immaterial and does not invalidate the act (Rosly and Sanusi 2001) (Rosly and Sanusi, 2001). However, the contract remains controversial even in Malaysia, and many scholars consider it undesirable are calling for its replacement (Meera and Razak 2005; Noor and Azli 2009).

Malaya, the Dutch East Indies, French North Africa and French and British West Africa, British East Africa, and British-dominated Egypt and Sudan, colonial authorities reduced the role of the ulama in legal affairs by imposing European legal codes and court systems on colonial subjects. The space of secular law in public life expanded at the expense of Islamic law, reducing religious jurists' role as legal experts and advisors to matters of private law: marriage and divorce, dietary law and other forms of ritual obligation, and sometimes inheritance and other small-scale economic affairs. Colonial authorities also diminished the ulama's role in the reproduction of knowledge by enacting educational reforms, closing madrasahs, and reorienting curricula away from traditional Islamic studies.

The gradual étatization of the jurists in the seventeenth to nineteenth centuries

Outside European-controlled lands, native reform movements also weakened the ulama.[64] In the Ottoman Empire, the Tanzimat reforms of 1839–1876 reorganized the civil and criminal code along French lines, introduced a European-style judiciary, and established European-style institutions of higher education and a ministry of education.[65]

Islamic modernism and a new model for the Islamic intellectual

The rise of Islamic modernism in the late nineteenth and early twentieth centuries also threatened the ulama. Unlike secularist reformers, Islamic modernists sought to retain the central role of religion in social life, but re-imagined it to accommodate Western-style education, civil rights, constitutional democracy, nationalism, and rational scientific inquiry. Leading Islamic modernists included Jamal al-Din al-Afghani (1838–1897), Muhammad Abduh (1849–1905), Rashid Rida (1865–1935), Muhammad Iqbal (1877–1938), and Abu al-A'la Mawdudi (1903–1979). Many Islamic modernists considered the traditional ulama to be a deadweight on Muslim societies that held back social and intellectual progress, employed outdated scholastic methods, and lacked the political consciousness to confront colonialism and corrupt regimes. The Islamic modernists also provided a new model for how to be a Muslim intellectual.

Modernizing secularists threaten the jurists' survival: Atatürk and Reza Shah

Later, modernizing secularist rulers in the first half of the twentieth century — such as Mustafa Kemal in Turkey and Reza Shah in Iran — further diminished the power of the

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[64] The ulama in Qajar Iran do not fit this trend. See Algar (1980), Floor (2001), and Keddie (Keddie 1969).

[65] See Gerber (1999), who finds that the use of ḥiyal had become so widespread in Ottoman territory in the 16th century that the state set a maximum interest rate of 11.5% on loans. Yet the loans still had to be organized using ḥiyal. See also Kuran (2005). Çağatay (1970) also notes that simple ḥiyal were used widely in the Ottoman Empire.

ulama. These rulers not only reduced the ulama's social role, but sapped the strength of the ulama's historical allies and donors, such as the petty bourgeoisie and the landowning classes, by consolidating state power and expanding state control over the economy (Moaddel 1994:136–140).

The interest ban as a moral beacon: Survival in the interstices

Nevertheless, the traditional ulama survived. They worked as madrasah teachers, mosque preachers, and judges and legal advisors in Islamic courts handling personal law and small commercial matters. In some cases, they integrated into other aspects of civil administration. Moreover, both colonial governments and modernizing native governments were well aware of the prestige of the ulama, and thus sought to co-opt them and organize them under the umbrella of state-controlled educational and religious institutions. While this diminished the autonomy of the ulama in many cases, it also ensured their survival in the face of expanding state power.

Late economic modernization

In parallel to the decline of the strength of the ulama, the spread of Western-style banking in the Islamic world in the nineteenth and twentieth centuries diminished adherence to the ban on interest. At the level of haute finance (including lending to states, big businesses, and major financial institutions), the interest ban had long been essentially dead for practical purposes anyway.

Nonetheless, the interest ban survived among socially conservative fractions less integrated into the process of financial modernization, such as peasants, village dwellers, and the urban poor. Due to late economic modernization and religious conservatism in many Islamic societies, Western banking's penetration was limited in rural areas. Credit mechanisms that circumvented the interest ban, such as the *jual janji* in Malaya and the *hak gadai* in the Dutch East Indies, also preserved in the collective conscience of rural communities the idea that bald interest was un-Islamic. To the urban poor, meanwhile, banking services were unavailable anyway. And even among the expanding urban middle classes, religious leaders or individuals who considered themselves particularly pious often actively avoided Western-style banks, preferring to keep their savings at home or invested with family members or local businesses.

Petrodollars, Islamic revivalism, and modern finance: A new home for the jurists and the interest ban

In sum, the ulama and the Islamic ban on interest both grew weaker in the 19th and 20th centuries — but never disappeared. Two factors — the survival of the ulama and late

economic modernization — allowed the Islamic usury ban to survive into the twentieth century, despite the various threats facing it.

They survived until the 1970s and 1980s, when oil revenues, the growing power of Saudi Arabia, and Islamic revivalism led to a resurgence of the ulama and the reinvigoration of the usury ban via the emergence of Islamic economics and Islamic banking. The next chapter discusses these developments.

Conclusion

The main argument of this chapter is that a religious usury ban needs vigorous carriers — religious jurists — to survive. When religious jurists first emerge and cohere as a professional group, a systematic religious usury law first emerges. As long as religious jurists continue to thrive and keep heavy political interference in their work at bay, the interest ban survives. And when religious jurists lose their traditional prestige and significance in society — whether due to sudden reform or gradual social change — the interest ban weakens and dies.

This argument is not necessarily at odds with prior hypotheses about the fate of religious usury bans. Instead, it focuses on one meso-level mechanism — the professionalization and circumstances of the religious jurists — and explains how it affected the outcome of the ban. In particular, I have shown how the jurists mediate between religion and the economy, allowing religious usury law to survive in principle and in legal form while making adjustments that accommodate the expansion of capitalist activity.

In each of the three Abrahamic religions, I have discussed the "birth," "life," and "death" of both the profession of religious jurisprudence and a systematic usury ban. A brief review of findings across the three religions follows.

BIRTH: In all three religions, systematic usury bans emerged shortly after the emergence and professionalization of religious jurists (See Figure 3).

In Judaism, rabbinical scholars cohered as a distinct social group during the age of the Tannaim after the destruction of the Second Temple (70 CE). With the compilation of the Mishnah, a sophisticated, systematic usury law developed within about a century.

In Western Christianity, canonical jurisprudence was born with Gratian's *Decretum* (ca. 1150). Between that time and the middle of the 14th century, a systematic usury law developed rapidly and ecclesiastical courts began pursuing usurers with enhanced prosecutorial powers.

In Eastern Christianity, although systematic jurisprudence emerged at around the same time as in Western Christendom (especially in Byzantium with Theodore Balsamon, d. after 1195), it appears that religious jurists were not sufficiently autonomous from state power for a systematic usury ban to develop. (However, this conclusion requires further research.)

In Islam, religious jurists emerged as a distinct professional group (separate, notably, from judges) in the late 8th and early 9th centuries CE. Islamic jurisprudence, including a systematic and robust theory of usury law, developed shortly thereafter with the compilation of the canonical ḥadīth collections and the emergence of the major *madhāhib*.

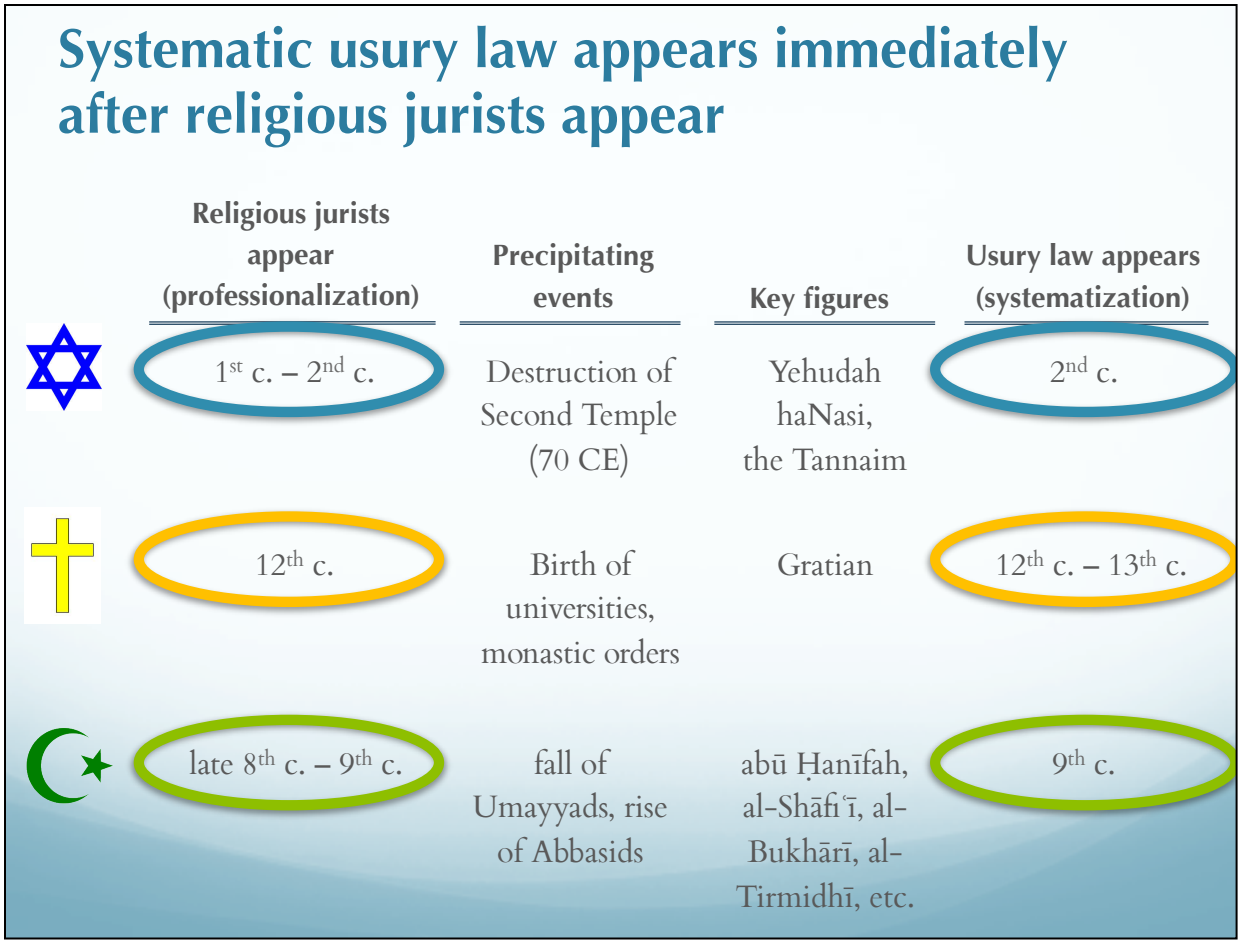

FIGURE 3: IN ALL THREE RELIGIONS, SYSTEMATIC USURY BANS EMERGED SHORTLY AFTER THE EMERGENCE AND PROFESSIONALIZATION OF RELIGIOUS JURISTS

LIFE: In all three religions, the survival of the religious usury ban coincided with the survival of the jurists. In all three cases, low interest rates became de facto acceptable — even to most religious authorities — by the 16th century if they were justified or disguised using various structures of religious law. Figure 4 lists some of the structures commonly used in each religious tradition to disguise interest. There is a great deal of overlap among the three religions.

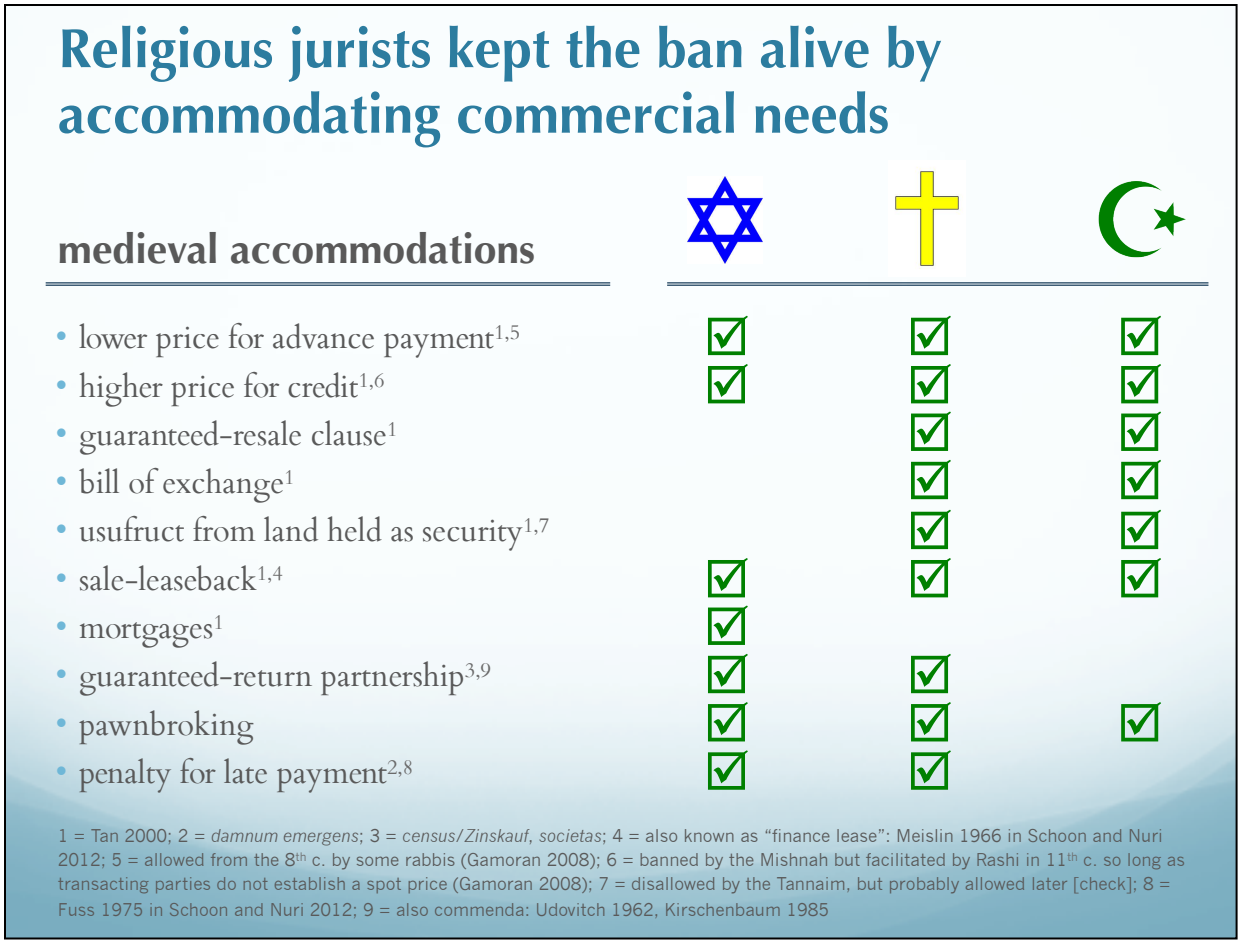

FIGURE 4: STRUCTURES USED TO DISGUISE INTEREST

In Judaism, the usury ban underwent a process of *expansion* in the age of the Tannaim (to ca. 220 CE) and Amoraim (ca. 200 CE – 500 CE) to cover a wide range of areas related to credit activity. At the same time, and all the way up to modern times, rabbinical scholars around the world engaged in a process of *accommodating* usury law to their communities' commercial and financial needs.

In Christianity, while usury law was rapidly *expanding* and systematizing in the Scholastic laboratory and prosecutions were growing stricter (12th–14th centuries), jurists also began *accommodating* the needs of Europe's nascent capitalists by increasing the scope of what counted as legal "interest" (elaborating such justifications as *poena conventionalis*, *damnum emergens*, *lucrum cessans*, and *periculum sortis*).

In Islam, the use of ḥiyal began almost as early as the birth of jurisprudence itself, serving as one form of *accommodation* to capitalist needs. However, the difficulty of enforcement, especially when jurists were often distinct from the class of judges and held a professional ethos and self-image that kept them separate from the messy and corrupt world of courts, meant that usury laws were also frequently flouted. Partnership structures — just as in other

pre-modern and early modern societies — were crucial ways of financing trade and commerce as well, potentially reducing the need for credit.

DEATH (OR NEAR-DEATH): In all three religions, reform movements and other major trends split or threatened to split the unity of religion and shook the respected status of religious jurists. The outcome of such events had decisive impact on the fate of the jurists and the fate of the usury ban.

In Orthodox Judaism, rabbinical scholarship and halakhah have continued to be important to the present. The Jewish usury ban survives, albeit in the attenuated form of the heter iska contract. In Conservative/Masorti and Reform Judaism, the halakhic regulation of market behavior, as interpreted by rabbinical scholars, is effectively absent. The usury ban is essentially dead among these congregations. (See Figure 5 for a summary of the fate of the Jewish usury ban.)

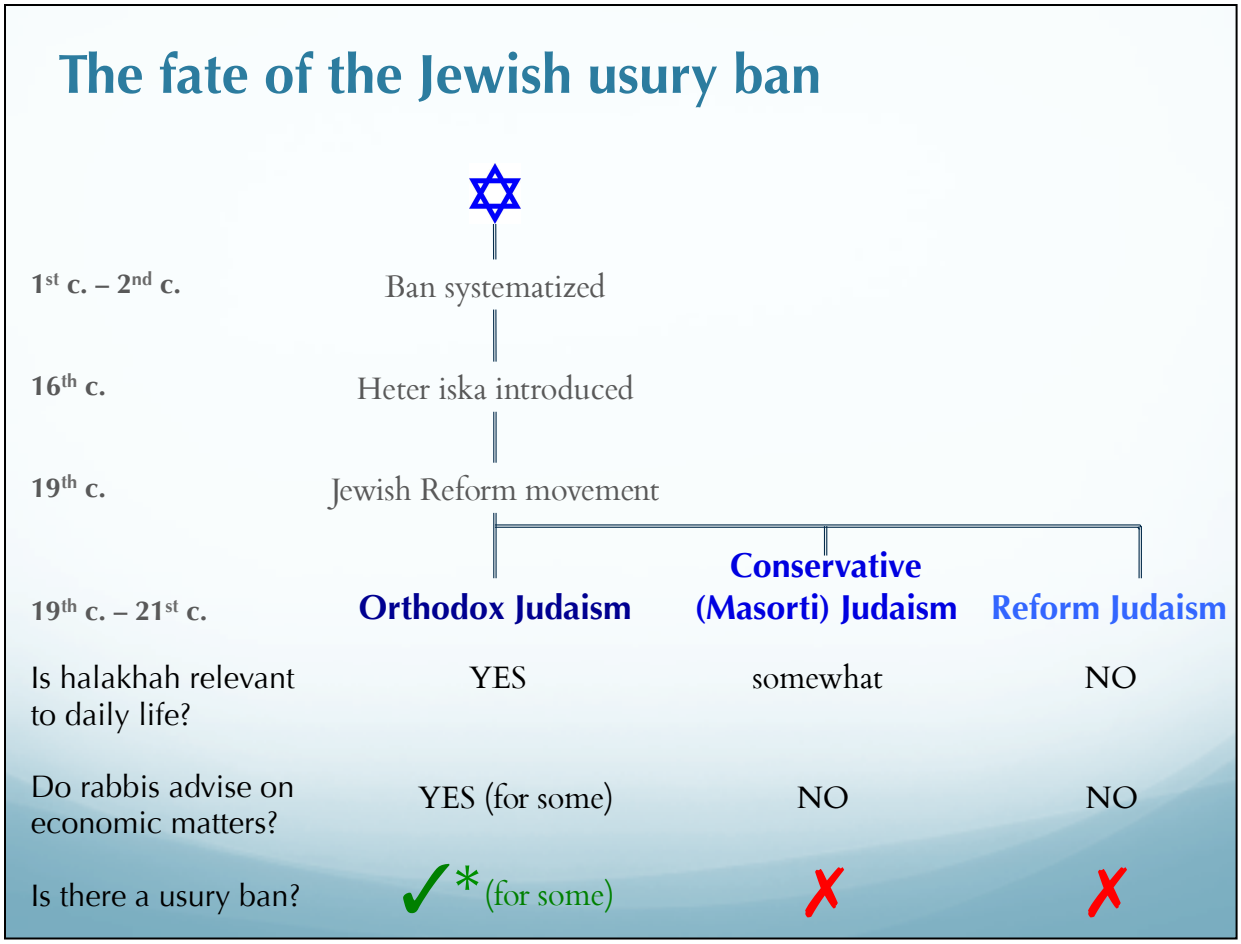

FIGURE 5: THE FATE OF THE JEWISH USURY BAN

In Western Christianity, the usury ban disappeared quickly among Protestants and slowly among Catholics. (See Figure 6 for a summary.) The Protestant Reformation of the 16th century dramatically shook both the status of religious jurists and the status of the usury ban. Both Martin Luther and the Anabaptists sought to retain the usury ban but eliminate juristic legalism — and failed quickly. Calvin, on the other hand, opened the door to limited usury. Among Roman Catholics, canonists continued to engage in relatively vigorous scholarship through the 17th century, but by the 18th and 19th centuries, canon law was becoming a matter that primarily governed the Church bureaucracy and internal affairs, with less and less to do with the lives of lay believers. The usury ban stayed on as a part of Roman Catholic doctrine, almost completely ignored by the 19th century, and disappearing quietly in 1917.

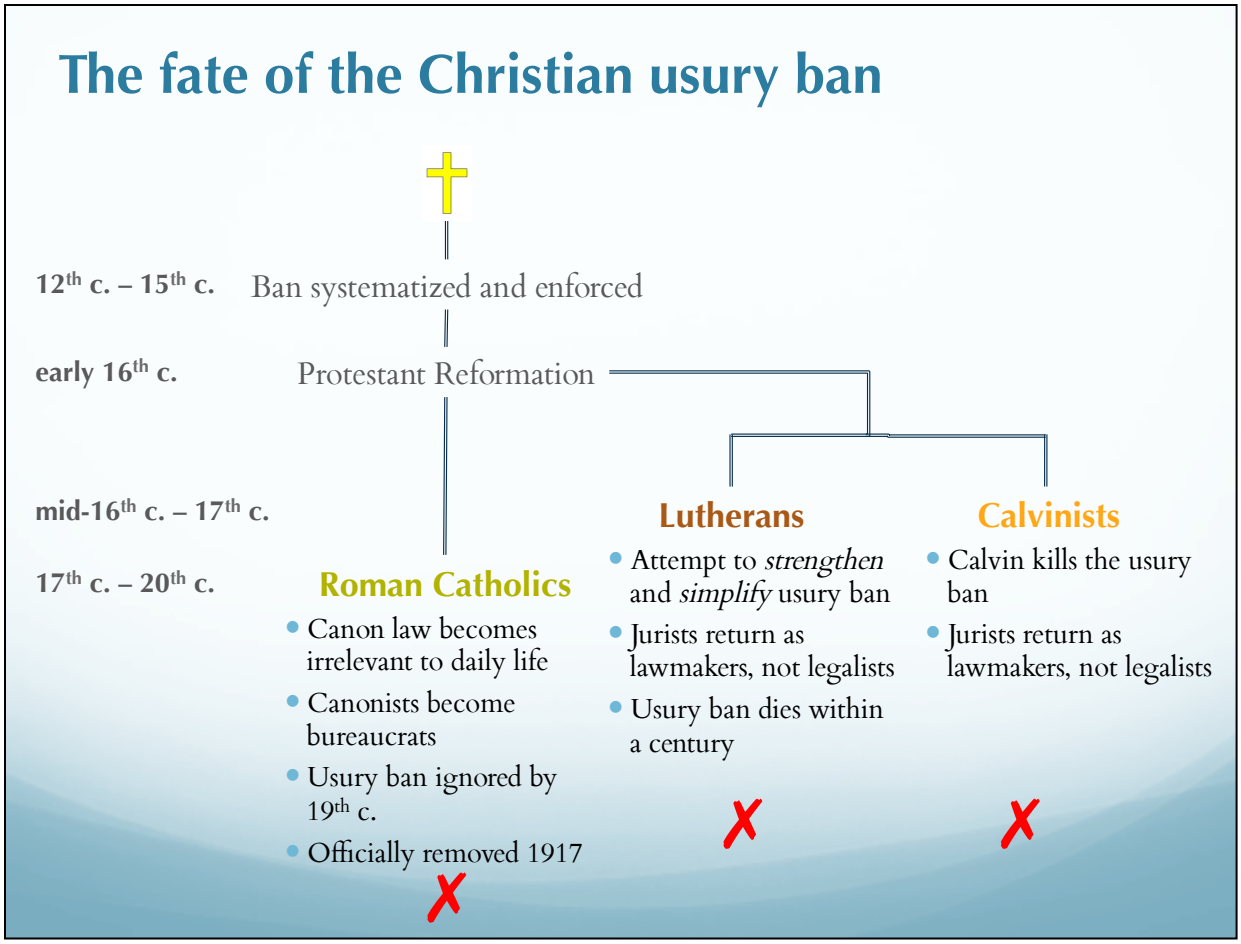

FIGURE 6: THE FATE OF THE CHRISTIAN USURY BAN

In Islam, the religious jurists managed to weather several major threats, surviving as a professional group that maintained its social role of interpreting religious law and advising believers on its application to daily life (see Figure 7 for a summary). The threats they faced included colonialism, the gradual étatization of jurisprudence in Ottoman lands, Islamic modernists who viewed the fuqahā' as a conservative deadweight on progress, and modernizing secularists such as Reza Shah and Atatürk. Ironically, the fact that colonial rule in particular allowed the ongoing application of shariah in personal law, and often treated the fuqahā' as a benign presence (as opposed to trying to eliminate them), may have helped the legitimacy of traditional Islamic jurisprudence sustain itself — *without putting it in a position where it had to adapt to 20th-century economic needs*. Eventually, in the context of Islamic revival in the 1970s, a petrodollar boom, and rapid late economic modernization, an alliance between financial entrepreneurs and jurists re-invigorated the usury ban through the medium of modern Islamic finance.

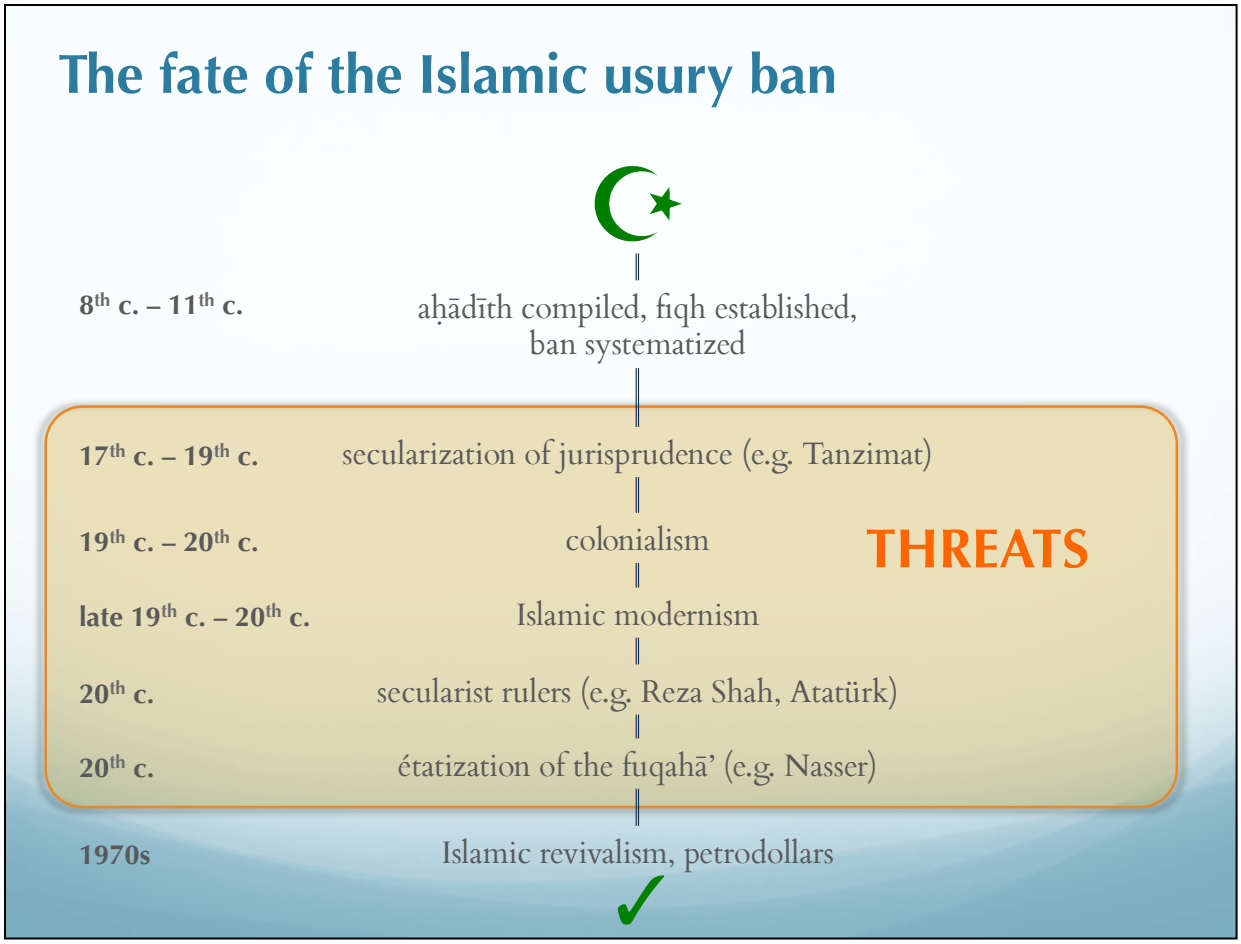

FIGURE 7: THE FATE OF THE ISLAMIC USURY BAN

Possible lessons for today's Islamic finance

The re-incorporation of Islamic religious jurists into finance began in the late 1970s, when newly formed Islamic banks in the Middle East asked experts in *fiqh* to advise them on the acceptability of various financial arrangements from the Islamic legal perspective. In the early 1980s, this involvement of religious jurists became institutionalized in the form of the shariah board. The jurists centuries'-old role of simultaneously enforcing the usury ban and accommodating commercial needs re-appeared, but this time within the bureaucratic context of capitalist financial firms. And today, having a shariah board is a *sine qua non* for an Islamic financial institution. Chapter Four examines these changes in detail.

Since the early 2000s, Islamic-finance professionals and state regulators alike have advocated greater harmonization and standardization in Islamic finance. Islamic-finance customers and central bankers alike express concern about a lack of harmonization of shariah standards, from bank to bank and country to country. They fear this entails unpredictability. In response, international industry bodies such as AAOIFI, the IFSB, and the International

Swaps and Derivatives Association (ISDA) have been publishing shariah standards they hope will become universal. Some actors in the field of Islamic finance are also calling for more national-level shariah boards with enforcement power over Islamic financial institutions — that is, national boards of the sort that exist in Malaysia, Sudan, Indonesia, Pakistan, and Brunei (Hasan 2010). Others believe transnational shariah boards at institutions such as the IFSB and AAOIFI should be stronger. And in 2013, Islamic Development Bank president Ahmad Mohamed Ali called for the creation of a global shariah board (Hamzah and Vizcaino 2013a).

The push for standardization and centralized shariah oversight may make life easier for Islamic banks and government regulators in the near term, but how will it affect the industry in the long run? The experience of Pakistan and Iran in the 1980s and 1990s showed that Islamic finance imposed as a mandatory state-imposed project from the top down is typically unsuccessful. Malaysia has been more successful in using state intervention to shepherd its Islamic-finance industry forward. But will creating uniform shariah standards across institutions and across borders rob Islamic financial institutions of the flexibility to adapt to changing market conditions?

More broadly, the history of the usury ban in Judaism, Christianity, and Islam has shown that religious jurists must continue to be (1) socially respected and (2) involved in the theoretical development of the usury ban in order for it to survive. Yet in the coming years, standardization efforts may reduce the number and importance of shariah scholars overseeing Islamic financial institutions. *Is Islamic finance possible without shariah scholars?* Could an industry based largely on a legalistic usury ban survive if the role of its legalist scholars were turned over to a single board, or — as one might imagine — to a bureaucratic set of rules and regulations? It is important to remember that religious jurists contribute not only expert knowledge to the Islamic-finance industry, but also individual flexibility to adapt to capitalist conditions and, crucially, a symbolic link to the legitimacy of Islam's textual tradition (Zaman 2010:3–11).

CHAPTER TWO

From communitarian experiments to shariah formalism: The birth and growth of Islamic finance, 1963–1999

ABSTRACT

This chapter focuses on the birth and development of modern Islamic finance through the second half of the 20th century. During this period, Islamic finance transformed from a geographically dispersed social movement into a fast-growing for-profit industry.

The chapter's first half focuses on 1963–1975: the period from the launch of the first modern Islamic financial institutions, which were non-profits, to the launch of the Islamic Development Bank in 1973 and Dubai Islamic Bank, the first for-profit Islamic bank, in 1975. Four international-level factors contributed to these developments: (1) the "Arab Cold War" from the 1950s onward; (2) the spread of Islamic conservatism and the expansion of political Islam from the 1970s onward; (3) the oil boom of the 1970s; and (4) the rise of global finance from the 1970s to the present. These forces gave rise to two very different forms of Islamic finance. Out of the marriage of social welfarism and Islamic revival appeared non-profit communitarian experiments in Islamic finance in the 1960s. Out of the marriage of market liberalism and Islamic revival appeared liberal Islamic finance in the 1970s and 1980s. Liberal Islamic finance is the dominant paradigm in Islamic finance today; communitarian projects are marginal.

The chapter's second half focuses on 1975–1999. Since the 1970s, liberal Islamic finance has turned economic piety into a question of adherence to *formal rules* of Islamic law rather than to *substantive economic principles*. Why has this shift taken place? I posit a cycle of formal rationalization triggered by the fact that Islamic banks compete in markets dominated by conventional banks. They therefore face a choice between less profitable solutions that advance a substantive agenda and more profitable ones that merely comply with shariah's formal requirements. A case study of the Islamic financial practice of *murabaha* illustrates this cycle.

Introduction

The survival of the Islamic usury ban was one condition for the birth of Islamic finance, but what forces pushed it into the world? Why did it emerge in the 1960s and 1970s, in particular? And why did it go from being a utopian non-profit movement in the 1960s and 1970s to being a fast-growing for-profit industry by the turn of the millennium?

This chapter's first half focuses on 1963–1975: the period from the launch of the first Islamic financial institutions to the launch of the first for-profit Islamic bank. During this period, four international-level developments contributed to the emergence of the first Islamic financial institutions: (1) the "Arab Cold War" from the 1950s onward; (2) the spread of Islamic conservatism and the expansion of political Islam, particularly from the 1970s onward; (3) the oil boom of the 1970s; and (4) the rise of global finance from the 1970s to the present. Below, I describe these trends. In the next section, I show how they shaped the emergence of the first modern Islamic financial institutions.

The chapter's second half focuses on 1975–1999. Since the 1970s, commercial Islamic banks have turned economic piety into a question of adherence to *formal rules* of Islamic law rather than to *substantive economic principles*. Why has this shift taken place? I posit a cycle that drives the industry toward formal solutions and away from substantive economic agendas. First, Islamic bankers try to practice Islamic finance in a world dominated by conventional banks. But because most potential customers are not interested in purchasing unfamiliar financial instruments that advance some substantive agenda other than capital maximization and risk minimization, the Islamic banks face an ethical tradeoff. They must choose between a less profitable solution that advances a substantive agenda and a more profitable one that merely complies with shariah's formal requirements. Whether to ensure the survival of Islamic finance or to please shareholders, the bankers choose the formal solution. Second, an apparatus of vendors, technologies, training programs, and fatwas emerges to enact this solution as efficiently, cheaply, and accurately as possible. A new ethical narrative also justifies it. Not only does the formal solution become an industry norm, but the technical exactitude with which it is executed becomes a measure of piety. Finally, new market challenges arise, generating more ethical tradeoffs.

The global trends that shaped Islamic finance

THE ARAB COLD WAR OF THE 1950S AND 1960S: ARAB SOCIALISTS VERSUS PRO-WESTERN PETRO-STATES

The defining tension of Middle Eastern politics in the 1950s and 1960s was between a revolutionary socialist, Arab nationalist ideology coming from Egypt and the Levant on one hand and the pro-Western, stability-seeking outlook of the governments of the Arabian peninsula on the other. This tension came to be known as the "Arab Cold War."

On one side of the Arab Cold War was a hybrid leftist ideological program that blended socialism, a heavy military role in government, and a variably secularist Arab nationalism. It emerged in the decade and a half following World War II, a moment of liberation from colonial and neocolonial suzerainty: Syria and Lebanon *de jure* in 1941, and *de facto* in 1946;[88] Egypt in 1952;[89] Iraq in 1958.[90, 91] This Arab leftism took form as Arab socialism in Nasser's Egypt — with much credence beyond Egypt's borders, including in the Maghreb[92] and Palestine — and as Ba'athism in Syria and Iraq.[93]

On the other side was a pro-Western, stability-oriented program that was more pragmatic than ideological. It was centered in the Arabian peninsula. Aside from impoverished Yemen, the other six states of the Arabian peninsula – all hydrocarbon-rich – have been ruled autocratically by the same pro-Western hereditary monarchies since the Second World War.[94] The House of Saud, cautious of the European powers in the interwar

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[88] Syria and Lebanon gained formal independence from France in 1941 and finally became truly free of major French presence in 1946.

[89] In Egypt, the Free Officers' coup of July 1952 overthrew the British-aligned monarchy and launched Gamal 'abd Al-Nasser's rise to regional pre-eminence.

[90] A bloody revolution in 1958 ended Iraq's British-installed Hashemite monarchy, leading to a decade of political upheaval in which four regimes followed one another in quick succession.

[91] Only Jordan and Palestine were the exceptions to the rule of successful anti-Western liberation movements among the region's Arab peoples: Jordan's Hashemite dynasty, which still rules today, remained staunchly pro-Western and reliant on massive aid subsidies (Owen and Pamuk 1999:187–188), and the Palestinian population was forced to exchange British rule for exile and Israeli occupation in 1948.

[92] Nasser and Algeria's Ahmed Ben Bella, for example, were particularly close.

[93] Lebanon, dominated by mercantile notables since Ottoman times, remained a laissez-faire hub for commerce and finance from independence until its descent into civil war in 1975.

[94] Yemen was partitioned into North and South and endured a complicated series of struggles among tribal confederations, Marxists of various stripes, and proxies of Saudi Arabia and Egypt. The Nasser regime, in addition to funding socialist groups in Yemen, also committed Egyptian troops directly to war there in the 1960s. The Saudi regime, sensitive to the humiliation that military defeat in their backyard would bring, armed and funded various proxies but did not send its own troops into Yemen.

years, became the United States' leading ally in the Middle East in the 1940s and 1950s. Oil, arms, anticommunism, and the desire for regional stability have conjoined Saudi government interests with those of every American president since Franklin Roosevelt. Oman has likewise been a staunch Western ally since 1970.[95] The other four countries of the Arabian peninsula – Kuwait, Qatar, Bahrain, and the UAE – were British protectorates until relatively late. Kuwait shed protectorate status in 1961 and the other three in 1971. Despite sensitivity over United States support for Israel, the ruling houses in all four of these states have remained aligned with the United States and its European allies during and after the Cold War, particularly since American military might has guaranteed the safe export of their oil and gas onto world markets.[96]

The pro-Western side won the Arab Cold War. The most dramatic turning point was the June 1967 Arab-Israeli war,[97] which shattered the dream of a proud, resurgent Arab polity in charge of its political and economic destiny – a dream that had seemed within reach ever since Nasser nationalized the Suez in 1956 and stood up to Britain, France, and Israel. Nasser died three years later in September 1970, still beloved but now humbled.

Having lost its legitimacy by failing to achieve many of its ambitious developmental goals and by creating vast, corrupt government bureaucracies instead, the populist welfarism of the Arab leftist regimes soon dissolved into other political agendas. Anwar al-Sadat, launching Egypt's *infitah* policy of marketizing reforms the late 1970s, ended up destabilizing Egypt's economy and entrenching its nepotistic morass of economic inequality.

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[95] It was in 1970 that Sultan Qaboos bin Sa'id Al Bu Sa'idi deposed his inward-looking father with British help. Sultan Qaboos subsequently put down a Marxist rebellion in the Dhofar region of Oman's west in the 1970s, again with support from Britain.

[96] Each side of the Arab Cold War had its dominant personality. On the side of socialism and pan-Arabism stood the Egyptian president, Gamal 'Abd al-Nasser.[96] Nasser soared to regional pre-eminence and international stardom during the 1956 war, becoming wildly popular across the Arab world when British, French, and Israeli forces retreated from the Suez. Nasser remained the Arab face of Third Worldism until his death in 1970, standing alongside the non-aligned movement's other titans: Nehru of India, Sukarno of Indonesia, Tito of Yugoslavia, and Nkrumah of Ghana.

On the other side of the Arab divide stood Saudi Arabia's Faisal bin 'Abd al-'Aziz Al Saud. Faisal reigned as king of Saudi Arabia from 1964 to 1975, but he had already begun to assert executive powers as early as 1958, when a power struggle began and his fellow royal princes began transferring much of the day-to-day administration to Faisal from the hands of his profligate and incompetent brother King Saud (r. 1953-1964). Unlike his brother Saud, who had flirted with Arab socialism, Faisal was staunchly anti-socialist. Contra Nasser's pan-Arabism, which sometimes played on Islamic motifs but retained its generally secularist orientation, the Saudi regime under Faisal reviled socialism and espoused pan-political Islam, constantly seeking to project itself as the global protector of Islam.

[97] The 1967 war was nothing short of a political earthquake. Arabs still refer to it as *al-naksa*, or "the setback." In six days, the Israeli military destroyed most of the Egyptian air force before it could get off the ground, trounced the combined ground forces of Egypt, Syria, and Jordan, and then occupied Gaza, the West Bank, and the Golan Heights.

Ba'athist socialism in Syria and Iraq, on the other hand, ossified into police states dominated by paranoid autocrats – Hafez al-Asad and Saddam Hussein respectively – and their cliques.

The rentier states of the Arabian peninsula, on the other hand, have transformed since the 1970s into market economies — albeit with heavy involvement in the economy on the part of ruling families through control over fossil-fuel extraction and major corporations. Thanks to energy rents, per capita GDP for these states has grown faster than in the rest of the Arab world (see Figure 8). With the exception of Yemen, the poor and unstable sibling of the peninsula, the remaining six states of the Arabian peninsula formed the Gulf Cooperation Council (GCC) in 1981. The GCC economies are highly globalized, with extremely high rates of expatriate participation in the workforce, high consumption of imported consumer goods, and exports of fossil fuels around the world. Public expenditure on health, education, and social safety nets has risen steadily as oil and gas rents have boosted incomes.

With the rise of the GCC economies, Islamic finance gained a center of gravity: the Gulf region. Since the 1970s, financial literacy has increased, domestic banking sectors have expanded, multinational commercial and investment banks have become active in the region, and an entire generation of Arab high-net-worth investors has appeared as well — none more famous than Prince al-Waleed bin Talal Al Saud, the "Arab Warren Buffett" and one of the world's richest people. It was in this climate that Islamic finance would evolve in new ways described in the next chapter.

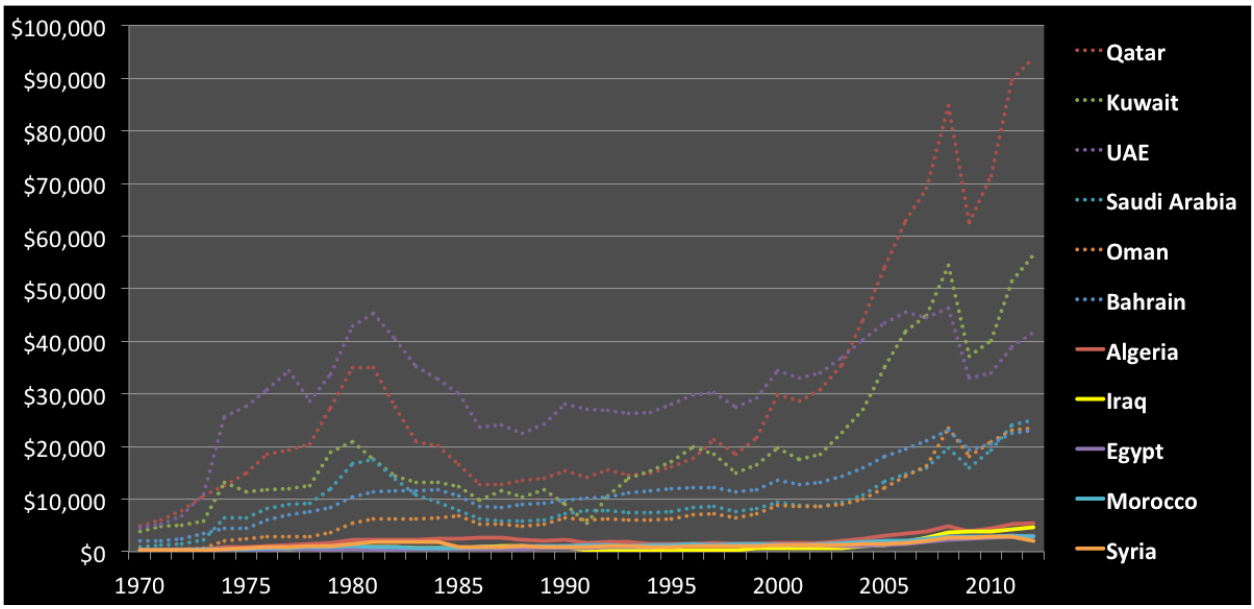

FIGURE 8: GDP PER CAPITA IN SELECTED ARAB COUNTRIES, 1970–2012 (REAL DECEMBER 2013 US DOLLARS)

Dotted lines = GCC members
Solid lines = other Arab countries
Source: United Nations Statistics Division

THE OIL BOOM OF THE 1970S

The oil boom of the 1970s was the second event that crowned the Saudi side as victors in the Arab Cold War. From 1926 until the 1970s, the average annual price of a barrel of crude oil expressed in 2005 U.S. dollars remained relatively stable, hovering between $9 and $20 (Wright 2008). Oligopoly was largely responsible for this stability. From World War II until the late 1960s, a group of vertically integrated American and European oil giants dubbed the "Seven Sisters" had ruled the oil world. As a cartel, they enjoyed the support of their home governments as well as long-term contracts negotiated on advantageous terms with the governments of oil-producing states. The Seven Sisters thus kept the price of oil stable and low, underwriting a quarter-century of global economic growth.

However, by the 1960s and 1970s, a new set of factors began to change the calculus of oil prices, eventually sending them skyrocketing in 1973 (Yergin 1991). First and most importantly, global demand for oil began increasing much more rapidly than supply. Thirst for oil in the rebuilt, fast-growing economies of Western Europe and Japan was growing fast. American consumption was also increasing thanks to Eisenhower's interstate highway system and the new suburban car culture. Second, the nationalization of oil production reversed the balance of power between the Seven Sisters and the governments of leading oil-producing states (Dezalay and Garth 1996). Between 1969 and 1974, Saudi Arabia, Libya, Iran, Venezuela, and Iraq all carried out partial or total nationalizations of oil companies previously run by private foreign oil concerns. Third, regional political upheavals served as triggers: the Yom Kippur War launched the 1973 shock and Iran's Islamic revolution prompted the shock of 1979.

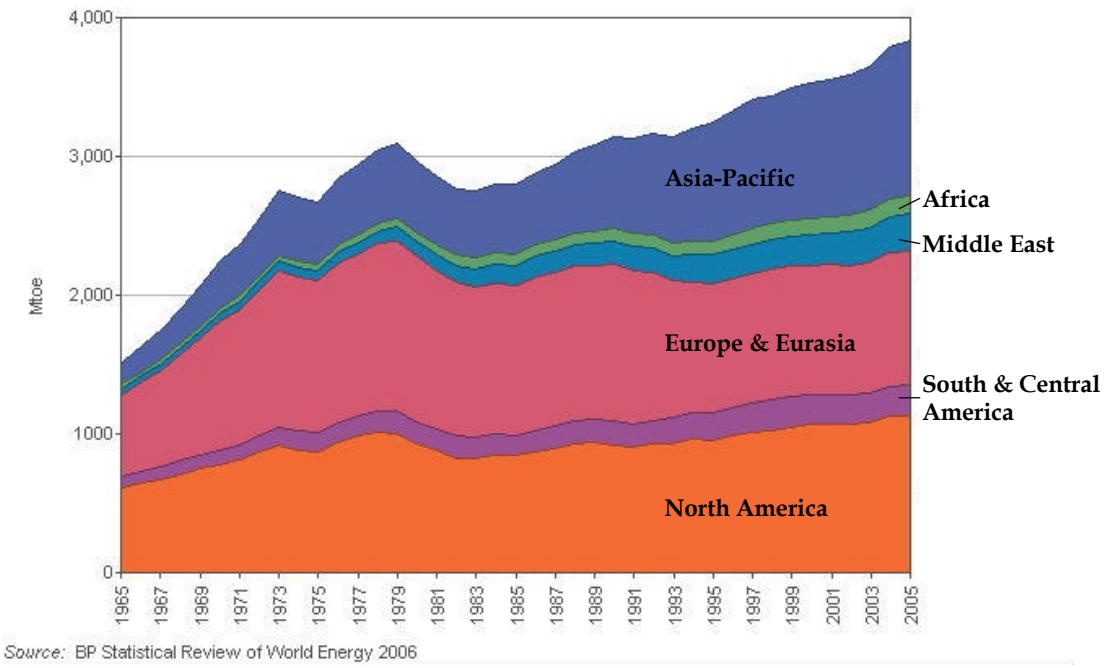

FIGURE 9: WORLD OIL CONSUMPTION BY REGION, 1965–2005 (MILLIONS OF BARRELS)

As a result of all these factors, the price of oil shot upward between 1973 and the early 1980s, transferring massive wealth from the world's oil consumers to its oil producers. Multinational banks such as Citibank flocked to the producers of the Middle East, recycling their petrodollars back to the consuming countries in the form of credit.[98] Thus the oil boom integrated the Arab countries of the Gulf – previously considered unsophisticated financial backwaters – tightly into global financial markets.

The oil boom also cemented Saudi Arabia's ascendancy as a regional Middle Eastern power and allowed it to project itself as the voice and defender of global Islam in the 1970s and 1980s. The House of Saud directed funds toward media outlets across the Arabic-speaking world in order to ensure good press and reduce criticism of the Saudi regime. This further marginalized the Middle East's leftist voices, already damaged by Nasserism's eclipse. Crucially for the development of Islamic finance, Saudi Arabia also became the unofficial leader of the Organization of the Islamic Conference (OIC), which was based in Jeddah. As discussed further below, King Faisal Al Saud (r. 1964–1975) began encouraging efforts to create a pan-Islamic bank through the OIC. This bank, the Islamic Development Bank, would serve both as a vehicle of political influence by spreading oil wealth to those Islamic countries that lacked it and also as a model for future projects in Islamic finance.

ISLAMIC REVIVAL

While rising oil rents bolstered the Saudi state's international influence and increased living standards in the GCC, they also contributed to the resurgence of religious conservatism across the Islamic world from the 1970s onward. The Six-Day War of 1967 signaled an epochal shift in which political Islam began to usurp socialism's place as the most resonant critique of neo-imperialism and the Middle Eastern status quo.

Political Islam had historical roots, of course. A lineage of influential Islamic modernists and revivalists reaches back to the 19th century and passes through figures like Jamal al-Din al-Afghani (1838-1897), the Iranian-born activist who sought to re-interpret and reform Islam in order to resist Western encroachment and suzerainty (Keddie 1972); al-Afghani's Egyptian protégé Muhammad Abduh (1849-1905) and Abduh's own disciple Rashid Rida (1865-1935), who advocated returning to Quranic essentials in order to rebuild a system of religious thought that could rejuvenate the *ummah* politically and economically (Haddad 1994); Abu'l A'la Mawdudi (1903-1979), the Indian-born founder of the Jama'at-i Islami who framed Islamic ideology in contradistinction to socialism and capitalism and elaborated the modern concepts of "Islamic revolution" and an "Islamic state" (Nasr 1996); Hasan al-Banna (1906-1949), the populist Egyptian activist who founded the Muslim Brotherhood

[98] Among other things, this contributed mightily to the Latin American debt crisis of the 1980s: private multinational banks had pushed credit haphazardly onto sovereign debtors during the liquidity glut of the 1970s and early 1980s.

(Commins 1994), and Sayyid Qutb (1906–1966), the long-imprisoned and vastly influential Egyptian theoretician finally hanged on the Nasser regime's gallows, who compared corrupt modern regimes to the *jahili* (willfully ignorant and un-Islamic) powers of the Prophet Muhammad's day and exhorted contemporary Muslims to rise up against them (Tripp 1994).

These pioneers of political Islam laid the ideological groundwork for the proliferation of Islamist movements, from moderate to radical and from modernist to fundamentalist, that would go on to shape opposition to corrupt Middle Eastern regimes and to Western hegemony during the 20th and early 21st centuries. These movements demolished the secularist proposition that religion be irrelevant in modern life and, in their various ways, argued for modern responses to religious concerns and religious responses to modern concerns.

FINANCIALIZATION AND FINANCIAL GLOBALIZATION

In addition to the Arab Cold War, the oil boom, and the rise of political Islam, a fourth international-level factor crucial to the emergence and evolution of modern Islamic finance has been the rise of global finance. The present era of global finance began when the collapse of the Bretton Woods system and the Nixon administration's closure of the gold window in 1971 launched the brave new world of floating exchange rates in 1973. Through the 1970s and 1980s, capital began moving across national borders more easily than before. Corporations began privileging finance more in their investment decisions (Krippner 2005), executive leadership, and goal-setting (Dore 2000; Fligstein 1990, 2001; Zorn et al. 2005). Financial consultants and investment gurus became staples of the evening news as more citizens – and not just the rich – became investors (Davis 2008; Thrift 2001). Capital markets deepened dramatically, spread geographically, and became for many businesses a more important source of funding than traditional bank lending. At the same time, advances in mathematical finance and information and communications technology gave rise to enormous markets in sophisticated new financial instruments such as futures, options, and more exotic derivatives (MacKenzie and Millo 2003; MacKenzie 2006).

The oil boom of the 1970s, the neoliberal turn of the 1980s and 1990s, and the expansion of multinational banks and other financial corporations all changed domestic financial conditions in the Middle East. Of all parts of the Middle East, banking and finance expanded most dramatically in the Gulf, and middle and upper-middle classes there gained greater exposure to banking services as a result. The oil boom also directed wealth to the other countries of the Middle East, largely in the form of remittances from guest workers in the Gulf states (Chaudhry 1997). In both the rich Gulf countries and the Middle Eastern and North African countries that exported labor to them, savers who had previously had little need for banking services, were unaccustomed to them, or who had been comfortable

keeping their savings outside the banking system became increasingly interested in banking. Many deposited their savings in conventional banks. A portion of these savers, however, mistrusted conventional banks because they considered their interest-charging activities to be impious. This reticence created a natural constituency for Islamic banking.

The birth of modern Islamic finance in the 1960s: Communitarian experiments

The aforementioned historical factors interacted in different ways to produce two very different forms of Islamic finance in the second half of the 20th century. The first form, which appeared in the 1960s, blended leftism with Islamic revival. This constituted what I call "communitarian experiments." The second form blended economic liberalism with Islamic revival. This constituted "liberal Islamic finance" — the dominant paradigm in Islamic finance from the 1980s to the present.

ISLAMIC ECONOMICS

Between the 1960s and the early 1980s, a hybrid of leftist social welfarism and Islamic revival flowered. Islamic revival provided a frame of reference and a set of discursive tools for activists around the Islamic world (and certainly not just around the Arab world) who sought a viable response to economic and social shortcomings of the postcolonial condition. Indeed, Islamic revival inspired the communitarian experiments of early Islamic finance (discussed below), which sought to pursue an Islamic "third way" between capitalism and socialism.

This hybrid also inspired efforts to build a distinctive system of Islamic economics. The founders and early theoreticians of Islamic economics in the 1960s and 1970s considered the conventional interest-based banking system to be a tool of neocolonial oppression. To these pioneers, such as Muhammad Baqir al-Sadr (Al-Ṣadr 1977), Nejatullah Siddiqui (Siddiqi 1972, 1983a, 1985), and Umer Chapra (Chapra 1979), usury was not only a formal sin to be ritually avoided, but an economic cancer that caused exploitation, inequality, and waste. They therefore planned an entire alternative economic system that eliminated entirely the charging of a consideration for the time value of money, replacing interest-bearing debt with equity partnerships. The pioneers expected that formal piety and substantive advancement would go hand in hand: since it was God who had decreed usury unlawful, a usury-free economy would necessarily improve the material and moral lot of Muslims and advance the higher objectives of Islamic law (*maqāṣid al-sharīʿah*).

While this program was explicitly religious, it was also sometimes expressed — at least until the 1980s — in a leftist vocabulary of class struggle and exploitation, equating the interest-based financial system with Western extraction and oppression:

> "Enemies of Islam … evolved the present system of interest solely with their notorious designs of rejecting the authority of Almighty God in the social and economic sphere, and exploiting the working class…" (Khan 1979 [1971]: vii — intro to Siddiqi 1979)

THE SPIRIT OF THE 1960S: COMMUNITARIAN EXPERIMENTS

The first modern Islamic financial institutions — Mit Ghamr Social Bank (MGSB) in Egypt and the Tabung Haji pilgrimage-savings fund in Malaysia — were both born in 1963.[99] These were not profit-seeking commercial banks. Instead, they were ventures launched to support the economic and spiritual development of local Muslims, and especially the rural and urban working classes. Informed by the nascent field of Islamic economics, all aimed to use interest-free investment. The origins of these institutions lie in a combination of postcolonial politics in the 1960s and creative approaches to using Islam to promote economic development.

Islamic financial institution	Type	Country	Year
Mit Ghamr Savings Bank	non-profit	Egypt	1963
Tabung Haji	non-profit hajj-savings fund	Malaysia	1963
Nasser Social Bank	non-profit	Egypt	1971
Islamic Development Bank	non-profit intergovernmental development finance	established on initiative of Saudi Arabia, Iran, Libya, Algeria, and other rentier states	1973
Dubai Islamic Bank	commercial	UAE	1975
Faisal Islamic Bank of Egypt	commercial	Egypt	1976

[99] A brief Pakistani experiment in Islamic banking launched in the late 1950s and aimed to provide interest-free loans (*qard hasan*) to poor farmers by using contributions from wealthier landowners. However, it was apparently unsustainable, and closed after a short time (Tripp 2006). Information about it is limited.

Faisal Islamic Bank of Sudan	commercial	Sudan	1977
Kuwait Finance House	commercial	Kuwait	1977
Jordan Islamic Bank	commercial	Jordan	1978
Al Rajhi	commercial	Saudi Arabia	1978
Bahrain Islamic Bank	commercial	Bahrain	1979
Qatar Islamic Bank	commercial	Qatar	1982
Bank Islam (BIMB)	commercial	Malaysia	1983

FIGURE 10: ESTABLISHMENT OF THE EARLY ISLAMIC FINANCIAL INSTITUTIONS

MALAYSIA'S TABUNG HAJI

The Malaysian experiment was called the Tabung Haji (*Hajj* Fund). When it formed in 1963, "its purpose … was simply to mobilize Malay peasant small-scale savings, according to Islamic principles, in such a way as both to benefit the Malay economy and to facilitate performance of the *hajj* [pilgrimage to Mecca]" (Roff 1998:222). Tabung Haji held its clients' deposits and invested them in industrial, agricultural, and construction projects that did not deal in interest and that Tabung Haji deemed Islamically acceptable (Kahf 2004:18, 20). By all accounts, Tabung Haji was quite successful, and in 1969 it merged with the Malaysian government's Pilgrims Affairs Office to become the Pilgrims Management and Fund Board, a state organization.

Tabung Haji still exists today. It has expanded its remit somewhat, but still focuses on savings for *hajj*. It has become a relatively small but diversified financial and administrative organization that collects the savings of Malaysian Muslims, invests them Islamically, pays dividends, provides interest-free pilgrimage loans to the needy, and provides Islamic home loans and car loans to its members. Tabung Haji also manages the travel and visa requirements of *hajj* pilgrims (Islamic Research and Training Institute 1995). Some contend that Tabung Haji's own success set the stage for the founding of Bank Islam in 1983 (Tripp 2006:136–137), Malaysia's first and largest Islamic bank.[100]

[100] One open question is whether Tabung Haji has managed to survive and retain its mutualist, communitarian mission in the current age of global Islamic finance because it has carved out a niche among lower-income Muslims (whereas Bank Islam may be offering services more to middle- and upper-income Muslims). In other words, do Islamic-finance ventures necessarily lose their mutualist, communitarian, or developmentalist characteristics if they begin to service customers in higher income brackets? One hypothesis is that they do because middle- and upper-income customers demand higher returns, are more likely to consider Islamic banks to be one among many banking options, and demand a wider and more sophisticated range of banking

EGYPT'S MIT GHAMR SAVINGS BANK

Egypt's communitarian experiment in Islamic banking occurred in the rural Mit Ghamr area of the Nile Delta in lower Egypt, where Ahmed al-Najjar founded nine branches of a mutual-savings bank between 1963 and 1967 (El-Ashker 1987; Mayer 1999). The Mit Ghamr Savings Bank (MGSB), though short-lived, epitomizes the "communitarian-experiments" phase of Islamic finance.

Al-Najjar's experiment reflects a syncretic intellectual background that combined Western development economics with Islamic approaches to the economy. He grew up in Egypt, but like many of the leading Egyptian intellectuals of the late colonial and Nasserite periods, his ideological trajectory was shaped by time spent in Europe. Al-Najjar earned a Ph.D. in social economics in West Germany in the 1950s before returning to set up the MGSB. He was influenced by the mutual-savings schemes he had observed in West Germany (Warde 2000:73), including the Sparkassen credit cooperatives (Henry 1996:259).[101] In fact, al-Najjar later involved West German advisers in the Mit Ghamr project. Yet Al-Najjar also had connections to a different economic tradition. His maternal uncle was Muhammad Abdullah al-Arabi, "a renowned professor of economics in Egypt and the first Arab professor to write on the Islamic economic system" (Kahf 2004:19). Thus the idea of combining religion with economic projects was not a new one for al-Najjar.

When Al-Najjar launched the Mit Ghamr project in the 1960s, development-oriented credit institutions accessible to most Egyptian *fellahin* (peasants) were lacking. Moneylenders existed in rural Egypt, but generally charged usurious interest rates. Pawnshops were widespread, but they hardly served to improve the condition of the rural poor. However, one informal credit institution – comparable to rotating-credit schemes in poor communities around the world – had also long existed in rural Egypt. Known as a *jam'iya* (literally "association"), it would usually form to finance a major financial need of one or several of the participants.[102]

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services. Being more profitable than small bank customers, they draw the mission of Islamic banks away I will direct part of my future research toward this question.

[101] The Sparkassen cooperatives contributed to the West Germany's postwar economic recovery by mobilizing the savings of poor people underserved by banks and employing them productively "in financing projects that would contribute to the local economy" (Mayer 1985:36). They were part of a long tradition of European agricultural cooperatives, worker cooperatives, and mutual-aid organizations that stretches back to the early 19th-century efforts of Robert Owen, William King, and others (Krishnaswami 1968).

[102] In a typical case, ten people might come together to form a *jam'iya*. Each month, every member would contribute 100 Egyptian pounds to the pool. One of the ten members would also receive that month's total pool of 1,000 Egyptian pounds. The order of payment over the ten-month period was determined in advance, and the person who needed money the soonest (e.g. to finance an upcoming wedding) would receive the lump 1,000-pound payment in the first month. Like many microcredit projects today, the *jam'iya* brought together

The Mit Ghamr Savings Bank had a collectivist, populist cast. It targeted the rural poor who, until then, had been forced to turn to pawnbrokers or wealthy moneylenders when their families and friends could not provide credit. The bank neither charged nor paid interest, but rather made its profits by investing on a partnership basis in commercial and industrial ventures (Warde 2000:73–74) and with craftsmen and small entrepreneurs (Kahf 2004:20). Like the other communitarian experiments in Islamic finance, Mit Ghamr did not offer current accounts or checking services (Kahf 2004:20), and therefore its appeal to commercial- and retail-banking customers in middle- and upper-income brackets was limited.

Yet despite his collectivist, developmentalist ideology, Al-Najjar also advocated a moral reconstruction of the peasant mind, a reorientation toward individualism and thrift. An effective mutual-savings scheme, he thought, would not only elevate the economic condition of the peasantry collectively but would also mold economic individuals acclimated to private-property ownership, habituated to individual saving, and inspired to become small entrepreneurs whenever possible (Galloux 1997:22–23). To some extent, this viewpoint reflected the hybrid of free markets and developmentalist savings systems that he had observed in the Sparkassen system in Europe. At the same time, Al-Najjar's vision for MGSB also reflected the influence of the efforts in Islamic economics that had emerged in the 1940s and 1950s, which embraced private property and individual enterprise while also stressing the obligation to support the poor and to reward hard work.

How exactly did Islam fit into the mission and message of the MGSB? Al-Najjar himself may have been more interested in the economic development of rural Egypt than in religion *per se*; Islam was to him a vehicle for appealing to the rural poor. He believed that only an interest-free scheme would be accepted in the countryside of lower Egypt. Thus the "Islamicness" of the MGSB rested largely on the fact that it did not pay or receive interest. The MGSB also paid *zakat*, or the annual contribution toward the poor and needy enjoined of Muslims (Galloux 1997:24–25). However, it did not make any high-visibility religious interventions in the community comparable to the services that Malaysia's Tabung Haji provided (management of funds and travel arrangements for pilgrimage). As Mayer notes, "the Islamic character of the MGSB was not the product of any theological orientation on Najjar's part"; rather, Al-Najjar simply recognized that "the Muslim clergy [in the Egyptian countryside] have sufficient influence and prestige to destroy the chances for success of any institution which they label un-Islamic" (Mayer 1985:37). At the same time, al-Najjar had to

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people who knew one another and thus could rely on moral censure, trust, and mutual surveillance to ensure that members lived up to their payment commitments. And as in many microcredit projects (Kabeer 2001), the primary participants in most *jam'iya* systems are women (Saoub 2007). But unlike microcredit systems, one could only get from the *jam'iya* as much as one could afford to contribute. Thus, the developmental purpose it could serve was grossly limited (Mayer 1985:34). Nevertheless, we might speculate that the *jam'iya* helped lay the groundwork for the Mit Ghamr experiment in the indirect sense that it acclimated the local population to the notion of collective credit projects.

be careful not to call too much attention to the MGSB's "Islamic" character because this could attract attention from an Egyptian security establishment deeply concerned about any form of mobilization that whiffed of Islamism. Thus Al-Najjar's approach was ethically driven, but pragmatic.[103]

Al-Najjar's balancing act between a religious peasantry and a wary state was successful at first, but short-lived. Opened in 1963, the MGSB expanded quickly from one to nine branches, generating triple-digit year-on-year growth in deposits and in number of depositors in its brief lifetime. Although it had as many as 250,000 depositors at one point, the project ended in 1967 with the closure of all its branches. Accounts are mixed as to whether the bank closed due to financial difficulties or to political interference from the Nasser regime. The cause may have been a combination of the two; there is no doubt on the one hand that Nasserites considered Islamic welfare schemes to be in competition with state-led developmentalism for the allegiance of the rural poor, but on the other hand, since the

[103] Al-Najjar and his project had a complicated relationship with the Egyptian government. On one hand, the MGSB needed the state's imprimatur merely to exist. In 1963, the same year that the MGSB was founded, Nasser's government nationalized and amalgamated virtually the entire banking sector into four state-owned banks: the National Bank of Egypt, the Bank of Alexandria, Bank Misr, and the Bank of Cairo. The central bank owned and regulated these four banks (Metz 1991:173). Setting up a private independent bank in this environment might have appeared nearly impossible, but al-Najjar had used family connections to gain access to high-ranking officials in the Ministry of Economic and Financial Affairs who approved his plan (Mayer 1985:36; Soliman 2004:267). President Nasser apparently granted an order approving the bank in 1961, although the order seems to be unpublished (Mayer 1985:37). One observer has surmised that Nasser countenanced Al-Najjar's project because Nasser "intended to neutralize the appeal of the Muslim Brotherhood" (Henry 1996:259), although it is impossible to say for sure. Al-Najjar even got the Egyptian government to subsidize the bank, though it is unclear (beyond leaning on his connections in the Ministry) how he managed to do so (Al-Najjar 1976). He managed to secure government support in part by keeping the term "Islamic" out of the bank's name and by avoiding any reference to Islam in the process of founding the bank (Soliman 2004:267). This move was politically necessary at a time when the Egyptian state under Nasser was simultaneously trying to fuse an Islamic credibility into its Arab-socialist ideology while also rooting out Islamist opposition, particularly from the Muslim Brotherhood.

On the other hand, the MGSB could not afford to appear to be too close to the state in the eyes of potential customers. Under Nasser's Arab socialism, the Egyptian state had become an ever-expanding bureaucracy that clumsily sought to control an étatist behemoth of an economy (Waterbury 1983). This expansion of the state, ostensibly aimed at improving the condition of the Egyptian masses, had instead generated considerable suspicion of government authorities in rural areas like Mit Ghamr. So had the state's vaunted land-reform programs of the 1950s and 1960s, which had failed to live up to their promise of dramatically alleviating rural poverty. Most landless peasants had not received land under the reforms, for example, because state planners assumed they lacked the skills or resources to use it efficiently (Sadowski 1991:58). Those peasants who did receive land were required to join state-run agricultural cooperatives. The cooperatives imposed mandatory cropping patterns on the peasants (Khedr, Ehrich, and Fletcher 1996:56) and forced them to sell strategic crops at fixed prices to the state, which then resold export-oriented crops like cotton on the world market and used food crops like wheat and rice to subsidize urban food consumption (Mehanna, Hopkins, and Abdelmaksoud 1994:58). As a result, suspicion of the state among the *fellahin* of the Nile Delta was often high. Al-Najjar therefore sought to keep state authorities at arm's length in the operation of the MGSB.

Mit Ghamr banking scheme was not designed with the purpose of turning a profit, it may not have been able to survive without regular infusions of cash from outside sources, particularly as it grew in size.

Yet regardless of its duration, the MGSB remains the paradigmatic example of a communitarian experiment in modern Islamic finance. Ahmed Al-Najjar went on to become internationally influential in Islamic finance, serving as an advisor to many large Islamic banks and as general secretary of the International Association of Islamic Banks. The MGSB served as a model for future Islamic banks of all kinds – including those with developmentalist motivations and those oriented toward profit – by demonstrating that a modern financial institution could be run on an interest-free basis.

Islamic finance in the early 1970s: An intermediate period of state-led Islamic banking

If the 1960s was the decade of communitarian experiments, the first half of the 1970s was a notable intermediate period in which states began to experiment in Islamic finance. One such experiment, the Nasser Social Bank, was an Egyptian domestic project. The second, the Islamic Development Bank, was an interstate project.

The Nasser Social Bank: State-owned developmentalist proto-Islamic banking

Changes in Egyptian politics opened the door again for Islamic finance in Egypt, this time in a state-supported incarnation. After Nasser died in 1970, his replacement, Anwar Sadat (r. 1970-1981), instituted an economic liberalization program called *al-infitāḥ* ("the opening") (Mitchell 2002; Owen and Pamuk 1999; Waterbury 1983).[104] In 1971, Sadat accused his leftist vice president, 'Ali Sabri, of plotting a coup, and forced him from his position. Sabri, a secularist socialist, had been one of the strongest opponents of the Mit Ghamr Savings Bank, so his ouster created the opportunity for Ahmed Al-Najjar to advocate again for a developmentalist Islamic bank — the Nasser Social Bank (NSB).[105] The NSB was comparable to the Mit Ghamr project of the 1960s, but targeted the urban

[104] Al-infitāḥ aimed at drawing foreign investment and freeing Egypt from the shackles of Nasser's managed economy.

[105] The NSB's name says a lot about the government's vision for it. Naming the bank after Nasser was clearly an attempt to mollify Nasserites opposed to Islamic banking. In the same vein, leaving the term "Islamic" out of the bank name – even though the bank was interest-free and explicitly operated according to Islamic principles – suggests that the Sadat regime in 1971 was still hesitant to associate itself blatantly with political Islam. The term "social" underscored the bank's developmentalist mandate.

proletariat rather than the peasantry. It extended loans to small urban entrepreneurs and artisans (Wilson 2002:146) and aimed to help the urban poor enter the middle class (Galloux 1997:31). According to the statute that formed the NSB, its goal was to "contribute to enlarging the base of social solidarity among citizens" (Galloux 1997:28) — a mission statement worded in developmentalist language.

The NSB has survived to the present, thanks partly to government subsidies. By 1996, it had 30 branches across most of Egypt's major towns, and 1,600 total employees (Wilson 2002); in 2009, it had 90 branches and 2,000 employees (Arab Banking Network 2014). Since it does not target wealthy depositors, it has never grown very large and remains a minor competitor in Egyptian banking.[106]

THE ISLAMIC DEVELOPMENT BANK

By the mid-1970s, new oil wealth and the passing of Egypt's charismatic Nasser had catapulted Saudi Arabia to a leadership position in the Islamic world. The heads of state of Saudi Arabia, Algeria, and Somalia called for the establishment of an international development bank for the Islamic world, both to act as a power base for Saudi Arabia and its allies and to serve as a channel for redistributing oil rents from newly rich Islamic countries to those that lacked oil (Kahf 2004). Thus the Islamic Development Bank (IDB), a multilateral development-financing institution, was born in 1974.

Unlike the Nasser Social Bank, which was a small domestic organization, the IDB is a large multilateral lending institution comparable to the Asian Development Bank and the African Development Bank. The IDB's mandate is to promote social and economic development among the 56 member countries of the Organization of Islamic Cooperation (OIC, formerly the Organization of the Islamic Conference) through *shari'a*-compliant means of financing, including participation in equity capital and interest-free loans. It extends financing "to its member countries for infrastructural and agricultural projects such as roads, canals, dams, schools, hospitals, housing, rural development, etc.," both in the public and private sectors (Islamic Development Bank 2008).[107]

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[106] Nevertheless, the NSB plays an important role for the Egyptian government. In the 1990s, with the ascendance of neoliberal structural adjustment, foreign donors began to prefer income-generating projects to direct aid or "charity." In response, the state has reoriented the NSB toward the international fashion for microfinance. As Rodney Wilson notes, the Egyptian state has used the NSB strategically "to influence NGO activity and involvement with the low-income Muslim masses," enabling it to "monitor" activities like the distribution of foodstuffs and the provision of small developmental loans to poor women (Wilson 2002:148).

[107] Thus the IDB is comparable in mission — if somewhat narrower in scope — to other multilateral development banks like the World Bank, the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, and the Inter-American Development Bank.

In order to demonstrate their commitment to Islam, the signatories inserted a clause in the IDB's charter requiring the IDB to conduct its activities in accordance with the *shari'a*. Ironically, at this time, none of the signatory countries except Malaysia and Egypt yet had functioning "Islamic banks" within their borders, suggesting that this was primarily symbolism for an international audience (Kahf 2004). Nevertheless, the IDB charter was an important step in providing early visibility and international legitimacy to the concept of Islamic banking, and the IDB has more recently become involved in transnational regulatory projects to set standards for Islamic banking (OICV-IOSCO 2004).

1975–early 1980s: Liberal Islamic finance emerges

LIBERAL ISLAMIC FINANCE: LIBERALISM MEETS ISLAMIC REVIVAL

With the decline of Arab socialism in the 1970s, pro-Western Saudi Arabia's "victory" in the Arab Cold War, and rapid income growth in the Gulf region, Islamic finance experienced a turn away from communitarian experiments and toward a model of Islamic finance that wedded economic liberalism and Islamic revivalism. The appearance of the Islamic Development Bank in 1973 opened the door for the internationalization of Islamic finance. And when the first commercial Islamic bank appeared in Dubai in 1975, it was a much more market-oriented institution than the left-leaning Egyptian project of the 1960s, reflecting the Gulf region's liberal orientation. Thus, since the 1980s, the Islamic-finance industry has been the expression *par excellence* of this marriage between economic liberalism and Islamic revival.

Islamic revival in culture and law

Islamic revival has been crucial to the success of liberal Islamic finance partly because it presents an increased consumer appetite for things Islamic. The aforementioned pioneers of political Islam of the 19th and 20th centuries distilled the notion that a re-interpreted, revived Islam could serve in the modern era as a holistic guide to human behavior in all spheres of life. Since the 1970s, in no small part thanks to funding from the Gulf region, most of the world's societies with Muslim majorities have experienced a resurgence of public piety and religious conservatism (Bayat 1998; Esposito 1983, 1999; Keddie 1994; Lapidus 1997). Increases in mosque-building (Howell 2001; Tazmini 2001), veiling and sartorial conservatism (Göle 2002; Howell 2001; Olson 1985; Parvez 2011; Secor 2002), interest in Islamic education (Hefner 2007; Sikand 2005; Talbani 1996; Thomas 1988; Zaman 2010), public audio-recorded sermons (Hirschkind 2006), piety movements (Mahmood 2011), and fasting during Ramadan (Haddad 1987; Schielke 2009) are manifestations of this trend.

Crucially for the success of liberal Islamic finance from the 1980s onward, Islamic revival has bolstered the visibility and popularity of a formalist understanding of Islamic law. Interest in Islamic law and jurisprudence as guides for everyday behavior has also increased since the 1970s, and with it the legitimacy and public visibility of religious jurists. Across the Islamic world, leading experts in Islamic law have become highly visible figures — occasionally even celebrities — who appear regularly on talk shows on radio and television, advising believers on how to live their lives in accordance with God's law. This public respect for Islamic jurisprudence and its carriers has opened a natural space for Islamic jurists to serve as the arbiters of the new financial piety that emerged in the 1970s with the rise of commercial Islamic banking.

Dubai Islamic Bank: Liberal Islamic finance is born, but with welfarist inclinations

Founded in 1975, Dubai Islamic Bank is the world's first for-profit commercial Islamic bank. It was the first in a line of for-profit Islamic banks that appeared around the Islamic world from 1975 onward. Thus, Dubai Islamic Bank is the first true instance of what would grow into the present-day Islamic-finance industry.

Yet at its founding, despite not being a development bank or a non-profit organization, Dubai Islamic Bank was still rooted in a fundamentally alternative vision of finance. It was launched in a two-room office (Abdul Alim 2014) by Saeed bin Ahmad al-Lootah, a pious Emarati trader and well-respected local business figure with a background in pearling, contracting, and trading. Al-Lootah enjoyed financial backing from his family and fellow Emarati merchants. Looking around him in Dubai and around the Islamic world, he found Muslim businesspersons everywhere involved in *ribā* (usury) via the banking system. "That made me think: Why do we have to accept their banking and financial system?" asked al-Lootah (Abdul Alim 2014).

Al-Lootah's vision for Dubai Islamic Bank combined deep piety with a pragmatic, creative, and independent approach. Now in his 90s, al-Lootah is from an earlier generation of Dubai's business leaders: he speaks no English, does not wear business suits, and still arrives every morning at 6:00 am to make detailed decisions about the work of the 11,000 employees of his holding company — most of whom he knows by name. Despite his keen managerial mind, commercial affairs are always secondary to religion for al-Lootah. When I met him for our scheduled interview, he was much more interested in discussing Islam than Islamic finance, and insisted that I read and digest a short religious text he had written before he would even speak to me about the founding of Dubai Islamic Bank. (His manner contrasts sharply with today's generation of Islamic-banking executives in Dubai, who have the cosmopolitan habitus, tailored suits, English-language skills, and polished demeanor of conventional-banking executives in any world financial hub.) Yet despite his religiosity, al-Lootah found religious scholars of little use in developing Islamic financial instruments when he launched Dubai Islamic Bank:

> I went to the religious scholars, but I found they knew nothing about the economy. And then I went to experts in economics, but I found they knew nothing about religion. So I found my own path, according to my own knowledge about savings and my experience in pearl trading around the world. (al-Lootah 2013)

He established his procedures for Islamic banking by "doing the same thing conventional banks were doing, but by taking away the elements that included ribā" (al-Lootah 2013). Instead of interest, Dubai Islamic Bank earned fees, trading income, and investment income.

The Johnny Appleseeds of Islamic banking: Prince Muhammad bin Faisal and Sheikh Saleh Kamel

Following Dubai Islamic Bank and a few other pioneering institutions, the early establishment of commercial Islamic banks around the world in the 1970s and 1980s has much to do with both Islamic revival and the oil boom. The two greatest international entrepreneurs of Islamic finance, Prince Muhammad bin Faisal Al Saud and Sheikh Saleh Kamel, are both Saudi billionaires whose wealth derives from Saudi Arabia's oil rents. These two figures went on to spread the gospel of Islamic banking in the late 1970s, 1980s, and 1990s, using their wealth and influence to build international Islamic-banking empires.

Prince Muhammad bin Faisal Al Saud of Saudi Arabia is chairman of the Dar Al-Maal Al-Islami Group (DMI Group, literally "Islamic Finance House" in Arabic). DMI Group owns (or partially owns) and manages a worldwide franchise of Islamic banks known as "Faisal banks." These are named after Prince Mohammed's father, King Faisal (r. 1964–1975). Prince Mohammed served as an financial advisor to the Saudi government for thirty years before launching his private global Islamic-finance venture at the moment when oil prices had made Saudi Arabia flush with money (Galloux 1997:37–38). The first Faisal banks, Faisal Islamic Bank of Egypt and Faisal Islamic Bank of Sudan, were legally formed in 1977. Other "Faisal banks" now exist or have existed in Bahrain, Sudan, Pakistan, Turkey, Qatar, Niger, Senegal, the UAE, Cyprus, Switzerland, the Bahamas, Jersey, Yemen, Bangladesh, Denmark, Guinea, Luxembourg, Morocco, and the Netherlands (Institute of Islamic Banking and Insurance 2008).[108]

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[108] Ibrahim Warde has called the DMI Group "a potent mix of finance, politics and religion," with its founding members "a who's who of Islamic political and religious leaders" including royals from around the Gulf and then-current or former heads of state from Pakistan, Guinea, Sudan, and Egypt (Warde 2000:77). Like the multinational giants of conventional finance, DMI has a presence in offshore financial centers outside the Islamic world, being registered as a trust in the Bahamas, having its administrative center in Geneva, and having offshore and private-banking units for the very wealthy in Jersey, Switzerland, and Luxembourg. It also

Like Prince Mohammed, Sheikh Saleh Kamel of Saudi Arabia operates an international Islamic-banking empire and has played an important role in developing an international infrastructure for Islamic banking. He founded and chairs the Dallah al-Baraka Group (DBG), which like DMI owns stakes in Islamic banks and private financial institutions worldwide. He is also chairman of the General Council for Islamic Banks and Financial Institutions, which supports training and the development of "a global expertise in the field of Islamic banking and finance" (AME Info 2004).

Late 1970s–1990s: The turn from risk-sharing to risk-shifting and the entrenchment of liberal Islamic finance

THE ETHICAL TRANSFORMATION OF ISLAMIC FINANCIAL PRACTICE

The remainder of this chapter traces an ethical transformation that occurred in Islamic finance between the founding of the first few Islamic banks in the late 1970s and the 1990s. When Saeed bin Ahmad al-Lootah founded Dubai Islamic Bank in 1975, his vision of what exactly made Islamic finance Islamic was simple: it avoided *ribā* (usury) and adhered to a few other prohibitions. In these early years, al-Lootah and his contemporaries interpreted ribā as a previously fixed charge for the time value of money. He did not see a need even for religious scholars to interpret this. Yet as we shall see below, defining the prohibited ribā in this relatively simple way quickly put the pioneering Islamic banks of the 1970s at various disadvantages relative to the conventional banks against which they were competing. Religious scholars became an institutionalized part of Islamic banking and helped Islamic banks find "shariah-compliant" solutions to commercial problems. Moreover, over time, the practical emphasis on improving the material and moral lot of Muslims via investment partnerships has diminished. In its place, emphasis on adhering to the formal letter of Islamic law has grown.

A formal understanding of shariah serves the banks' financial interests because it allows them to design products that meticulously circumvent the ban on usury. It may seem paradoxical that banks would benefit from shariah governance that is ever-more detailed and exacting. Yet as we saw in Chapter One, the same was true in medieval Judaism, Christianity, and Islam. Meticulously formal readings of religious law work in favor of merchants. Thus Islamic finance today is the product of a marriage between shariah formalism and finance capitalism.

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has investment stakes in Islamic banks, Islamic investment funds, Islamic insurers, and other private institutions of Islamic finance in countries as diverse as Yemen, Senegal, and Niger (Dar Al-Maal Al-Islami Trust 2006). In addition to setting up national Islamic banks, Prince Mohammed has been responsible for creating a large portion of the international infrastructure of Islamic finance, including the influential International Association of Islamic Banks, and for financing reference work like the *Handbook of Islamic Banking* (Warde 2004:40).

But why did this change occur? Why is Islamic finance today completely different from what its founders envisioned? How did a practice of Islamic finance that emphasizes legal form while largely neglecting social welfare become hegemonic worldwide, from Kuala Lumpur to Dubai to London? To answer this question, I focus on the evolution of an Islamic contract that has become the most widespread in Islamic finance: *murabaha* (markup sale). Since it was introduced in 1976, one year after the first commercial Islamic bank was launched, the fate of murabaha has been the fate of the industry.

Shariah-compliance and the cycle of formal rationalization

The establishment of a highly formally rational science of "shariah-compliance" has created a predictable, value-neutral framework within which bankers, lawyers, and Islamic jurists can engineer highly profitable shariah-compliant versions of conventional (i.e. non-Islamic) financial products ranging from car loans to currency derivatives. A senior vice president at one of the world's largest Islamic banks put it thus:

> What happened in Islamic finance is that we clung to the form and forgot about the principles, about the essence, about the substance. In green investing and socially responsible investing, you have substance without form. And in Islamic finance, we have form without substance. We should marry this form and substance – we should translate the ethical into the legal.
>
> *- Abdurrahman Habil, Abu Dhabi Islamic Bank, 2013 (Habil 2013)*

Today, business success in Islamic finance comes from replicating conventional finance in a shariah-compliant way, and doing so as efficiently and as precisely as possible. As a result, the portfolio of financial products available to the Islamic investor is converging with the conventional portfolio: fewer and fewer products are off-limits to Islamic investors. The management process is converging too: although Islamic finance does have its own lexicon, contract structures, and ethical arbiters, "ninety percent of what it takes to run an Islamic bank is the same as what it takes to run a conventional bank," as one management consultant remarked (M. W. (Anonymous) 2004). To assert merely that the forces of capital have "corrupted" Islamic finance would not tell us much. It would also beg the question: why has religious oversight of economic practice in the industry grown stricter and more meticulous over the years, not more lax?

Instead, I argue that a cyclical mechanism drives the industry toward formal solutions and away from substantive economic agendas. First, Islamic bankers try to practice Islamic finance in a conventional financial world, which creates ethical tradeoffs. They must choose between a less profitable solution that advances a substantive agenda and a more profitable one that merely complies with shariah's formal requirements. Whether to ensure the survival

of Islamic finance or to please shareholders, the bankers choose the formal solution. Second, an apparatus of vendors, technologies, training programs, and fatwas emerges to enact this solution as efficiently, cheaply, and accurately as possible. Much of this apparatus — its agents, its technologies, its expertise — comes from conventional finance. Not only does the formal solution become an industry norm, but crucially, the technical exactitude with which it is executed becomes a measure of piety. Finally, new market opportunities and challenges arise, generating yet more ethical tradeoffs.

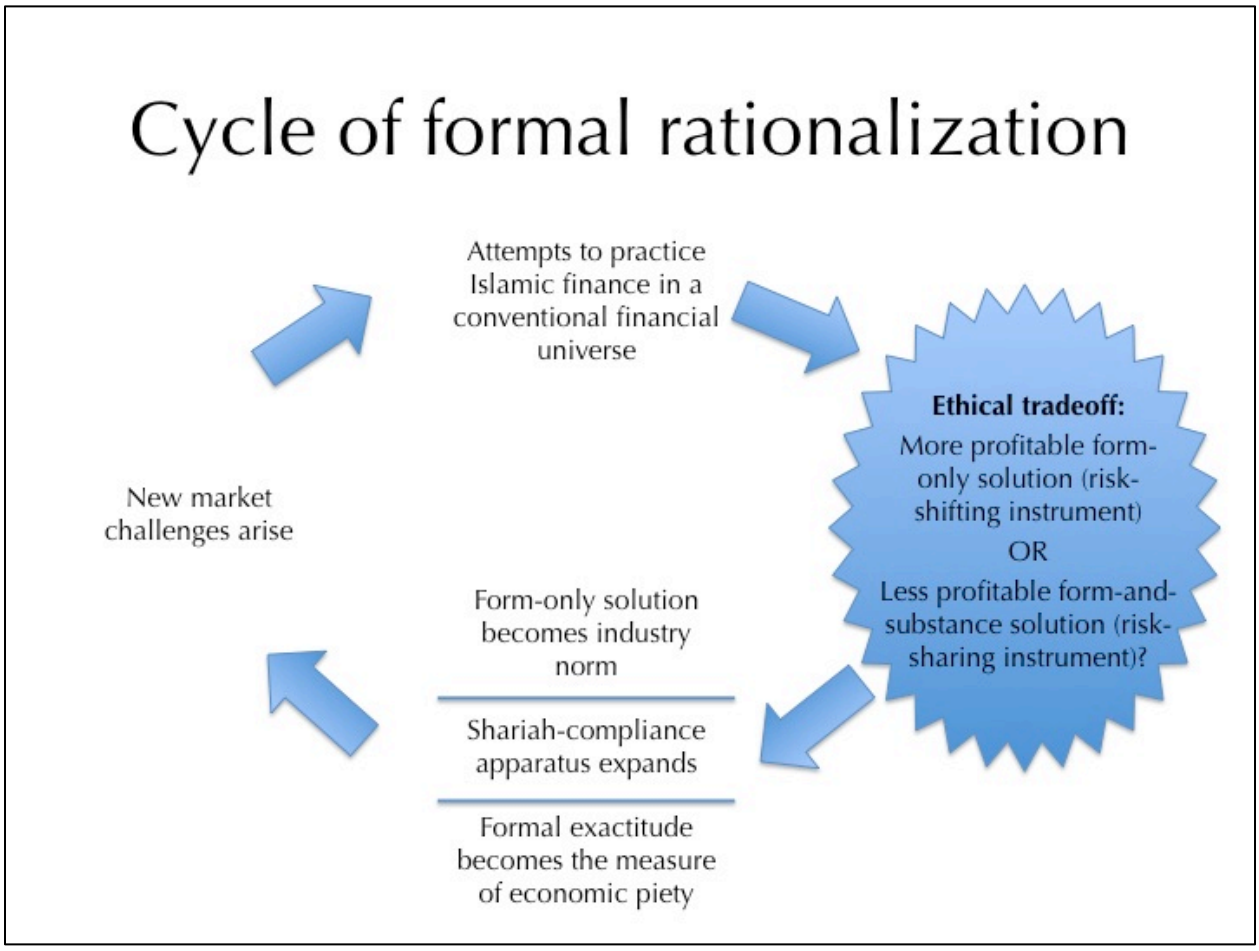

FIGURE 11: CYCLE OF FORMAL RATIONALIZATION IN THE ISLAMIC-FINANCE INDUSTRY

In the remainder of this chapter, I offer an example of this cycle in action: the popularization and mutation of an Islamic contract known as *murabaha*. Murabaha is a simple Islamic financing arrangement that was used by medieval Muslim traders, and that a Jordanian economist introduced to Islamic banking in 1976 in a novel form — "modern murabaha." Because it adheres to the usury ban in form but is no different from a conventional interest-based financing in economic substance, modern murabaha was

initially controversial. Even its proponents intended it to be a stopgap measure, used only when substantively better alternatives were unworkable. However, modern murabaha quickly took over the industry. Today, it is by far the most common contract used to finance asset purchases, a staple of everyday Islamic banking.

Below, I describe the founders' vision of Islamic finance, which was based on "risk sharing"; the introduction of murabaha, which is based on "risk-shifting"; and the spread of murabaha and other risk-shifting practices to industry dominance. This trajectory takes us from the mid-1970s to the mid-1980s and beyond. It illustrates how market forces interacted with a rising legalist understanding of Islamic economic piety to create the mode of Islamic finance that is dominant today.

Risk sharing and risk shifting

In the language of Islamic economics and finance, there are two possible approaches to finance: risk sharing and risk shifting. Risk sharing involves investors owning a stake in a business. Stock ownership is a simple example of risk sharing; so are private equity and venture capital. When the business succeeds, the investors earn a profit. But when the business struggles or fails, they lose part or all of their investment. The capital user's obligation to repay the investment is closely tied to the success of the business venture. The interests of the capital user and of the capital provider are closely aligned. Risk shifting, by contrast, divorces the obligation to repay from the success of a business venture. Conventional loans, bonds, and all other interest-based instruments are risk-shifting. If an entrepreneur takes out a loan to start a business, she is obligated repay it in full — plus interest — regardless of whether her business succeeds or fails. The burden of risk is shifted much more onto the shoulders of the capital user than the capital provider.[109]

Both risk sharing and risk shifting have been used in the conventional financial system throughout its history. But at its inception in the 1960s and 1970s, Islamic finance sought to rely only on risk sharing and eliminate risk shifting. Today, however, risk shifting, manifested as the replication of conventional interest-based lending, has become not only prominent in Islamic finance, but even predominant.

How did this transformation come about? The early theorists of modern Islamic economic thought in the 1940s–1970s proposed a system of finance based on risk sharing, establishing partnership structures as the pillars of their new Islamic economic system

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[109] A common objection to this use of the terms "risk-sharing" and "risk-shifting" is that even in a conventional interest-bearing loan, the lender is bearing risk — the risk of default. The price of this risk is, of course, one of the components of an interest rate. Yet this is merely a semantic objection. The fundamental difference between risk-sharing and risk-shifting as understood in Islamic finance is best understood as the difference between equity financing and debt financing.

(Qureshi 1946; Ahmad 1947; Uzair 1978 [originally written 1954–1978]). These structures include *mudaraba* and *musharaka*. In mudaraba, an investor contributes capital while a manager contributes work and know-how (see Figure 12). The investor bears all losses, while the manager and the investor split the profits. Mudaraba is comparable to conventional private equity. Musharaka is similar: it is simply a partnership in which two or more parties each take an equity stake. Any of the parties may contribute capital, labor, or expertise. Profits are shared based on a pre-agreed ratio (often equal to equity participation) and losses are shared based on equity participation. Musharaka is similar to many conventional limited partnerships or joint ventures.

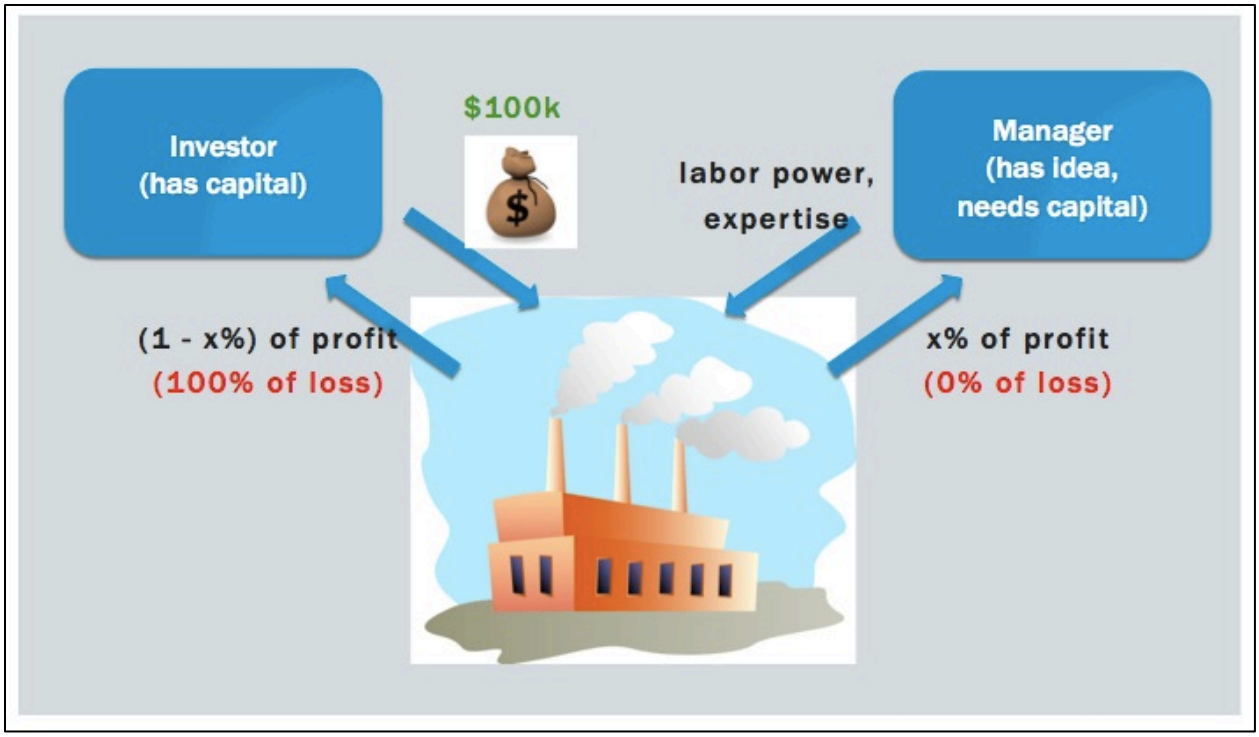

FIGURE 12: MUDARABA (PARTNERSHIP FINANCE)

Islamic banking based on risk sharing faces various obstacles

Islamic banking based on risk sharing was truly a novel proposition for bankers, regulators, and customers. In the 1960s and 1970s, some Muslim economists — primarily from the Subcontinent — turned this partnership concept into a blueprint for an interest-free *banking* (Siddiqi 1985 [Urdu 1966], 1983b [Urdu 1969], 1983a; Anwar 1987; see Kahf and Khan 1992 for an intellectual history of the risk-sharing model).

Interest-free partnership banking was supposed to work in two tiers — a model called *two-tier mudaraba* (Figure 13). Mohammad Nejatullah Siddiqi, arguably the most

renowned modern Islamic economist, was among the first to explain two-tier mudaraba in detail (Siddiqi 1981). In the first tier, depositors would invest their money with the bank. Much as in a mutual fund, they would become capital-providing partners in the bank's investment fund. In the second tier, the bank would likewise invest with local businesses as a partner, just as a mutual fund invests in corporations.

This was completely different from conventional interest-based banking in that depositors' returns were not fixed in advance. It was more like a mutual fund or a private-equity fund. It was a completely different way of doing banking that was supposed to transform society by preventing those who had capital from benefiting regardless of the success or failure of those to whom they provided capital. It was to be more just than interest-based banking.

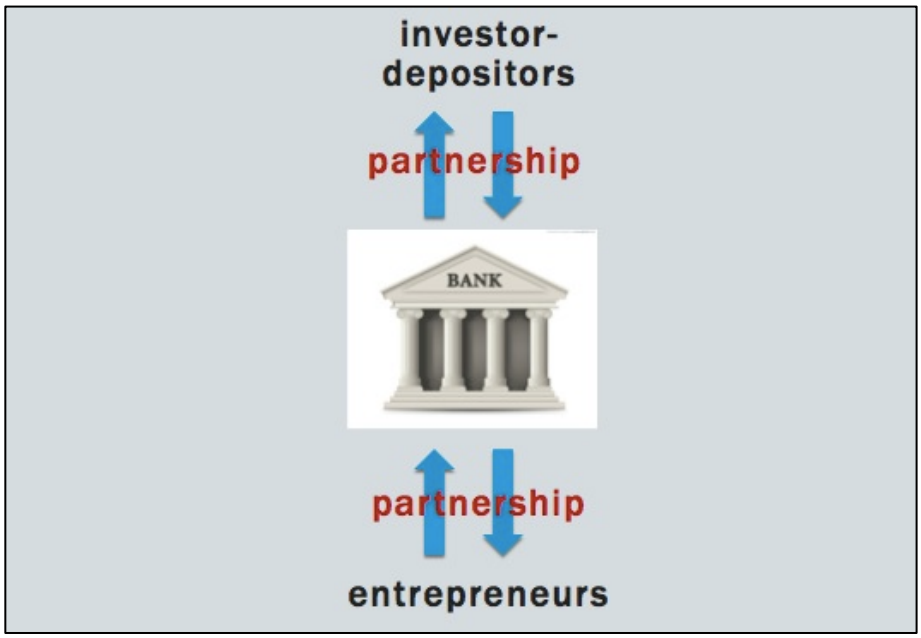

FIGURE 13: TWO-TIER MUDARABA (MODEL FOR INTEREST-FREE PARTNERSHIP BANKING), CA. 1975

However, for-profit Islamic banking based primarily on risk sharing has always faced a number of obstacles. The first is customer familiarity. Most potential retail customers of Islamic banks have grown up in a world of conventional banking. They are familiar, for example, with conventional savings accounts, which guarantee depositors' money and promises a specified rate of return. The first mudaraba-based Islamic savings accounts of the 1970s, however, did not guarantee a specific rate of return. Initially, some Islamic banks did not even guarantee the principal on these deposit-investment accounts, for some of the Islamic scholars advising these banks considered any guarantee on the depositors' invested principal as tantamount to usurious lending. (Eventually, pragmatic Islamic bankers — such

as Jordan Islamic Bank's Sami Hamoud — won this debate with the Islamic scholars, insisting that the principal must at least be guaranteed for the Islamic banks to avoid losing most of their customers.) Instead, the return they paid on the deposited principal varied based on the success of the bank's own investments.

Indeed, in an Islamic banking truly based on risk sharing, the Islamic bank acts much more like an investment bank or a private-equity firm than like a conventional commercial bank. Instead of earning money by borrowing low and lending high, it aims to earn money by making strategic investments in entrepreneurs and local businesses using risk-sharing equity arrangements such as mudaraba or musharaka, and sometimes by trading commodities and capital goods.

A second obstacle to risk-sharing in Islamic banking has been the problem of investment expertise and management expertise. In order for an Islamic bank to invest successfully in firms using the risk-sharing model, it must have deep knowledge of the firms' balance sheet, operating profits, management, competitive space, and strategy. These are the tasks that modern private-equity firms take on. However, the early Islamic banks did not necessarily have this kind of expertise: many of their executives and employees either had backgrounds in conventional commercial banking or were merchants. Moreover, the process of running Islamic banks required new expertise in Islamic law, and there were few people who shared all these various kinds of management expertise.

A third obstacle is moral hazard. Risk sharing requires the investor to keep close watch on business operations because the manager of the business may have little or none of his own money at stake. Both as a result of moral hazard and simply poor internal management, prominent Islamic banks suffered a number of scandals throughout the 1980s and 1990s, including an embarrassing embezzlement at Dubai Islamic Bank in which one branch manager gave away millions of dollars to a customer whom he later claimed had used witchcraft to cast a spell on him (DeFede 1998, 1999).

ISLAMIC BANKING BASED ON RISK-SHIFTING: THE RISE OF MURABAHA

The essence of all murabaha is simple: it is a resale at a stated markup. However, its economic function in the modern Islamic-finance industry — that is, since the late 1970s — differs from its economic function in pre-modern times. Below, I describe how medieval merchants used murabaha and how Islamic banks use it today.

Medieval murabaha

Imagine a medieval merchant who buys some cloth at a distant market for 40 dinars, carries it to the city by caravan at a cost of 15 dinars, pays 10 dinars to have it sewn into a garment, and then sells the garment in the city for 100 dinars. His total cost is 40 + 15 + 10 = 65, his

total revenue 100, and his net profit therefore 35. For the sale to be a valid murabaha, the merchant must state truthfully to the garment buyer that he is earning a profit of 35 dinars on the transaction (Udovitch 1985: 454). In other words, the seller must let the buyer know how much profit he is earning.

Classical Islamic legal texts suggest that murabaha's original purpose was to ensure transparency and fair dealing (Udovitch 1985). In the language of economics, murabaha is an institution that reduces information asymmetry between sellers and buyers. Though only relatively thinly documented in medieval texts, medieval murabaha does appear to have been practiced to some degree in the medieval Islamic world.

Modern murabaha

Modern murabaha, as used in the Islamic-finance industry, adheres to the same formal rules as medieval murabaha while serving a different substantive economic purpose: to perform financial transactions while avoiding interest. Instead of using murabaha in long-distance trade, Islamic financial institutions today use it overwhelmingly to build shariah-compliant financing structures that mimic conventional financing structures. These range from simple consumer loans to complex derivatives and multibillion-dollar syndicated financing facilities. These murabaha-based structures act like conventional (i.e. non-Islamic) financial products in that they compensate the lender for the time value of money, but they have the religious benefit of avoiding the sin of interest.

Consider a typical product currently offered by Islamic banks all over the world: a murahaba-based auto financing (see and Figure 15). This is the "Islamic version" of an auto loan. Its basic structure is similar to that of medieval murabaha: a "merchant" buys an item at one price and resells it at a higher price. In this case, the merchant is the Islamic bank. It buys the car from the dealership for its normal price and then almost immediately sells it on to the customer at a higher price. The first sale is a spot sale: the bank makes a lump-sum payment to the dealer right away for the full cost of the car. However, the second sale is a deferred-payment sale that is settled in monthly installments.

Economically speaking, a murabaha auto financing acts just like a conventional auto financing, but does so without involving interest. The customer's monthly installment payments to the Islamic bank (of the Islamic bank's initial purchase cost from the dealership plus the Islamic bank's markup) take the place of monthly payments (of principal plus interest) on a conventional car loan.

FIGURE 14: EXAMPLE OF MODERN MURABAHA — ISLAMIC AUTO FINANCE

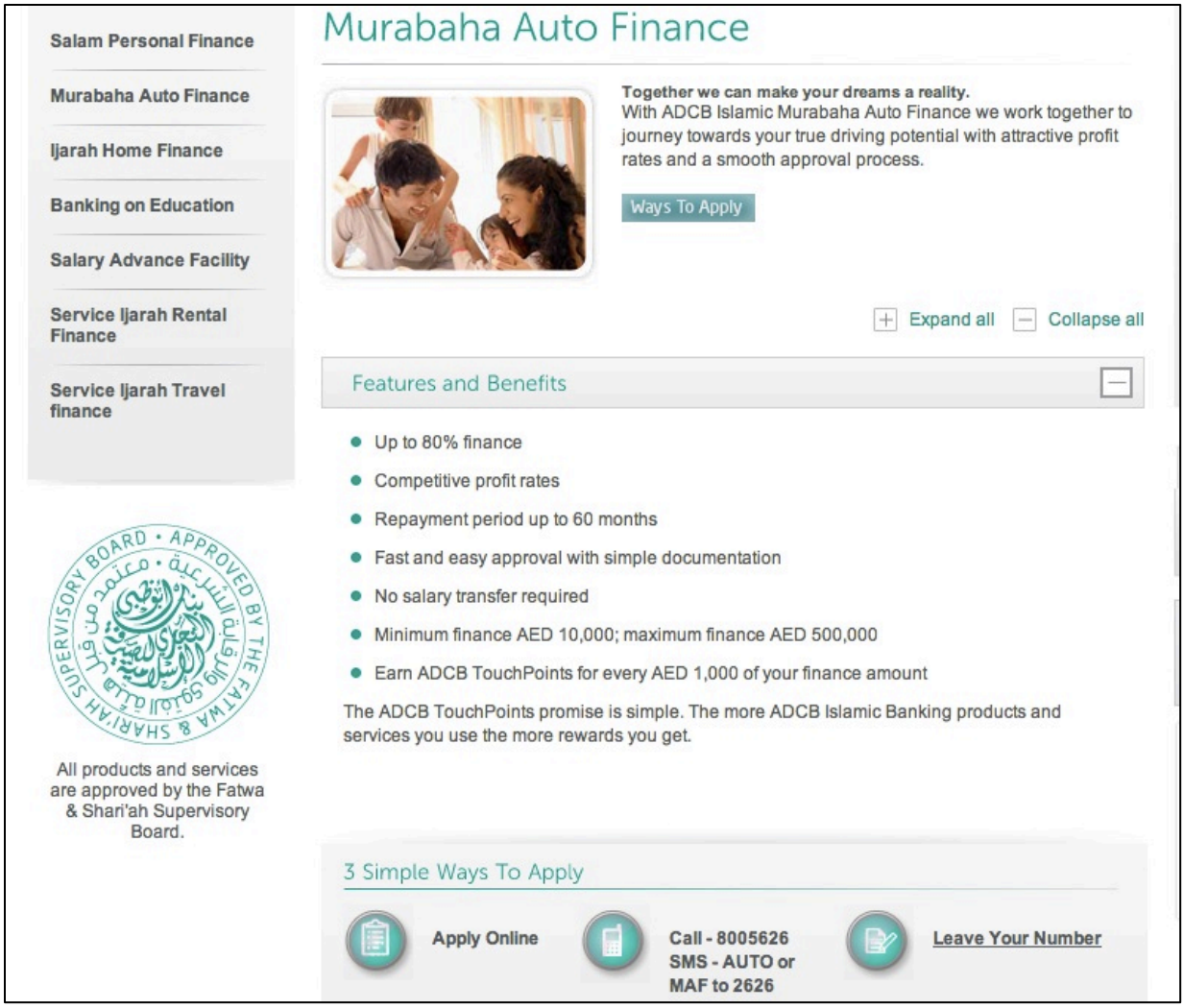

FIGURE 15: ADVERTISEMENT FOR ABU DHABI COMMERCIAL BANK'S MURABAHA AUTO FINANCE

Note that Islamic banks advertise "profit rates," not "interest rates," because the amount above principal that the borrower pays is not interest, but the difference between two sale prices. The bank calls this its "profit." This language also reassures the customer that sinful interest is not involved.

Sami Hamoud and the birth of modern murabaha

The introduction of modern murabaha into Islamic finance is one of those rare turning points that can be traced back to a single individual. In 1976, Jordanian economist Sami Hamoud submitted his Ph.D. thesis to the University of Cairo's College of Laws. For-profit Islamic banking was still in its infancy: Hamoud began his doctoral studies in 1973, and the first for-profit Islamic bank, Dubai Islamic Bank, did not open until in 1975. The thesis "was widely viewed as the most substantial academic piece on Islamic banking that had been written until that time" (Malley 2004: 192) because it provided a blueprint for how to develop a modern banking system that avoided interest and complied with other Islamic principles (Maali and Napier 2010: 7).

In his 1976 Ph.D. thesis, Sami Hamoud became the first person to suggest modern murabaha. Hamoud devised modern murabaha by revisiting the *Kitāb al-Umm*, a masterwork of the great classical Islamic jurist Imām al-Shāfiʿī (767–820 CE). In the *Kitāb al-Umm*, al-Shāfiʿī writes:

> if a person shows another a commodity and says, 'buy this and I will give you such and such an amount as profit' and the second buys same, then the purchase is permissible... Thus if he says: 'buy me (a certain) object' and then describes such object, or if he says: '[buy me] any object you wish and I will give you a profit for same', then this is all the same, the first sale is permissible, and this would be an exercise of his option.. (Elgari et al.: 48).

Hamoud used this dispensation from al-Shāfiʿī to design modern murabaha.[110]

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[110] After finishing his Ph.D., Hamoud went on to build support in Jordan for Islamic banking, and eventually to found Jordan's first Islamic bank. He introduced his ideas to the public by appearing on a weekly Islamic television program in 1977. He built connections with the two wealthiest and most prominent international advocates of Islamic banking of the day: Prince Muhammad bin Faisal Al Saud of Saudi Arabia and the Saudi businessman Sheikh Saleh Kamel, both of whom would go on to seed and open Islamic banks around the world over the next two decades. The Saudi prince's influence proved vital in winning over the Jordanian royal family, who — like rulers of some other Arab countries, including Egypt — were nervous that Islamic banking might build the influence of the Muslim Brotherhood and other Islamist groups. To mollify the Jordanian government, Hamoud stressed the developmentalist aspects of his scheme, such as its use of risk-sharing instruments and its potential for bringing people into the banking system who had been avoiding it for religious reasons. Sheikh Saleh eventually became the largest shareholder of Jordan Islamic Bank, which Hamoud founded in 1978; Prince Muhammad was also a major shareholder.

Hamoud's own background foreshadowed the mixture of expertises that would go on to underpin Islamic finance: he was influenced by both Islamic legal studies and conventional banking and economics. Having worked at a conventional bank in Jordan since 1956, Hamoud was familiar with modern banking techniques, but was troubled to see that bank interest forced some customers into bankruptcy. He also noted that many Jordanians avoided depositing their money in banks because of the Islamic prohibition on usury (Maali and Napier 2010: 7). Hamoud's father was an Islamic scholar and encouraged him to study the possibility of an

As an economist and a banker, Hamoud recognized the difficulty of devising a banking system based entirely on risk sharing. While he intended to make risk-sharing contracts such as mudaraba and musharaka the centerpieces of his Islamic banking system, he worried that Islamic banking would also need a profitable way to provide loans and financing. Hamoud's murabaha was a means for doing this. However, it did not follow the risk-sharing paradigm; it was clearly a risk-shifting transaction that could serve to copy conventional interest-based lending. Therefore, at the time, murabaha was quite controversial among Islamic scholars in Jordan and beyond. Also controversial was Hamoud's practice at Jordan Islamic Bank of pricing murabaha financings with reference to prevailing interest rates in the conventional banking market (Maali and Napier 2010). However, Hamoud used a strong hand to overrule the Islamic jurists on his Fatwa Committee. Although he believed strongly in the risk-sharing vision for Islamic finance, his two decades' experience in banking also gave him a pragmatic bent. He saw that without some use of risk-shifting tools and without offering some analog to interest-based financing, the entire Islamic-banking project would die a young death.

Modern murabaha spread quickly through the nascent Islamic-finance industry. Crucial to this spread was the first Islamic Banking Conference, hosted in 1979 by Dubai Islamic Bank. In attendance were representatives of the handful of Islamic banks that now existed: Dubai Islamic Bank, the Faisal Islamic Bank of Egypt, the Faisal Islamic Bank of Sudan, Kuwait Finance House, Jordan Islamic Bank, and a few others. In a case of institutional isomorphism (DiMaggio and Powell 1983) with deep consequences for the future of the industry, shariah scholars at the conference issued a fatwa endorsing the use of modern murabaha (Abdul Alim 2014). This clarification gave banks the assurance that they could continue to use modern murabaha to mimic conventional interest-based banking without the fear that religious scholars would suddenly declare it un-Islamic.

Islamic finance today: Consumed by the "murabaha syndrome"

While many feel the risk-sharing model makes Islamic banking substantively different from conventional banking in theory, there is very little risk-sharing actually happening at Islamic banks today. Critics argue that actually existing Islamic banking is therefore little different from conventional banking — except that it increases transaction costs by requiring convoluted structures and expensive shariah oversight (El-Gamal 2008).

One focus of criticism is that the actual practice of Islamic banks today is dominated by murabaha and other debt-based financing that mimics interest-based banking, largely by relying on markups. Yousef (2004) calls this phenomenon the "murabaha syndrome." He

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interest-free banking system (Maali and Napier 2010: 7).

found that in 1994–1995, murabaha and other markup instruments accounted for 85.6% of Islamic bank's total financing in the Middle East and North Africa, 70.4% in East Asia, 92.2% in South Asia, and 55.7% in Sub-Saharan Africa (ibid.: 65). Subsequent studies have confirmed the finding that debt-based financing is widely preponderant in Islamic banking, including Iqbal and Molyneux (2005), Hasan (2007), Nagaoka (2007), and Jan (2011) (see Asutay 2012). These authors note that risk-sharing instruments such as mudaraba and musharaka compose a remarkably small portion of most Islamic banks' balance sheets. For example, Hasan (2007) finds that in Malaysia in 2006, musharaka accounted for a mere 0.2% of financing in the Islamic-banking sector and mudaraba for 0.7%. Nagaoka (2007) finds that between 1988 and 2006, mudaraba and musharaka combined accounted for 1.7% of financing at Bank Islam Malaysia and 9.3% at Dubai Islamic Bank.

Conclusion

This chapter began with a few questions. What forces pushed Islamic finance into the world? Why did it emerge in the 1960s and 1970s in particular? And why did it go from being a utopian non-profit movement in the 1960s and 1970s to being a fast-growing for-profit industry by the turn of the millennium?

First, we saw that four forces were crucial in the emergence of Islamic finance. One was the Arab Cold War. On the left side of this war was a postcolonial developmentalist ideology that fostered a climate of experimentation with novel economic arrangements of the sort seen in Mit Ghamr and the Nasser Social Bank. On the right side was the stability-seeking, pro-Western, merchant-friendly orientation of Saudi Arabia and the Gulf states. It was out of the latter that Dubai Islamic Bank, Kuwait Finance House, Bahrain Islamic Bank, and many of the other early commercial Islamic banks emerged. A second factor was Islamic revivalism, which gathered speed in the 1970s and 1980s, creating a resurgence of piety in public culture and heightened interest in Islamic jurisprudence. A third factor was the oil shocks of the 1970s, which channeled petrodollars to the Islamic world, and especially to the Gulf. These rents not only provided funds for Muslim depositors to place in Islamic banks, but also seeded international projects such as the Islamic Development Bank and the transnational Islamic-banking empires of Prince Muhammad bin Faisal Al Saud and Sheikh Saleh Kamel. A fourth factor was the rise of global finance, which increased financial literacy and deepened financial markets in the Islamic world, spread financial technologies across borders, and transferred expertise from Wall Street and the City of London to Islamic financial institutions, as we shall see in the next two chapters.

Islamic finance first appeared in the form of communitarian experiments such as the Mit Ghamr Savings Bank and Tabung Haji in the 1960s. But with the appearance of Dubai

Islamic Bank in 1975, it entered its liberal phase. Islamic banks were now competing in capitalist financial marketplaces against conventional banks.

This sent the Islamic finance industry into a cycle of formal rationalization that simultaneously set the stage for its growth and raised new ethical quandaries. As Islamic-banking entrepreneurs such as Sami Hamoud of Jordan Islamic Bank faced problems associated with practicing Islamic finance in a world dominated by interest-based conventional finance, they have made ethical concessions, accepting risk-shifting instruments such as modern murabaha that effectively mimic interest-based finance from a substantive economic perspective while meticulously avoiding the formal taint of interest. In the wake of these ethical concessions, the risk-shifting instruments become an accepted part of Islamic finance. They go from being ethically questionable to relatively uncontroversial.

Since Islamic finance's most rapid phase of expansion began around the year 2000, what I call the "shariah-compliance apparatus" has developed around new risk-shifting practices: a matrix of agents, ethical narratives, and technologies that execute and certify them with precision. This conversion of ethical oversight into a formal science of shariah-compliance has raised new ethical contests in Islamic finance — the topic of Chapter Four. One fault line in these contests is the question of whether legal formalism has gone too far in trumping matters of economic substance. As we shall see, form-versus-substance debates find their way into the very pores of the industry: into many different types of Islamic financial practice. It is through the practice of Islamic finance that Islamic bankers, shariah scholars, lawyers, and even regulators construct and contest the meaning of Islamic economic piety.

CHAPTER THREE

"Capitalism with a human face":
Ethical-consumption certification apparatuses

Introduction: Building capitalism with a human face

> "It's not just what you're buying. It's what you're buying into."
> - Starbucks

> "We invest as an act of faith in the future, with the belief that we can shape it."
> - Calvert Investments, a pioneer of socially responsible investment

"Socialism with a human face" was Alexander Dubček's slogan during the ill-fated Prague Spring of 1968. Today, with the Soviet experiment dead and China and Vietnam socialist in name only, socialism with a human face seems to be locked in the reliquary of beautiful ideas unsullied by prolonged efforts to consummate them.

Today, one asks: How to build "capitalism with a human face" (Žižek 2004:316–317)? How might one tame the excesses, crises, and injustices to which liberal capitalism gives rise — while retaining the innovation and growth that markets offer?

The most familiar blueprint for capitalism with a human face is a top-down one: the welfare state. From Bismarck to Beveridge to Sweden's 57% top tax rate, the welfare state is founded on the hope that social safety nets, robust public services, and income redistribution can temper the unequal outcomes and social dislocation that free markets engender (Esping-Andersen 1990).

But in the past two decades, a bottom-up blueprint has begun gaining steam: *ethical consumption*. Ethical consumption is the practice of attempting to address ethical problems endemic to the current model of capitalism through the act of consumption itself. Proponents of ethical consumption argue that it has the potential to alleviate social and environmental ills ranging from sweatshop labor to global warming. Cynics see it as an spiritual palliative for first-world consumers and a distraction from the structural character of problems that only large-scale political intervention can solve.

My goal here is not to judge the efficacy or virtue of ethical consumption. Rather, I ask what ethical consumption can tell us about the relationship between ethics and contemporary capitalism. The two ethical-consumption projects I describe in this chapter —

fair trade and socially responsible investing — penetrated public consciousness in the 1960s and 1970s as something akin to social movements, but by the 1990s and 2000s had evolved into highly formalized regimes of certification and labeling. In the beginning, they fired indignant arrows at the established corporate firmament; today, they are stars within it. Islamic finance, as we shall see in subsequent chapters, has followed a very similar trajectory.

Ethical-consumption certification apparatuses

A central argument of this book is that Islamic finance has spread so prolifically partly because it has transformed into an ethical-consumption certification apparatus (ECCA). Official certification by shariah scholars gives customers the peace of mind to know that they are not violating God's law. Customers do not have to understand the details of how a financial instrument avoids usury: as long as they trust the shariah scholars on their bank's shariah board, they can buy the bank's products without worry. Fair-trade products and other ethically certified products operate the same way: they grant the customer peace of mind. A large technical apparatus stands behind the certification, radically condensing the burden of research and understanding required to be an ethical consumer into the simple question of whether to trust a particular certification label (e.g. the "Fair Trade Certified" logo shown here).

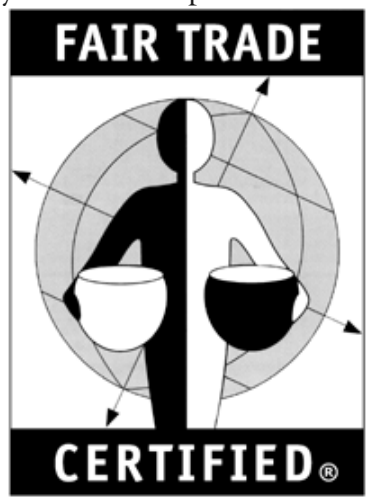

FIGURE 16: FAIR TRADE CERTIFIED™ LABEL BY FAIR TRADE USA

In this chapter, I introduce the concept of ECCA and explain why it is potentially useful by situating it in the context of relevant literature. I begin by touching on three bodies of work: the literature on ethical and political consumption, the literature on non-state product certification, and writings on the concept of "apparatus" or *dispositif*. I then bring ethical consumption, non-state product certification, and the apparatus together into the ethical-consumption certification apparatus.

ETHICAL CONSUMPTION

What is ethical consumption?

Scholars have paid increasing attention to ethical consumption in the past two decades. But what does the field of ethical consumption (also known as ethical consumerism) include? Highly visible causes for ethical consumption today include environmental sustainability (e.g. pollution, climate change, genetically modified organisms, energy use), labor

conditions (e.g. sweatshop labor, forced labor, child labor, workplace health and safety), and animal welfare (e.g. product testing on animals, factory farming). While some of these causes are new, ethically and politically targeted purchasing is not a new phenomenon. It goes back at least to the "healthy food movement" of the 1830s and 1840s and the "pure food crusade" of the 1890s and 1900s (Haydu and Kadanoff 2010). In addition to particular causes, ethical consumption incorporates *modes of consumption* such as shopping, banking, and investment (Barnett et al. 2005:27); and *products* ranging from food commodities, consumer packaged goods, and clothing to pension funds and mutual funds.

Defining ethical consumption is tricky, but two factors seem essential. The first is *ethical motivation*: the consumer holds some socially or politically oriented goal beyond merely acquiring the best possible good at the best possible price. The second factor is *belief in efficacy*: she believes buying a particular good ("positive buying") or refraining from buying it ("negative buying," i.e. a boycott) will advance this goal.

The organizational structure of ethical consumption

The organizational structure of ethical consumption is diverse, occupying several points in the value chain. The chain begins with *producers*, such as coffee growers and clothing manufacturers. In socially responsible investing and Islamic finance, the producers are banks and other financial institutions. Some producers sell ethically certified products exclusively, while others sell non-certified products as well. *Distributors* and *wholesalers* occupy the middle of the value chain. *Retailers* sell ethically certified products to the end consumer. Some sell these exclusively (e.g. Traidcraft plc's stores, Oxfam shops), while others stock ethical products among many others (e.g. Starbucks, which brew some types of Fairtrade-certified coffee and sells water produced by its Ethos® subsidiary; The Body Shop; financial institutions that sell socially responsible mutual funds alongside hundreds of conventional funds).

Finally, there are *certifiers*, who occupy a vital place in this system. These are organizations that develop, monitor, and sometimes also market the standards and labels that identify products as "ethical." Some certifications have government affiliations, such as the "dolphin-safe" label established in 1990 by the United States Department of Commerce and monitored by the National Marine Fisheries Service or the free-range certification for poultry monitored by the United States Department of Agriculture. In such situations, ethical-consumption certification is effectively an extension of pre-existing mandatory government labeling regimes, such as for food ingredients. On the other hand, ethical-consumption certification by non-profit non-government organizations has become a fast-growing arena.

NON-STATE PRODUCT-CERTIFICATION REGIMES

Bureaucratized product certification is what distinguishes ECCAs, which are overwhelmingly a phenomenon of the past three decades, from other modes of ethical consumption, such as boycotts and fundraisers. In most ethical-consumption regimes, certification is performed not by the state, but by non-state certification organizations. These include for-profit firms and non-profit NGOs.

The literature on non-state product certification offers six lessons that will inform our investigation of ECCAs.

1. *Non-state product certification is growing.* Non-state product certification in general has grown significantly across the globe since the 1980s (Gereffi, Garcia-Johnson, and Sasser 2001). Indeed, the rise of non-state market-driven certification systems such as forest certification has been arguably "one of the most innovative and startling institutional designs of the past 50 years" (Cashore, Auld, and Newsom 2004:4). Some scholars take a market-based approach, attributing the rise of non-state governance institutions to *cooperation* among firms trying to solve collective-action problems and protect their reputations (Prakash and Potoski 2006). Others develop a model of political *conflict* and contestation among states, firms, and NGOs in which certification regimes are negotiated settlements (Bartley 2007). Regardless, scholars agree that several causal factors have been crucial (Hatanaka, Bain, and Busch 2005): the crescence of neoliberalism and its advocacy of private governance rather than public governance (Biersteker and Hall 2002; Cutler 2003); globalization and the expansion of global supply chains that increase the distance between producer and end consumer; and the consolidation of retailers in advanced industrialized economies, including the ascent of big-box retailers with tremendous purchasing power; and a lack of transnational regulatory capacity (Fligstein 2005). In this environment, diverse forms of private governance regimes have appeared: industry self-regulation, co-regulation between industry and government, and purely private systems of governance (Havinga 2006).

2. *Supply-chain structure shapes certification regimes.* In non-state product-certification regimes, the structure of the supply chain matters greatly (Higgins, Dibden, and Cocklin 2008; Tran 2013). We must begin by asking: Who is it that cares about product "quality"? (I use "quality" in the broad sense here to refer to any desired characteristic of a product, including its safety characteristics and its ethical characteristics.) Likewise, who demands certification? Non-state certification regimes can be consumer-driven, retailer-driver, producer-driven, NGO-driven, or even state-driven (that is, the state encourages the private development of certification regimes).

3. *Non-state certifiers must often strike a balance between being too strict and too lenient.* While this is true of state certifiers as well, it is a particular concern for non-state certifiers, who must navigate "between risking their reputation or accreditation and losing their clients" (Havinga 2006).

4. *Firms do not necessarily do the bare minimum.* We should not assume that firms will necessarily do the bare minimum required to satisfy certification requirements (Havinga 2006). In some cases, firms will go beyond certification requirements in order to burnish their image, meet public demands, or satisfy internal stakeholders within the firm. Thus firms are often not economically rational actors, but also "political citizens" who generally comply with regulations but who may resist when they consider certain standards unreasonable (as opposed to just unprofitable) (Kagan and Scholz 1984).

5. *Systems of certification compete with one another.* It is not only firms that compete, but entire systems of certification. Rao (1994) describes the case of multiple certification systems for automobile safety and performance competing during the early decades of the automobile (1895–1912). Competition among certification systems is likely to occur in new industries with many new entrants, because certification allows these firms to build reputations and legitimacy (Rao 1994). Meanwhile, certification systems themselves must establish their legitimacy among a wide range of stakeholders (Cashore 2002).

6. *Certification is always embedded.* Both systems of certification and certification agents themselves are always socially and politically embedded (Bartley 2007; Hatanaka and Busch 2008; Higgins et al. 2008). Taken to its logical conclusion, this axiom suggests that there is no "truly objective" certification. Moreover, the formal rationalization of certification systems can obscure the fact that the reasoning of human certification agents is contextual and deliberative, as in the case of doctors who must certify clients' physical and mental status for disability judgments (Meershoek, Krumeich, and Vos 2007).

FIGURE 17: EXAMPLES OF NON-STATE CERTIFICATION PROGRAMS (taken with minor edits from Gulbrandsen 2010:14–15) (also draws on Bernstein and Cashore 2007)[111]

	Origin	Initiators	Policy goal
Forest Stewardship Council	1993	Environmental NGOs and socially concerned companies	Environmentally and socially responsible forestry
Rainforest Alliance Certification	1993	Rainforest Alliance (an NGO)	Sustainable farming through certification of tropical commodities
Sustainable Forestry Initiative	1994	American Forest and Paper Association	Sustainable forest management
Marine Stewardship Council	1997	World Wide Fund for Nature (WWF) and Unilever	Environmentally responsible fishing
Social Accountability International	1997	Council on Economic Priorities (an NGO)	Workers' rights and working conditions
Fairtrade Labelling Organizations International	1997	NGOs and consumer groups	Fair prices for developing-country producers; workers' rights
Marine Aquarium Council	1998	Environmental NGOs, aquarium industry, public aquariums, hobbyist groups	Responsible aquarium trade to conserve marine ecosystems
Programme for the Endorsement of Forest Certification	1999	European forest-owner associations	Sustainable forest management
Fair Labour Association	2001	Industry, Clinton administration, consumer organizations, labor-rights organizations	End sweatshop labor
Roundtable on Sustainable Palm Oil Certification System	2007	WWF and Unilever	Promote growth and use of sustainable palm oil
Aquaculture Stewardship Council	2010	WWF with participants of the Aquaculture Dialogues	Sustainable fish farming

APPARATUS (*DISPOSITIF*)

> Purposeful action and intentionality may not be properties of objects, but they are not properties of humans either. They are the properties of institutions, of apparatuses, of what Foucault called *dispositifs*. Only corporate bodies are able to absorb the proliferation of mediators, to regulate their expression, to redistribute

[111] Gulbrandsen (2010:15) includes the following notes: "(1) 1993 was the year the Rainforest Alliance certified the first two tropical farms under its agricultural certification program; (2) Initially an industry code of conduct with mandatory self-reporting for members of the American Forest and Paper Association, the Sustainable Forestry Initiative provided for voluntary third-party verification in 1998; (3) Fairtrade Labelling Organizations International united 15 separate initiatives; (4) 2001 was the year the Fair Labour Association established an independent auditing system; (5) A certification system for sustainable palm oil was launched at the fifth roundtable meeting in 2007."

> skills, to force boxes to blacken and close. Objects that exist simply as objects, detached from collective life, are unknown, buried in the ground. (Latour 1999:192–193)

While others have explored why non-state certification systems emerge, less attention has been paid to the way these systems give rise to new subjectivities and worldviews — including among producers, consumers, and certification agents. One of the main arguments of this book is that the emergence of a highly formalized certification system in Islamic finance has generated new modes and understandings of Muslim piety. In order to interrogate this relationship between system and subjectivity, I turn in this section to the concept of "apparatus" (*dispositif*, also translated as "device"), merging Michel Foucault's use of it with Michel Callon's (see also Dumez and Jeunemaître 2010). I also touch on Giorgio Agamben's history of the concept.

Foucault's dispositif

In a 1977 interview, Foucault explained that an apparatus (*dispositif*) is

> a resolutely heterogeneous grouping composing discourses, institutions, architectural arrangements, policy decisions, laws, administrative measures, scientific statements, philosophic, moral and philanthropic propositions; in sum, the said and the not-said, these are the elements of the apparatus. The apparatus itself is the network that can be established between these elements. (Foucault 1980)

From this description, it seems an apparatus could contain everything but the kitchen sink. Foucault's apparatuses include prisons, schools, madhouses, factories, academic disciplines — a wide range of institutions and systems. Foucault's use of the concept in his work, however, makes it is possible to draw out more-specific features of an apparatus:

- An apparatus emerges at a given historical moment *in response to an urgent need*.
- An apparatus thus has a dominant *strategic function*. It is "a specific strategic response to a specific historical problem" (Rabinow and Rose 2003).
- However, the technologies of an apparatus can be *rationalized and generalized*. The "initial response to a pressing situation can gradually have a more general rationality extracted from it, and hence be turned into a technology of power applicable to other situations" (Rabinow and Rose 2003).
- As a result, an apparatus *evolves as it becomes entrenched*. "New, unanticipated functions, strategies, and processes emerge and contribute to stabilize and entrench

the device" (Dumez and Jeunemaître 2010: 31).

Callon's dispositif

Dumez and Jeunemaître (2010) note similarities and differences between Callon's *dispositif* (usually translated as "device") and Foucault's *dispositif* (usually translated as "apparatus"). Both are hybrids of discourses and non-discourses — "the said and the unsaid" (*du dit et du non dit*). A *dispositif* is both "a unity" and "heterogeneous" (ibid.: 32). The unity comes from a single intention: in Callon's example of air-traffic management, it is ensuring that aircraft avoid accidents while taking off and landing efficiently. (In the shariah-compliance apparatus, the unity of intention is ensuring that financial transactions adhere to Islamic law.) The heterogeneity encompasses both legal and technical rules, such as those governing which airplanes may fly where, and technical systems, such as radar, telecoms, and software (ibid.: 32). A Callonian *dispositif* governs the behavior of individuals, firms, and even states. It both relies on legal and technical knowledge and produces it. It also encompasses *algorithms*: step-by-step procedures for calculation.

Callon and Muniesa (Callon and Muniesa 2005) note that markets themselves act as calculative devices. At least three aspects of markets facilitate the calculation of prices: (1) well-defined, calculable economic goods; (2) calculative economic agents or agencies — that is, actors or entities to do the calculating; and (3) calculated exchange: "the rules and material devices that organize the encounter between calculative agencies and calculable goods."

Agamben: What Is an Apparatus?

In a short book *What Is an Apparatus?*, Giorgio Agamben traces the history of "apparatus" and its antecedent concepts and then reflects on apparatuses in contemporary capitalism (Agamben 2009). The essay is imaginative and historically lush; for present purposes, a few points stand out.

First, Agamben situates the genealogy of the concept in early Christian thought. Whereas the term *oikonomia* had long referred to administration of the home (*oikos*) and more generally to *management*, early Church thinkers (2nd-6th centuries CE) employed it to refer to God's management of humanity. Expositing the controversial new notion of the Trinity, theologians such as Tertullian, Irenaeus, and Hippolytus faced a question: Why was a tripartite godhead necessary? They justified Jesus's existence by arguing that God entrusted to Jesus the task of *oikonomia* — "the administration and government of human history" (Agamben 2009:10), just as a father might entrust management of the family business to his son. Christian thought divided into a *logos* (discourse) of theology, which contemplates the nature of God, and a *logos* of economy (*oikonomia*) — the economy of redemption and salvation, and thus presumably of the Christian's responsibilities and duties. This split between theology and economy was simultaneously a split between being and praxis,

between ontology and administration. To the Latin Fathers, *oikonomia* became *dispositio* (Agamben 2009:11); to Heidegger, *Gestell*.

This leads Agamben to define "apparatus," first etymologically and then directly:

> All these terms … refer back to this *oikonomia*, that is, to a set of practices, bodies of knowledge, measures, and institutions that aim to manage, govern, control, and orient — in a way that purports to be useful — the behaviors, gestures, and thoughts of human beings. (Agamben 2009:12)

> Further expanding the already large class of Foucauldian apparatuses, I shall call an apparatus literally anything that has in some way the capacity to capture, orient, determine, intercept, model, control, or secure the gestures, behaviors, opinions, or discourses of living beings. (Agamben 2009:14)

Thus Agamben's definition of "apparatus" is even broader than Foucault's: it includes not only "prisons, madhouses, the panopticon, schools, confession, factories, juridical measures, and so forth," but also the pen, writing, literature, philosophy, agriculture, cigarettes, cellular telephones, and language itself (Agamben 2009:14).

Another vital point is that Agamben divides the universe into three: apparatuses, "substances" (that is, the living beings that apparatuses act upon), and subjects. To simplify, I would call these, respectively, *that which does*, *that which is done to*, and *that which is*. A subject — that which is — is the product of the struggle between apparatuses and the substances they act upon. This is a poststructuralist definition of subjecthood.

A feature of contemporary civilization, and contemporary capitalism, is the tremendous proliferation of apparatuses, which results in a multiplicity of subjectivities — to put it simply, a multiplicity of possible *identities*:

> The same individual, the same substance, can be the place of multiple processes of subjectification: the user of cellular phones, the web surfer, the writer of stories, the tango aficionado, the anti-globalization activist… The boundless growth of apparatuses in our time corresponds to the equally extreme proliferation in processes of subjectification. (Agamben 2009:14–15)

Now as Foucault has shown, in a disciplinary society, "apparatuses aim to create — through a series of practices, discourses, and bodies of knowledge — docile, yet free, bodies" (Agamben 2009:19). "Apparatus … is first of all a machine that produces subjectifications, and only as such is it also a machine of governance." For example, from the apparatus of penance and the mechanism of confession results "the production of a new subject, which found its real truth in the nontruth of the already repudiated sinning I."

So what does Agamben's expansive notion of the apparatus do for us? First, it calls attention to the religious origins of the concept. The problem of *oikonomia* is a problem of imposing divine order — an ethically sound condition — upon humanity. As we shall see below, all three ECCAs I discuss here — fair trade, socially responsible investing, and Islamic finance — have religious origins. This is not a coincidence, for all three are apparatuses aimed at tackling the fundamental problem of the moral economy: the problem of how to construct and govern an ethical system of exchange, and thus an ethical society that fulfills the will of God. Second, Agamben — like Foucault — shows how apparatuses generate new subjects, upon which they then depend for their survival and expansion. And as we shall again see below, these new forms of subjectification were crucial to the spread of fair trade, socially responsible investing, and Islamic finance.

PUTTING IT ALL TOGETHER: THE ETHICAL-CONSUMPTION CERTIFICATION APPARATUS (ECCA)

An ethical-consumption certification apparatus (ECCA) is a system for formally classifying and certifying market-produced goods and services according to standards of ethical consumption. Being an apparatus, it is heterogeneous and emerges at a particular historical moment; it is also oriented toward a particular strategic objective, even if no individual or group of individuals directs it. Like Callon's markets-*qua*-calculative-devices, an ECCA calculates and categorizes. However, its outcome variables are explicitly ethical (e.g. fair-trade-certified or not, socially responsible or not, shariah-compliant or not).

Crucially, following Foucault and Agamben, an ECCA performs subjectification: it generates particular types of subjects — or perhaps better, particular modes of being-in-the-world, with particular modes of concern and ethical orientation, and therefore particular possibilities for acting authentically toward those modes (Dreyfus 1991). In later chapters, I discuss the way the shariah-compliance apparatus performs subjectification: the way it not only certifies Islamic financial products, but produces new kinds of Muslim subjects and subjectivities.

* * *

In the next two sections, I sketch the emergence of two prominent ECCAs: fair trade and socially responsible investing. The history of these ECCAs is strikingly similar to the history of Islamic finance. All three have religious roots. All three emerged between the 1960s and 1980s from activists' dissatisfaction with existing capitalist markets. All three sought to re-embed free markets in collective ethics. From the 1980s onward, all three developed formal

certification systems that simplified customers' experience of ethical consumption. And in all three cases, great commercial success ensued from the 1990s onward.

From Christian handicrafts cooperatives to Starbucks coffee: The evolution of the fair-trade apparatus

Though commonly associated today with specially labeled coffee sold in Whole Foods or Starbucks, fair trade and its progenitor "alternative trade" were once associated with handicrafts sold at "Third World shops," church basements, and activist gatherings.

What changed, and why? Below, I address these questions by touching on the history of fair trade. This is not a comprehensive history, but a stylized periodization that elucidates how ECCAs have evolved under contemporary capitalism since the mid-20th century.

Roots: Alternative economies, Christian charities, consumer activism

The fair-trade system has roots in at least three types of ventures. The first is *alternative economies*: novel ways of reorganizing production, distribution, and/or consumption that aim to offer an escape from existing systems. In the 19th century and the first half of the 20th, this included cooperatives and mutuals, utopian industrialist schemes, and religious business movements (Low and Davenport 2005). These aimed at the construction of a better society — either locally or universally — through changes in the relations of production. In the 1960s and 1970s, globally minded alternative trade networks also emerged. Informed by dependency theory and the Bandung ethos, they sought to redress the structural inequalities of trade relations in the world-system. "Solidarity trade" was a movement to import goods from politically or economically marginalized regions of the Global South (Kocken 2006; Renard 2003). It explicitly opposed neo-imperialism. "Developmental trade" was likewise an effort by international development agencies and charities to support Southern producers with production and export while addressing unjust rules of international commerce (Gendron, Bisaillon, and Rance 2009:65; Kocken 2006).

The second is *charity initiatives* in the Global South — particularly Christian charities that originated in the Global North. Between World War II and the 1970s, some of these charities converted into development initiatives (Low and Davenport 2005), following the modernization paradigm and the Cold War expansion of foreign aid.

The third is *consumer activist movements*. In the the 19th and early 20th centuries, this included various boycotts and labeling movements. One example was the "white-label campaigns" launched by American middle-class female activists in the late 19th and early 20th centuries and peaking in 1904 (Schmelzer 2010). Clothing carrying the white label was

certified by the National Consumers' League to have been produced by manufacturers obeying state factory laws and avoiding overtime work and child labor. In Western Europe, similar movements existed, including the Christian Social Union's labeling system in England that certified manufacturing and safety standards (Schmelzer 2010:224).

First phase: Alternative trade

It was during the 1940s, 1950s, and 1960s that the organizational progenitors of today's fair-trade network was born — under the moniker "alternative trade." At first, Christian NGOs from Europe and North America sold handicrafts and other items made in the Global South, with the surplus being returned to disadvantaged groups: associations of the poor and unemployed, divorced and widowed women, the landless (Fridell 2004; Gendron et al. 2009; Low and Davenport 2005). Leading organizations included Oxfam (UK — founded by Quakers and other religious groups), the Catholic group S.O.S. Wereldhandel (Netherlands), the Mennonite Central Committee's SELFHELP Crafts of the World (North America), and the Church of the Brethren's Sales Exchange for Refugee Rehabilitation and Vocation (SERRV) (Fridell 2004:417).

The alternative-trade model persisted and grew through the 1970s and most of the 1980s. During this period, not only was production of the crafts "alternative" in that it supported disadvantaged peoples, but distribution too: the charities avoided profit-making importers or middlemen, instead selling the goods to customers via specialized "World Shops," in church basements, among student groups and activist organizations, and by mail order. Initially, it was not always the marginalized people receiving the surplus who produced the handicrafts — a decoupling that seems curious in retrospect given the standards that have emerged in the industry — but eventually, that become the norm. Hand-made craft products, visibly imprinted with the humanity and (exotic) culture of the producer, remained at the heart of alternative trade during this period.

From alternative trade to fair trade: Out of crisis, commodification

It was in the late 1980s, in response to multiple challenges and crises, that the alternative-trade network transformed into what would become today's fair-trade ECCA. This transformation was a dramatic rationalization of production, distribution, marketing, and authentication that re-engineered "alternative trade" as "fair trade."

The shift from alternative trade to fair trade is best understood by comparison (see Figure 18). Alternative trade, as discussed above, uses alternative distribution channels. The "ethical" surplus value it generates flows to marginalized groups in the Global South (the unemployed, the widowed, the landless); indeed, the marginalized character of those groups is a large part of the appeal marketed to consumers. Alternative trade does not impose rigorous certification standards to determine who is or is not worthy of receiving the ethical

surplus value. The discourse of alternative trade also tends to be highly politicized, often in terms of solidarity with oppressed peoples facing the injustice of impenetrable Northern markets (Low and Davenport 2005:147–148) — or, if not politicized, then phrased in the religious language of *caritas*.

Fair trade is alternative trade's precision-engineered alter ego. Fair-trade products are sold in supermarkets, coffeehouse chains, and other mass-market channels. The ethical surplus value they generate typically does not accrue to fractions of populations in the Global South disadvantaged by virtue of misfortune and selected somewhat arbitrarily. Instead, is distributed in a formally rational way via the labor market: fair-trade-certified producers must to adhere to specified wage standards and employment practices. Instead of handicrafts and other hand-made products that bear *prima facie* traces of the humanity and culture of the producer, fair-trade products are overwhelmingly *commodities*: coffee, tea, bananas, juices, sugar, honey, nuts, and over 130 others (Vidal 2004).

FIGURE 18: COMPARISON OF ALTERNATIVE TRADE AND FAIR TRADE

	Alternative trade	**Fair trade**
Prominence	1940s–1980s	1970s–present
Core products	handicrafts	commodity foodstuffs: coffee, tea, bananas, sugar, etc.
Core distribution channels	World Shops, activist fundraisers, church basements, mail order	supermarkets
Core targets of support	groups marginalized within their societies (e.g. the unemployed, the widowed, the landless)	all workers
Certification	informal or none	certification NGOs (e.g. FLO) monitor producer labor standards and environmental sustainability using quantitative metrics
Marketing techniques	humanize and exoticize products (e.g. "ethnic" handicrafts sold with a story about the group that made them)	certification labeling (e.g. Fair Trade Certified™)

Crucially, the commodification of ethical trade has required a formal rationalization of ethical distinction: fair-trade products now carry certification labels whose imprimatur is backed by a massive transnational apparatus of standards, certification algorithms, standard-setters, and monitoring agencies.

Why did alternative trade, focused on handicrafts, evolve into fair trade, which focuses on commodities? Multiple forces coincided in the 1980s. First, extreme volatility in coffee prices (see Figure 19) created immediate human suffering in many of the economies that

alternative-trade organizations were already serving. This accelerated the turn toward coffee and other commodity food products. (The coffee crisis of 1999–2004, during which real coffee prices reached lows not seen for a century (Goodman 2008:3), was similarly a major driver of fair-trade activity in the 2000s.) Second, recession in the Global North during much of the 1980s dampened consumers' inclination to pay extra for handicrafts and other niche products that they would not use on a daily basis. The raft of high-visibility aid fundraisers (such as Live Aid in 1985) may also have contributed to "aid fatigue" among donor-consumers (Goodman 2004:892). Third, competition increased in the market for "exotic" handmade craft products from the Global South as lifestyle retailers such as Pier 1 Imports and the Bombay Company appeared, often taking advantage of multilateral agreements that lowered trade barriers on textiles and other imported goods (Low and Davenport 2005:146). Fourth, the progressive expansion of health-and-safety regulations in the Global North blocked handicrafts using azo dyes, lead paints, and other inputs, increasing production costs.

While this shift from handicrafts to coffee and other food commodities opened new channels and customer segments to Southern producers, it also raised a problem. Without tangible evidence — in the form of "ethnic" or "exotic" handmade products — that their payment of surplus value was truly ethical, what connected consumers to producers on the other side of the world? How would they know their consumption was truly ethical?

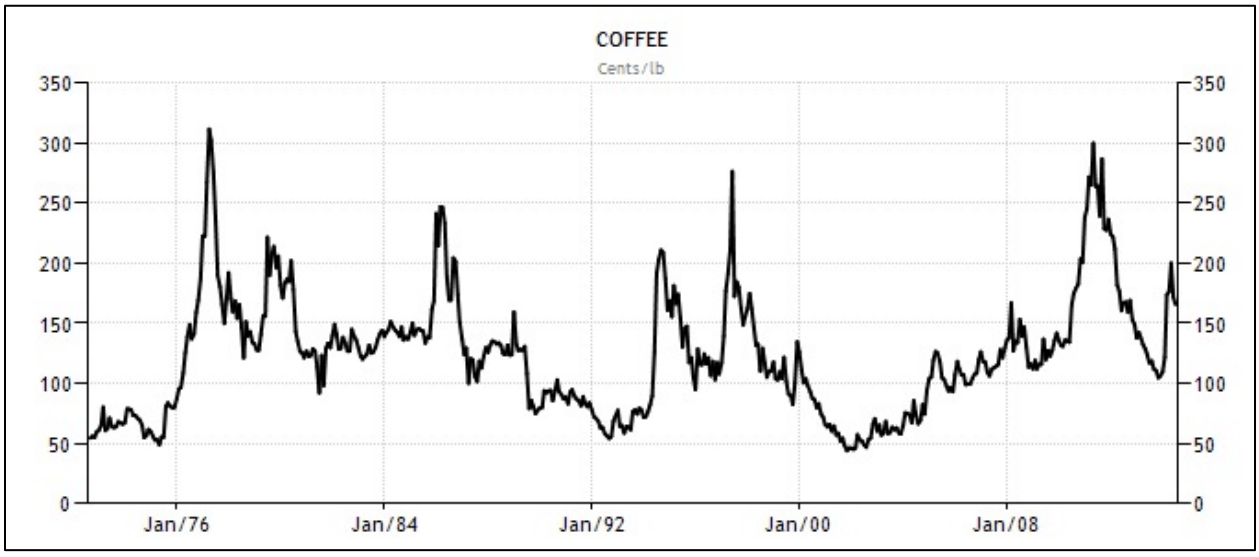

FIGURE 19: WORLD COFFEE PRICE 1972–2014, CENTS/LB.

Source: Trading Economics / Intercontinental Exchange (Trading Economics 2014)

The answer was certification. In 1988, the Netherlands' Max Havelaar became the first fair-trade coffee label. Max Havelaar was the creation of two Dutch clergymen, Frans van der Hoff and Nico Roozen, who were frustrated by the limited distribution network for alternative-trade coffee. Van der Hoff and Roozen were inspired by the peasants of Mexico's Unión de Comunidades Indígenas de la Región del Istmo (UCIRI), who realized that to achieve maximum benefit for their members workers, their coffee had to be sold in supermarkets to the average consumer (Roozen and Hoff 2002:99–100 in Gendron et al. 2008: 66). With the success of Max Havelaar, fair-trade coffee labels also appeared in various countries, including the United Kingdom (1994) and the United States (1998). And with the expansion of certification has come the standardization of certification: in 1997, Fairtrade Labeling Organisations International (FLO International) appeared to harmonize certification systems across borders. As the members of UCIRI expected, sales of fair-trade coffee boomed (see Figure 20). Certification agencies have subsequently diversified into new sectors. Figure 21 shows a typical example: the launch of Fair Trade Certified coconuts in the United States.

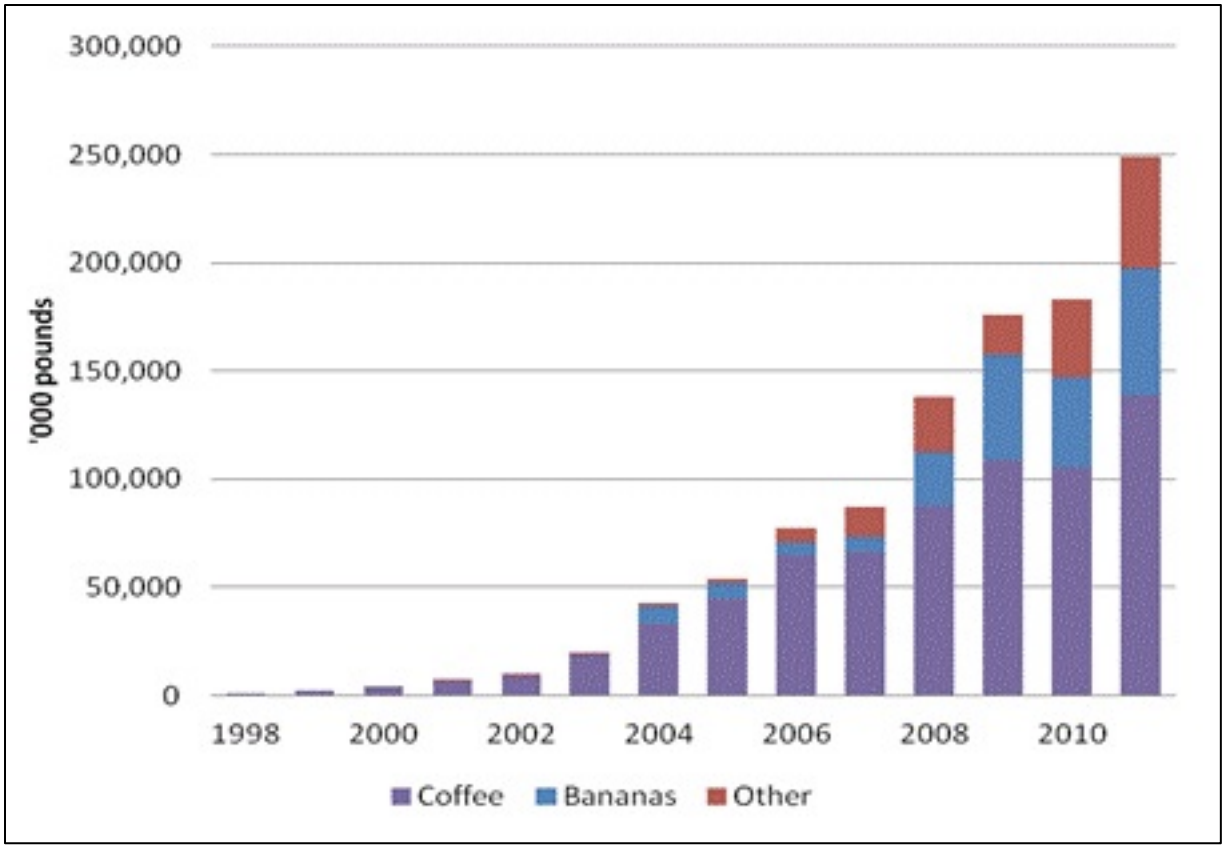

FIGURE 20: FAIR TRADE SALES IN THE UNITED STATES (taken from Elliott 2012; original data source Fair Trade USA 2011)

Fair Trade USA Launches Fair Trade Certified™ Coconuts

02/19/2014

Amid coconut boom, Fair Trade certification empowers farmers and workers to improve their lives and protect the environment

Oakland, Calif. (February 19, 2014) – Fair Trade USA, the leading third-party certifier of Fair Trade products in North America, today announces the launch of Fair Trade Certified™ coconut products into the global market. Beginning with coconut waters and oils, Fair Trade USA welcomes the versatile nut into its offerings with the aim of improving the lives of small-scale coconut farmers, and protecting workers in coconut processing facilities.

Although coconut products are booming in popularity, the individuals producing them are not reaping the rewards. There is a significant gap between skyrocketing sales in North America, and poverty-level incomes earned by farmers in key coconut producing economies. In the Philippines, for example, 60 percent of coconut farmers live in poverty.

FIGURE 21: PRESS RELEASE FROM FAIR TRADE USA, FEBRUARY 2014

The fair-trade apparatus generates new subjectivities

Fairtrade-certified products generate new subjectivities and cognitive geographies in consumers. Indeed, they generate new types of consumers: new subjects who experience new tensions and moral quandaries. While such consumers may be motivated by a general desire to "do good," their feelings are neither unproblematic nor naïve. Instead, they experience a welter of competing ethical imperatives and "gut feelings." For example, no consumer will pay an unlimited premium for ethical products, so ethical consumption involves compromises between ethics and cost (Boulstridge and Carrigan 2000). "A typical shopping trip will be a balancing act between my social conscience and the size of my purse," said one consumer (Adams and Raisborough 2010:263). And shoppers can be cynical as to whether ethical consumption makes a difference, sometimes seeing ethical certification as a "cynical marketing exercise" (Adams and Raisborough 2010:266). Academics can be cynical too. Some argue that ethical-consumption projects "greenwash" corporations' reputations while doing little good and even some harm, as by masking anti-union activities and other anti-progressive activities (Fridell 2007; Hudson and Hudson 2009; Žižek 2009:52–54, 98).

Further complicating the ethical character of ethical consumption it the impossibility of drawing a clear line between altruism and other motivations. One is the simple alleviation of anxiety and guilt: "I don't know much about Costa Rica," confessed one woman shopping for bananas in a British supermarket, but "at least [Fairtrade] takes the worry out of your shopping choices" (Adams and Raisborough 2010:265). To some consumers, presentation of self matters too. Just as conspicuous consumption signals wealth and success (Veblen 1994),

ethical consumption signals moral virtue and cosmopolitanism (Heath and Potter 2005; Pupavac 2010:478–480). This raises the question of whether ethical consumption is a fad, and whether it will channel surplus value toward its presumed targets or merely to the hippest ethical brands. To complicate matters further, consumers must navigate multiple mental geographies, confronted with a choice between buying locally produced goods or supporting faraway, unfamiliar peoples and causes (Adams and Raisborough 2008; Tallontire, Rentsendorj, and Blowfield 2001:5).

In a cognitive environment of competing imperatives, ethical consumers can hardly be expected to shop in a consistent or coherent manner (Low and Davenport 2007). Research on buying habits suggests consumers say they will pay extra for ethical products more often than they actually do so. Cowe and Williams describe the "30:3 syndrome": around 30% of consumers profess concern for companies' social and environmental responsibility, but ethical products rarely achieve more than a 3% market share (Cowe and Williams 2000).

The SRI apparatus

Religious roots

Like fair trade, socially responsible investing (SRI) is often described as having religious roots (Peifer 2011:237). Academic and popular sources on SRI often begin by stressing the the importance of rules governing financial activity and investment activity in Jewish and Islamic law (Louche, Arenas, and Cranenburgh 2012; Schueth 2003; see also Chapter One of this book). From the 18th century, many Quakers and Methodists avoided investments that funded slavery or war (Kreander, McPhail, and Molyneaux 2004; Schueth 2003). John Wesley, in his 1744 sermon "The Use of Money," enjoined Methodists "to observe that first and great rule of Christian wisdom with respect to money, 'Gain all you can'" — but without investing in those who hurt others, whether distillers and other sinners or employers who make their workers deal in arsenic "or the breathing of air tainted with steams of melting lead" (Wesley 1760). And in the era of modern investing, some SRI funds have retained religious connections. The first mutual-fund family to screen for social issues was established in 1971 by Methodist clergy (Shapiro 1992; in Peifer 2011:238), and religious mutual funds — including Catholic funds, funds affiliated with Protestant denominations, non-denominational Christian funds, and Islamic funds — today remain a part of the American mutual-fund landscape (Peifer 2011).

Vietnam and South Africa

Two geopolitical events served as catalysts for the ascent of institutionalized SRI: the Vietnam War and transnational mobilization against South African apartheid. This came against a backdrop of activist shareholders, newly empowered by legislation granting them greater rights (Fligstein 2002), launching a broader discourse of corporate social responsibility. In 1970, for example, Ralph Nader's "Campaign GM" was able to place two social-responsibility resolutions on the proxy ballot of the corporation's annual meeting. One sought to bind GM's operations to be consistent with "public health, safety and welfare" (Monks and Minow 2008:419). The gripping photograph of nine-year-old Phan Thị Kim Phúc running naked down a road in South Vietnam following a napalm attack led to condemnation of napalm manufacturer Dow Chemical and triggered broader investor sensitivity about support for arms manufacturers and other war profiteers (Vogel 2004:90–92). And in the 1970s and 1980s, divestment and disinvestment initiatives focused on South Africa to combat apartheid. In the second half of the 1980s, state and municipal governments, colleges and universities, unions, churches, and foundations faced pressure to avoid investing in companies that placed new investment in South Africa. These measures, together with international sanctions, trade embargoes, and cultural and sports boycotts, were successful in discrediting the apartheid-era regime (Paul and Aquila 1988).

The SRI ECCA appears

Responding to investor concerns, a growing number of mutual funds in the 1980s began marketing themselves as "ethical" or "socially responsible" by applying negative screens (a technique also widely used in the Islamic funds sector today). Some SRI avoided "sin sectors" such as alcohol, tobacco, weapons, and gambling; others screened based on environmental causes such as nuclear energy and pollution. Just as the South Africa divestment movement spurred funds to market themselves as South Africa-free.[112] High-visibility corporate environmental scandals such as the Bhopal Union Carbide gas disaster in 1985 and the Exxon Valdez oil spill in 1989 bolstered the market for environmentally oriented funds, and later, corporate scandals during and after the 2007–2009 financial crisis would benefit funds that screen in favor of corporate governance and transparency. Thus SRI funds respond to leading social, environmental, and governance concerns of the day, leading them recently to target climate change ("Is Your Portfolio Melting Polar Caps?" asks the website of the Forum for Responsible and Sustainable Investment, a leading industry group for SRI), sweatshop labor, and so-called "rogue states" and terrorism.[113] Behind all of these causes are

[112] As of 1988, the South Africa-free funds included New Alternatives, Calvert Social Investment Managed Growth Portfolio, Pioneer, Pioneer II, Pioneer Three, Pioneer Bond, Parnassus, Pax World, and Dreyfus 3rd Century (Paul and Aquila 1988:694).

[113] According to the Forum for Sustainable Investment's 2012 *Report on Sustainable and Responsible Investing Trends in the United States* (US SIF Foundation 2012), the top environmental, social, and governance (ESG)

rules and screening algorithms employed by fund managers and — since 1990, when the first SRI index was launched (Domini Social Index) — index operators as well. As of 2012, SRI assets in the United States totaled $3.7 trillion (US SIF Foundation 2012), or about triple the size of worldwide Islamic financial assets at that time. In sum, the institutionalization and growth of SRI since the 1980s blends religious roots, the ethos of the new social movements that began in the 1960s, and the expansion of mutual funds, pension funds, and other institutional investors since the 1980s.

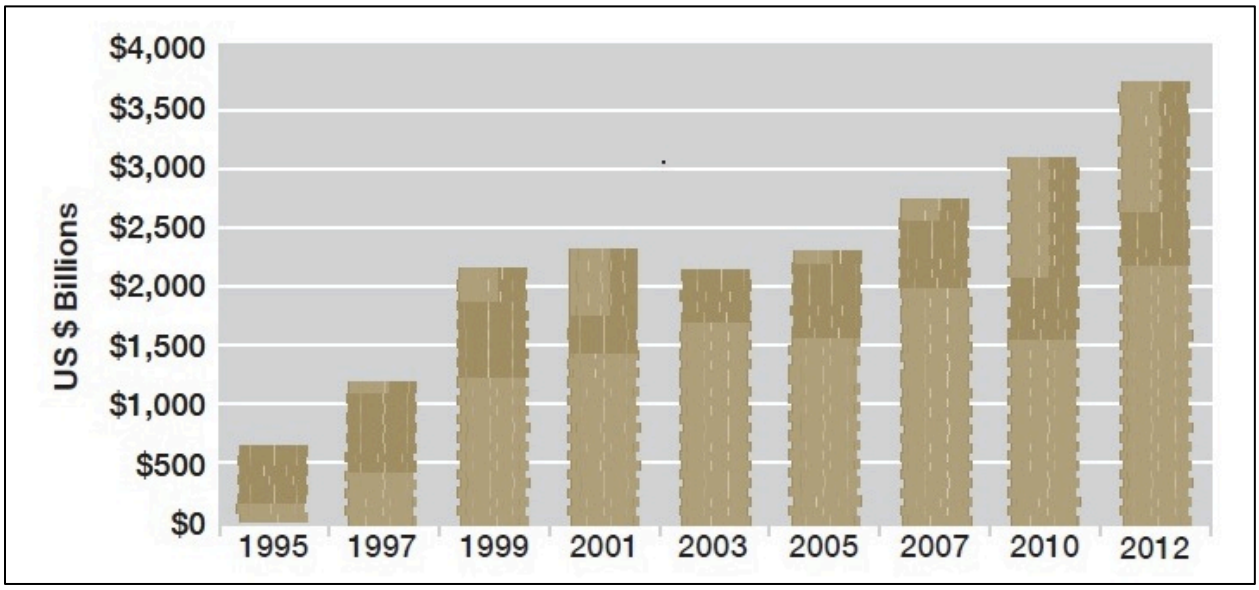

FIGURE 22: GROWTH OF SUSTAINABLE AND RESPONSIBLE INVESTMENT IN THE UNITED STATES (US SIF Foundation 2012)

A brief theory of ECCAs

Why ECCAs emerge: External forces

It is no coincidence that these three ECCAs — fair trade, socially responsible investing, and Islamic finance — all came of age in the 1990s and 2000s. The following external forces shaped them similarly.

considerations in 2012 for institutional investors were: #1-Sudan, #2-Iran, #3-Terrorist/Repressive Regimes, #4-MacBride Principles for Northern Ireland, #5-Executive Pay, #6-Board Issues, #7-Tobacco, #8-Climate Change/Carbon, #9-Labor, and #10-Political Contributions.

The decline of socialism and the rise of new social movements: Fair trade and Islamic finance both have roots in utopian alternative economic arrangements that sought to replace or radically alter existing capitalist practice (Chapra and Ahmad 1985; Chapra 1979; Siddiqi 1972, 1983a, 1985). Even SRI stems from trenchant critique of the sins that corporations commit when markets are left to operate freely. But the decline of class-based ideologies after the 1970s, the rise of neoliberalism, and the fall of the Soviet Union made activists who explicitly aimed to subvert free markets look like they were fighting against gravity. As revolutionary goals lost credence, new social movements — among which we can include Islamism here — set the stage for tempered moral-economy projects that sought to secure a niche within existing capitalist structures, not overturn them. The "mainstreaming" of identitarian politics, enviromentalism, and Islamic piety movements since the 1970s has also served to "mainstream" fair trade, SRI, and Islamic finance.

Financialization and the rise of shareholder-value capitalism: Following the mid-twentieth-century golden age of managerialism and the crisis of the 1970s, the balance of power within corporations swung in favor of shareholders and finance experts (Fligstein 2002), and the financial sector began to grow rapidly in the 1980s (Davis 2008; Krippner 2005). In SRI and Islamic finance, this created new financially literate customers, new demand for innovative financial products, apparatuses of financial certification and classification, and a hunt for new market niches by established conventional firms. At the same time, shareholder-value capitalism has the potential to distort the ethical vision of movement founders. Saeed bin Ahmad al-Lootah founded the world's first commercial Islamic bank, Dubai Islamic Bank, in 1975. When I asked him in 2013, at age 90, why he felt Islamic banking had strayed so far from what he felt were its ethical roots, he replied: "Because of the shareholders" (al-Lootah 2013).

The globalization of media, markets, and supply chains: The globalization of mass news media (Appadurai 1996) has made people worldwide more aware of the structural position of those on the other side of the globe, while also transmitting cognitive geographies of "the needy" and "the rich." The expansion of cross-border trade and investment has also given some consumers and investors a sense of global responsibility that has worked in favor of fair trade and SRI.

Information technology: Advances in information technology have made it much easier to develop certification technologies for ECCAs. Stock screening and portfolio allocation in SRI and Islamic finance are much easier to perform than 30 years ago, for example. Fair-trade labeling likewise benefits from digital transmission of compliance standards and data among producers, certification agents, distributors, and retailers.

How ECCAs emerge: The internal dynamic

Fair trade, socially responsible investing, and Islamic finance all began as social movements. In the 1960s and 1970s, they were led by social-movement activists who envisioned *alternative moral economies* in which new ways of directing capital would completely transform the existing economic order and establish a more just society. It is important to note that these activists envisioned not only "negative" agendas in which market forces would be subject to formal checks, but "positive" agendas for the establishment of a new order based on non-market economic forces.

Yet when these activists attempted to implement their visions, they ran up against the *paradox of scale*: the more they rejected existing capitalist markets and distribution channels, the fewer customers they would reach, the less economic clout they would enjoy, the less transformational potential they would have — and the less profitable they would be. As a result, the activists in each movement — or some portion of them — pursued market-friendly compromises in order to expand their customer bases.

As their products — fair-trade handicrafts and food products, socially responsible investments, and Islamic financial products — gained popularity, producers, distributors, and retailers from the existing conventional side of the market took notice. Some entered the "ethical" niche. In this increasingly crowded marketplace for ethical goods, providers turned to *certification agents* to demarcate their products as authentically "ethical." These certification agents developed and enforced precise rules for what did and did not count as an "ethical" product.

As products themselves and the technologies for distributing and marketing them grew more sophisticated, certification rules proliferated and the bureaucracy of certification became more and more complex, congealing into dense *ethical-consumption certification apparatuses* (ECCAs). By the 1990s and 2000s, the ECCAs were embedded in existing capitalist networks and distribution channels. This allowed ethical products to reach millions of consumers. But the ECCAs required technical experts to run them, not ideologues. As a result, the leaders of the moral-economy projects today are generally far removed from the radical and highly politicized agendas of the activists of the 1960s and 1970s. They no longer envision the revolutionary overhaul of capitalism, but seek to expand their share of capitalist markets. Thus the moral-economy projects have successfully achieved scale, but at the expense of ideological purity.

Chasing commodification without commoditization

Commodification refers to the process of turning something into a commodity. In Marxian political economy, a commodity is something with use-value that is exchanged or produced for exchange (Marx 1992, Chapter 1). In sophisticated regulated markets, goods and services must fulfill a range of conditions to become commodities: they must take some standardized form (as in the case of financial securities, which are at heart merely bundles of contracts), meet regulations (governing health, safety, credit risk, and so on), be marketed to customers, and find distribution channels. All of these activities require formal rationalization. This book is largely an exploration of what happens to financial instruments imbued with ethical and religious virtue when they are commodified.

Whereas commodification is a concept made famous by Marx and enjoying an august intellectual history, *commoditization* is a neologism that late-twentieth-century business-speak has left us. Commoditization is the process of a product losing its distinctiveness in the eyes of consumers — the dilution and disappearance of brand identity. So commoditization is the act of a product becoming a "commodity," but in the business-speak sense: a product undifferentiated from its competitors and seen as interchangeable, just as one bushel of wheat sold on the Chicago Board of Trade is indistinguishable from, and interchangeable with, the next. Cultural critic Douglas Rushkoff gives examples: "The collapse of Marlboro's brand value in the early 1990's convinced cigarette manufacturers that their products had become commoditized"; "Unless Intel comes up with a new kind of computer memory chip, Japanese equivalents will commoditize RAM" (Rushkoff 2005). Commoditization is every marketing director's bugbear.

Commoditization is particularly dangerous to ethically certified products. If customers stop believing that fair-trade bananas are any different from ordinary bananas, or that Islamic auto financing is any different from conventional interest-based financing, the market for the ethical product collapses. Ethical producers therefore make great efforts to brand, certify, market, and publicly defend their products as trustworthy and genuine. Later in this chapter, we see how producers in fair trade and socially responsible investing do this. In Chapter Four and Five, we see how shariah scholars work together with Islamic financial institutions to do this in Islamic finance.

A periodization of ECCA emergence

It is useful to compare Islamic finance to fair trade and socially responsible investing because all three are ECCAs that evolved in strikingly similar ways. The comparison allows us to develop a general theory of how ECCAs emerge and become entrenched in late-twentieth-century and early-twenty-first-century capitalism. This occurs in four phases.

PHASE ONE: Crisis. What begins as a relatively un-rationalized mode of "alternative," ethically oriented economic behavior faces some type of crisis. This may be a supply-side crisis, like the coffee crisis that launched institutionalized fair trade; or a demand-side crisis, like public suspicion about corporate values during the Vietnam War and apartheid that launched SRI. In the case of Islamic finance, the crisis was the failure of the profit-and-loss-sharing model of Islamic banking in the late 1970s.

PHASE TWO: Commodification. During the crisis, supporters of alternative moral economies face the "paradox of scale." The more they reject existing capitalist markets and distribution channels, the fewer customers they reach, the less economic clout they enjoy, and the less potential they have to do good and transform society. As a result, some or all of them commodify their offerings to reach a wider customer base. This involves making their products fit within existing standards, rules, and forms. In the case of fair trade, activists shifted from handicrafts (which are difficult to standardize) to coffee, developed certification systems like Max Havelaar for coffee, sold their products in supermarkets instead of specialized shops, and marketed the FairTrade label. In SRI, fund managers developed and marketed SRI funds. In Islamic finance, Islamic banks in the late 1970s and 1980s developed and marketed as "shariah-compliant" standardized non-PLS-based products that mimic conventional financial products by imitiating the effect of interest.

PHASE THREE: Mass-market growth. Commodification makes the ethical product accessible to mass-market consumers, leading to growth and institutionalization. In fair trade, SRI, and Islamic finance, this occurred in the 1990s and 2000s.

PHASE FOUR: "Bandwagon" (entry of established conventional firms). Attracted by growing revenues in the ethical-consumption arena, firms already established on the conventional (i.e., mainstream) side enter the ethical-consumption side. This can happen at the producer level, as in the case of conventional mutual-fund titans such as Dreyfus offering SRI funds or HSBC and Standard Chartered launching Islamic-banking divisions, or at the distribution level, as when Starbucks begins selling fair-trade coffee. Increased competition and the presence of large, established firms in the ethical-consumption market leads to further rationalization of production and distribution, increased visibility, increased demand for certification and standardization (including cross-border standardization), and regulatory accommodation of ethical products. In some cases, the rationalization of the production process is so effective that the "ethical price premium" — that is, the additional cost that

customers pay for an ethical version of the same product — drops to zero.[114] We can call this "price commoditization": even though customers trust that ethical products are distinctive and superior, they become accustomed to buying them at the same price as conventional products. (The other type of commoditization, "brand commoditization," is when customers no longer feel ethical products are distinctive and superior.) Price commoditization has already happened in retail Islamic finance, where a conventional auto financing and a shariah-compliant auto financing with identical terms can cost exactly the same, as we shall see in the next chapter.[115]

Conclusion

From social movement to consumer label:

The evolution of Islamic finance under contemporary capitalism

Between the 1960s and 1990s, Islamic finance evolved from a social movement into a consumer label backed by a complex certification apparatus. This chapter has traced the similar trajectories of two other moral-economy projects from the same era: fair trade and and socially responsible investing. (By "moral-economy projects," I refer to collective theoretical and practical ventures aiming to bring market behavior under ethical control.) In all three cases, we find the commodification of ethics via the marketization of social-change objectives and the establishment of an ethical-consumption certification apparatus (ECCA) that satisfies multiple stakeholders' demands for consistency and reliability by providing a formal labeling system for "ethical" products.

Why did all three moral-economy projects evolve similarly during this period? I argue that their internal dynamics and external conditions were similar. Internally, activists had to choose between their project's survival on one hand and its commitment to a revolutionary social vision on the other. Once they entered the marketplace, Islamic banks competed against conventional banks, fair-trade coffee brands against conventional coffee brands, and

[114] Indeed, the appearance of price uniformity due to competition (in this case, the entry of new competitors into the Islamic-finance market) is by some measures the sign that a (mature and efficient) market actually exists (Lie 1997:342).

[115] In Islamic haute finance, price commoditization is occurring in the sukuk market, which is an increasingly standardized and liquid market. Bond traders increasingly treat sukuk as "just another flavor" of bonds, and while there are transaction costs associated with structuring a sukuk (including getting the approval of expensive shariah scholars), those costs are declining as the market matures. On the other hand, Islamic syndicated financings and other often complex large-scale deals are always of a bespoke nature and therefore typically incur significant "Islamic" transaction costs due to additional documentation and arcane structuring needed to meet shariah scholars' demands. Lawyers and other experts in Islamic structuring extract much of this "Islamic premium" in Islamic haute finance. Chapter Four discusses this in detail.

socially responsible funds against conventional funds. This led to a cycle of ideological compromises for the sake of competitive survival. Externally, similar forces shaped all three movements: the decline of socialism and class ideologies, the globalization of markets and supply chains, the rise of shareholder-value capitalism, and the spread of information technologies. Together, the internal dynamic and external forces encouraged the instrumental rationalization and formal institutionalization of the moral-economy projects. By the 1990s and 2000s, these three ventures had managed to survive and grow only by discarding (or at best radically reducing) their political and ideological challenges to liberal capitalism and by converting themselves into niches *within* liberal capitalism.

Why is the concept of ECCA useful?

The examples of fair trade and socially responsible investing point to two reasons why the concept of ECCA is useful.

First, by creating a class that captures a diverse range of market behaviors (yet is narrower than just "moral economies" or "alternative economies"), the concept of ECCA opens new analytical doors. It takes the study of ethical consumption beyond just the study of consumer attitudes (e.g. toward socially responsible funds), of systems' efficacy in achieving ethical goals (e.g. in redistributing surplus value to coffee growers), and of the reasons why private certification systems emerge. Instead, it trains focus on the relationship between the operation of markets (drawing on political economy and organizational sociology), technical practice (drawing on the social studies of finance and, in the case of Islamic finance, the study of Islamic law), and the formation of subjectivities (drawing on anthropology and the study of religion). While all of these are interrelated, they are often not studied as such.

Second, the concept of ECCA highlights the tensions that arise between certification and ethics. In particular, it foregrounds the tension between the formal rationalities inherent in certification (and, more generally, in modern bureaucracy) and the substantive rationalities (*caritas*, environmentalism, love of God) that spurred the creation of ethical-consumption projects in the first place and that motivate consumers to patronize them.

Beyond doux commerce and "capitalism corrupts"

It is important to note that these tensions between the formal rationality of certification and substantive ethics cannot be reduced to a contest between the corrupting, inhuman force of capitalist bureaucracy versus the heroic, humane resistance of ethical true-believers. In studying morality in markets, we must move beyond a Manichean dichotomy that Hirschman identified: the view that capitalism either fosters moral virtue (the *doux commerce* theory) or crushes it (Hirschman 1982). This dichotomy — with its heaven-or-

hell binary — obscures the new subjectivities and moral categories that emerge from markets themselves. Yet it is my experience that with regard to Islamic finance in particular, observers (both scholarly and non-scholarly) tend to hew toward the view that the current practice of Islamic finance is either morally deficient (because of the corrupting force of capital) or morally virtuous. Avoiding these positions, I aim instead to answer a call posed by Fourcade and Healy, who call for the study of *dispositifs*:

> Clearly, it is time to combine the analysis of … moral discourses … with arguments about their cultural basis and the performative techniques that enact them. In this way, we see how markets are being actively moralized by the deployment of practical techniques, whether self-consciously (as in the case of social responsibility) or in the name of neutrality and objectivity (as in the case of efficiency). Indeed, many of the perspectives discussed above can now be understood not only as discursive arguments about the market, but also as practical *dispositifs* (to use a Foucauldian term) that work to bring markets in line with moral ideals so the processes that go on inside them can be considered legitimate… (Fourcade and Healy 2007:304)

Ethical contests and boundary work

How, then, do we study the new subjectivities and moral categories that emerge from the current practice of Islamic finance? A fruitful approach, I believe, is to focus on contestation within the ECCA.

I described above the "mass-market" and "bandwagon" phases of ECCA emergence. During these phases, the moral-economy project gains access to a mainstream consumer base through mainstream distribution channels. Large, established mainstream firms enter the heterofore "alternative" field of ethical consumption.

It is at this moment that new and fascinating tensions, debates, and struggles arise among stakeholders in the moral-economy project. The following questions arise:

- Are we staying true to our original values? What is our goal?
- Are new entrants, especially those entering from the conventional space, as committed to those values or as authentically "alternative" as longstanding firms in the alternative space?
- How do we justify our growing profits in light of our ethical mission?
- Having commodified our product offering, how do we stave off commoditization? In particular, as conventional firms enter the alternative space and the ethical price premium shrinks, how do we ensure that our products still stand out as "ethical"?

- Is the "ethical price premium" shrinking? That is, are customers willing to pay less and less extra money in order to get an "ethical" product?
- How do we ensure that stakeholders trust the certification apparatus and the certification agents? As certification rules proliferate, the certified product threatens to become an ethical "black box" whose ethical nature is understood only by a few expert certification agents. How do we balance the need for product compliance against the need for product transparency and simplicity?

Stakeholders in Islamic finance have posed such questions almost since the first commercial Islamic bank opened in 1975. But since around the year 2000, when Islamic finance began its current phase of rapid growth, these sorts of questions have gained more attention. Much of my fieldwork in Islamic finance consisted of exploring these debates and seeking to understand the relationship between the certification apparatus of Islamic finance (with shariah scholars at its center), the actual practice of Islamic finance (including the structuring of shariah-compliant instruments), and the new subjectivities and discourses that emerge concerning authentically Islamic economic piety. It is to these ethical contests and their protagonists that I turn in the rest of this manuscript.

CHAPTER FOUR

Shariah scholars

Introduction

> The loss of the moral community is the quintessential triumph of modernity. How this community can be revived under the clutches of the modern project is perhaps the most central and urgent question of all.
>
> - *Wael Hallaq (2011: 27)*

Islamic finance is an effort to revive the Islamic moral community by economic means. Yet Islamic finance is also a business, and a lucrative one. Being both an ethical project and a commercial one creates basic tensions — particularly for shariah scholars, the ethical arbiters of Islamic finance.

Between two fields

Shariah scholars live at the intersection of two universes.

On one hand, they are embedded in fields relatively autonomous from capital. Many of them — especially those who began their careers in the 1970s, 1980s, and 1990s — made names for themselves as Islamic judges. Many also advised ordinary believers before becoming full-time professionals in Islamic finance. (Even the world's most prolific shariah scholar, Sheikh Nizam Yaquby, described to me how he still makes time to return to his family's storefront in Bahrain and provide walk-in advice to those with everyday questions about how to live in accordance with shariah (Yaquby 2009).) This tradition of Islamic jurists acting as advisors on the daily practice of piety goes back over a millennium, as discussed in Chapter One; but it got a boost in the 1960s and 1970s, as discussed in Chapter Two, with the rise of Islamic revivalism, which promoted the concept (captured in the writings of figures such as Mawdudi and Sayyid Qutb) that Islam is a "total religion" that guides the believer in every facet of daily life. Shariah scholars are also embedded in academic fields beyond Islamic finance. They hold degrees in shariah and fiqh from the world's leading Islamic universities.

On the other hand, shariah scholars are deeply enmeshed in the capitalist marketplace of Islamic finance. The most prestigious scholars in the world earn large honoraria for each shariah board on which they sit — up to $100,000 per year or more. Such shariah boards meet only several times a year, and the most celebrated scholars in the world sit on over 50

boards. Leading scholars also earn honoraria by speaking at international conferences and lucrative seminars and trainings. Shariah scholarship in Islamic finance has become big business, especially for those at the top.

This presence in two fields creates a tension for shariah scholars. How do they maintain prestige and trust in the eyes of their scholarly peers and ordinary Muslims on one hand while also working hand-in-hand with the forces of capital on the other? This is precisely the same issue that Islamic jurists, and indeed Jewish jurists and Christian jurists, have always faced, as shown in Chapter One. How do religious jurists accommodate profit motives — including, today, those of large financial corporations — without looking like hired guns who are "selling out" their religion?

As we shall see in this chapter, the answer today — as it has always been — is for religious jurists to become *technical experts*. They succeed in reconciling their ethical obligations with the interests of capital by interpreting religious law as much as possible as a set of *impersonal formal rules*. Formally rational law requires technical experts, and technical experts can elide many of the most challenging questions about the social and ethical balance-sheet of Islamic finance. This approach to shariah is not so much a deliberate tactic to formalize Islamic finance as it is a deeply embedded part of the scholars' Weltanschauung. And as they have gained power and centrality in the field of Islamic finance, their formal-technical approach to Islamic economic ethics has suffused through the entire field.

The scholars' world

A HISTORY OF THE SHARIAH BOARD

An alliance is born: Traditional learning and new capital

When Saeed bin Ahmad al-Lootah founded Dubai Islamic Bank — the world's first for-profit commercial Islamic bank — in 1975, he appointed no shariah board, and had only arm's-length contact with Islamic jurists. Instead, he used his own knowledge of commerce and shariah to design financial instruments that avoided ribā (usury) (see Chapter Two). In general, the early Islamic banks of the mid- to late 1970s took inspiration from the writings of Islamic economists who advocated a partnership-based interest-free financial system, or simply from their own experience, as al-Lootah seems to have done.

In 1976, however, the first shariah board appeared. The world's second for-profit Islamic bank, Faisal Islamic Bank of Egypt, appointed a panel of shariah scholars to oversee its implementation of Islamic law. These scholars served as ethical arbiters by issuing fatwas, or Islamic juristic decisions, that guided the bank in avoiding interest and other unlawful financial activities.

The scholars also served to legitimate Islamic banking. Early capitalizers of the Islamic

banking system of the 1970s and 1980s, especially the Saudi millionaires Prince Muhammad bin Faisal Al Saud and Sheikh Saleh Kamel, wanted to know that the banks were going to be truly Islamic. Customers wanted to know that too. Institutionalizing the affiliation of well-known jurists with the fledgling Islamic banks thus increased trust in the banks. Banks already had a bad name among many Muslims, and businesspersons or governments alone could not sell a new form of banking to the masses (Siddiqi 2006).

Thus emerged what Monzer Kahf has called a "new power alliance between wealth and scholarship" (Kahf 2004). Islamic bankers in Egypt, Jordan, Kuwait, and elsewhere reached out to conservative jurists, many of whom came from or were aligned with the government-sanctioned "establishment ulama" in these countries. Steeped in traditional Islamic learning, and often with strong ties to famous madrasas such as al-Azhar as well as visibility and good reputations among the pious bourgeoisie of the Islamic world, the scholars helped the banks attract business. The scholars bestowed on the banks the symbolic capital associated with their traditional prestige. Meanwhile, the scholars themselves found the alliance attractive because it made their deep knowledge of classical Islamic commercial law suddenly more useful. Even though the first shariah boards were generally unpaid, the scholars gained status, visibility, and purpose by participating.

As Islamic banks began springing up around the Islamic world from the late 1970s onward, shariah scholars and Islamic bankers seeking baseline standardization of Islamic financial practices began to form an epistemic community (Haas 1992) via conferences and other networking events. The first Islamic Banking Conference, held in 1979 in Dubai, was an early example (see Chapter Two). While this conference did introduce murabaha, the majority of fatwas issued during the late 1970s and early 1980s by institutions such as Dubai Islamic Bank, Kuwait Finance House, and Faisal Islamic Bank of Sudan concerned profit-sharing products such as *mudaraba* and *musharaka* and trade-related instruments such as guarantees and bills of trade (Siddiqi 2006). According to one well-known observer of that day, "there was no conscious effort to find Islamic substitutes for conventional financial products" (ibid.) But this would soon change.

The arrival of Western banks sparks a turn toward replication

In the 1980s, the fledgling Islamic banks in the Middle East — especially those in the Gulf — were still minnows in a banking market whose biggest fish were (a) Western behemoths such as Citibank, HSBC, ABN AMRO, and Deutsche Bank and (b) Arab giants such as Saudi Arabia's National Commercial Bank, the venerable Amman-based Arab Bank, and National Bank of Kuwait (Sherbiny 1985). For many years, these titans had enjoyed a double benefit from their pious Gulf clients: not only were some of them fabulously wealthy, but many considered interest to be against their religion and therefore wanted no returns on their deposits. So for Citibank and its peers, rich pious Muslims were a bonanza.

The emergence of Islamic banks in the 1970s threatened to kill the big banks' cash cow. Middle Eastern corporate and high-net-worth clients began switching to the new Islamic banks, taking their hefty deposits with them. Others demanded that their Western bankers find a way to provide financial services that complied with shariah. One industry veteran describes the situation in the 1980s and early 1990s:

> Institutions in the West — Citibank, for example — they said, if we don't find something that we can sell to these guys, we're going to lose this market. It contains a pool of liquidity that we've always had access to. Now, if we don't come up with products to absorb this liquidity, it's potentially going to leave. (E. F. (anonymous) 2013)

By the 1980s, some of the wealthiest merchant families from Kuwait, the UAE, and Saudi Arabia were switching to Islamic banking.

In addition to corporates and rich individuals, governments began moving their *awqāf* funds into Islamic banks too. Awqāf (singular: *waqf*) are Islamic charitable endowments. Many governments of Muslim-majority countries have a ministry of awqāf that manages, among other things, the accumulated *zakat* (wealth-tax) payments of citizens. Awqāf funds represent the government's own commitment to Islamic ideals of charity and redistribution, so it is important that they appear as "Islamic" as possible. A lot of money is involved: Since zakat is an annual payment of 2.5% of the wealth (not income) of Muslims, these ministries manage billions of dollars. In some cases, government petrodollar revenues also flowed directly into the awqāf. This put even more pressure on Western banks to get into Islamic banking:

> The ministries of awqāf in the Gulf countries — these guys have a budget allocation from petrodollars. The minister [of awqāf] may be a[n Islamic] scholar, because usually [the government] get[s] some learned Islamic scholar [to run the ministry], or someone conservative close to the scholars. They're looking after orphans and widows; they're building mosques. So this guy says, "I'm not going to invest my *waqf* budget in anything not Islamic." He's not going to put it in Citibank.
>
> With this $1 billion or $2 billion, he says [to his bank], "Find something Islamic… We want you to come up with a way for us to invest our money in a manner in keeping with our belief system." And that's when financial services for the Islamic market emerged on a wide scale. (E. F. (anonymous) 2013)

Indeed, with the support of the major merchant families that are intertwined everywhere in the Gulf with the royal houses, governments — such as the government of Kuwait — themselves began backing and placing their funds in Islamic banks such as Kuwait Finance

House. The same happened in Bahrain, Qatar, and the UAE. The presence of trusted shariah scholars on the new Islamic banks' boards was crucial for attracting the newly mobile capital. Thus from the 1980s onward, the small fraternity of jurists who had "gotten in on the ground floor" of Islamic banking, familiarizing themselves with the world of finance and building on connections to the Gulf's ruling families and major banks and corporations, became powerful figures in the industry. Path dependence was strong. "They were accidental heroes," opines one economist and veteran industry observer (T. E. (anonymous) 2013).

THE SHARIAH BOARD TODAY

Since its institutionalization in the 1980s, the shariah board has come to sit at the center of organizational governance. Figure 23 depicts its relationship to other organs.

The Islamic financial institution could be of various types: an Islamic bank, Islamic insurance company, an Islamic investment fund, and so on. The institution's CEO and other executives report to a corporate board of directors. However, they also report to the shariah board.

Just like members of the corporate board, members of the shariah board are not *employees* of the bank. They do not receive a salary. They only meet several times a year. However, they do receive an honorarium for their time. For famous scholars, this honorarium can be as much as $50,000 to $100,000 per year, or more.

At a still higher level of governance, international bodies such as the Organization of Islamic Cooperation (OIC) have their own shariah boards, which are populated by elite scholars. However, their judgments are non-binding because they have no means of enforcement. Some countries also have national shariah boards, whose rulings may or may not be binding depending on the country.

In the 1980s and 1990s, internal shariah departments within the financial institution also became common. These monitor the application of the shariah board's rulings on a day-to-day basis — work too granular and time-consuming for the shariah board itself. The internal shariah department also works with product developers to create new shariah-compliant products.

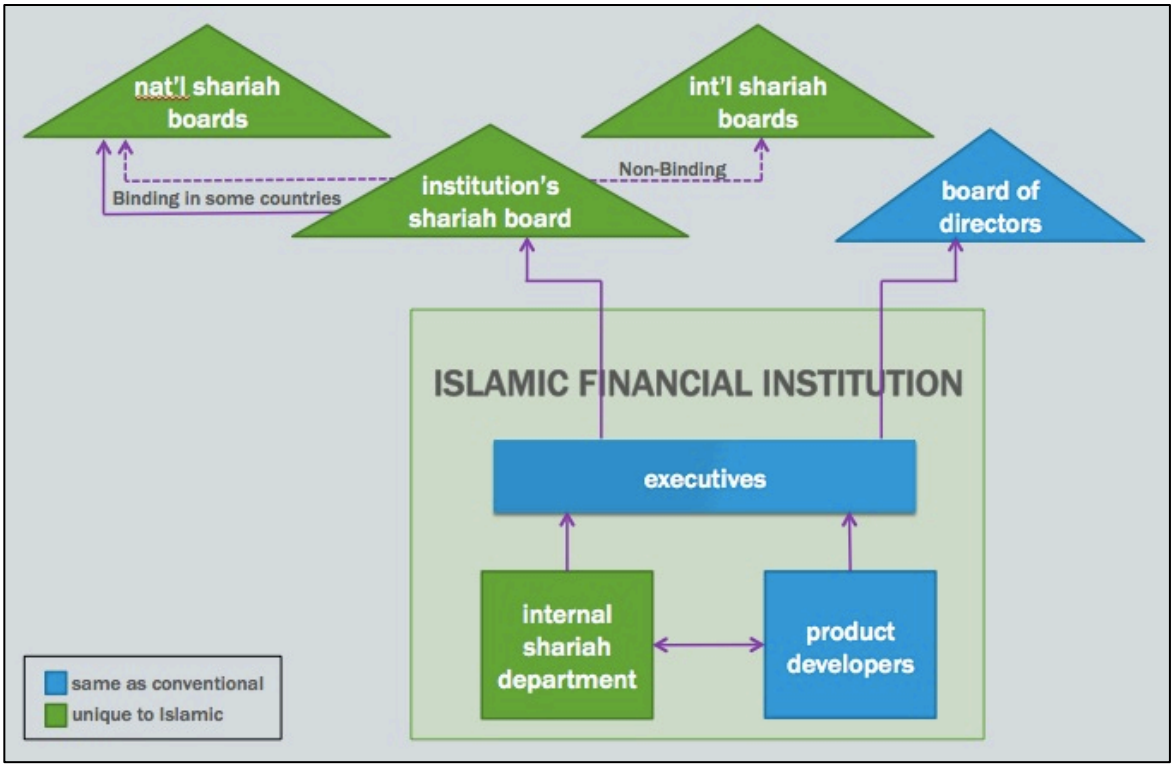

FIGURE 23: THE ORGANIZATION OF SHARIAH GOVERNANCE AT CONTEMPORARY ISLAMIC FINANCIAL INSTITUTIONS

THE SCHOLARLY ELITE

At international conferences on Islamic finance, it is easy to spot the elite shariah scholars. Whether in Kuala Lumpur, Dubai, Abu Dhabi, Doha, Manama, or London, flash bulbs pop when they walk on stage to participate in panel discussions or to receive lifetime-achievement awards from CEOs and heads of state. After they descend from the stage, audience members throng them, eager to shake their hands, proffer business cards, ask questions about points of Islamic law, and snap celebrity photos while standing next to them.

These are the Islamic-finance industry's "rock stars": the approximately ten to fifteen celebrity scholars who are known around the global community of Islamic-finance practitioners. Corporate clients request them by name. Discerning retail customers know them too, and feel comforted to see their familiar and reliable names on their bank's shariah board. The scholarly elite hail from around the Islamic world, though disproportionately from the Arab world. But they are global celebrities in that they serve on shariah boards and have institutional affiliations beyond their home countries.

Elite shariah scholars are name brands

The elite scholars are important partly because they have the power to attract customers to banks. Some customers are more likely to choose an Islamic bank if highly respected scholars sit on its board. This is certainly true of wholesale and large corporate clients, who are often keen to work with well-known scholars respected for both their religious learning and their innovative approach to Islamic financial structuring. But it is true of some retail customers as well. Ijlal, a young Indian shariah expert working at an Islamic bank in Abu Dhabi, said this:

> Many of these [retail] customers, they see that some great scholars are sitting [on the shariah board], and they trust them.
>
> Even my family members — when I tell them Sheikh Nizam Yaquby is sitting on our shariah board, they get confidence. That's why the bank needs the top scholars. (U. A. (anonymous) 2013)

In short, famous shariah scholars impart to customers peace of mind and a sense of legitimacy. The best-known American shariah scholar, Yusuf Talal DeLorenzo, put it this way: "I would rather have Tiger Woods endorse my product than some no-name golfer" (Power 2009).

Concentration at the top

One consequence of the name-brand status of famous shariah scholars is that there is tremendous concentration at the top of the profession. Figure 24 shows this using data from a 2010 survey of most of the world's shariah boards (Ünal 2011).

There were 370 shariah boards surveyed, with about 3 scholars per board, for a total of 1,171 board positions. Of these 1,171 positions, 450 were occupied by just 10 scholars.

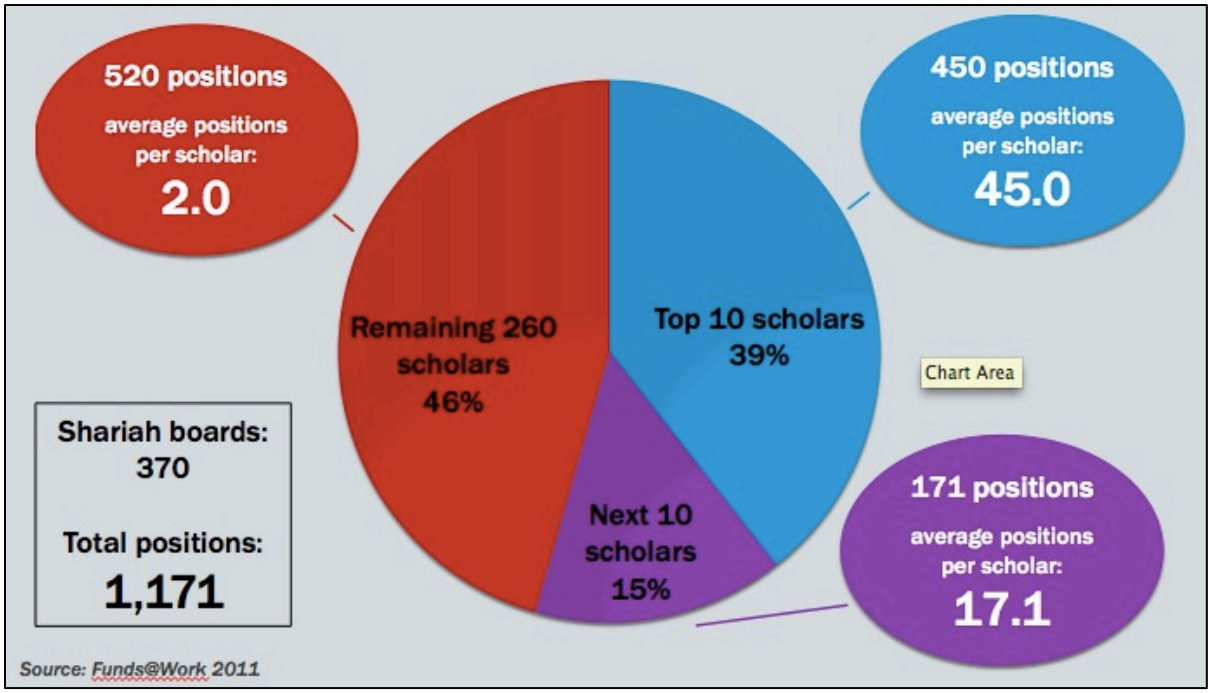

FIGURE 24: A SURVEY OF MOST OF THE WORLD'S SHARIAH BOARDS SHOWS THAT THE TOP SHARIAH SCHOLARS ARE PROLIFIC, OCCUPYING A HUGE PORTION OF THE WORLD'S BOARD POSITIONS (data from Ünal 2011)

The scholarly elite are tremendously busy. Figure 25 shows the top ten shariah scholars who sit on the most shariah boards worldwide. The top two scholars, Sheikh Nizam Yaquby and Dr. Abdul Sattar Abu Ghuddah, each sit on 85 shariah boards of Islamic financial institutions, which is astounding considering that shariah boards meet several times a year and members must attend in person.

FIGURE 25: THE TEN MOST PROLIFIC SHARIAH SCHOLARS IN ISLAMIC FINANCE (data from Ünal 2011)

But the vast majority of scholars are not so prolific: 77% of the scholars surveyed sat on only one or two shariah boards.

Top scholars are "good to work with": The language and habitus of haute finance

In addition to being knowledgable, I consistently hear from bankers and lawyers that the most famous scholars are, as one British lawyer put it, "good to work with." Success as a shariah scholar requires deep knowledge of shariah and fiqh. But today, it also demands facility in the world of international business and *haute finance*. This is a much higher standard today, in a world of Islamic derivatives and complex Islamic asset-backed securities, than it was in the early 1980s, when Islamic financial products were mostly basic trade-finance facilities such as deposit instruments and letters of credit.

The very existence of shariah scholars who understand finance is a function of Islamic finance's boom era, which began around the year 2000. Richard de Belder, a partner at the international law firm Dentons, is a tall, gentlemanly Belgian who has been involved in Islamic finance since the 1980s, making him an old industry hand. He describes a different era, when scholars were less informed about finance. He recalls trying to arrange a syndicated loan Islamically in London in 1994:

> These [shariah] scholars were very senior people in their field of scholarship, but they didn't know about international banking, or about secular law — especially English law. So it took a huge amount of time. I was trying to understand where they were coming from, and they where I was coming from. (de Belder 2013)

De Belder finds that today, shariah scholars are far more conversant in the nuances of financial deals and instruments.

Elite shariah scholars in Islamic finance must have a habitus consonant with the norms of international business because the process of structuring Islamic financial transactions involves a constant back-and-forth among shariah scholars, lawyers, and bankers. This is especially true in wholesale finance and corporate finance, where transactions are worth hundreds of millions of dollars and can be very complex. The groups concerned speak different professional languages and worry about different risks: shariah scholars about violating religious law, lawyers about violating secular law and financial regulation, and bankers about their competitors' strategies and their customers' credit. So personality and charisma must hold them together. For shariah scholars, lawyers, and bankers, working together is not only a matter of understanding juridical rules or market imperatives, but just as much a matter of interpersonal negotiation, navigation of cultures, and careful presentation of self:

> [We lawyers] might get irritated in private [while working with a shariah scholar to structure a deal]. You might leave the room and bang your head against the wall because you know you've got to redraft everything [because of a shariah scholar's objection to a legal structure]. But the [lawyers] who succeed are the ones who listen [to the scholars] and show a willingness to learn. If [the scholars] see someone who is willing to listen, learn, and understand what the issue is, then they will respond to you when you come back and say, "Look, sheikh, I know you're telling me to draft it in this way, but I can't do it" because of the legal issues. (de Belder 2013)

Lawyers and bankers know the right habitus and charisma for international business when they see it — and they do see it in the elite scholars. In my interviews, I found that the characteristics lawyers, bankers, and other specialists in *haute finance* valued the most in world-famous shariah scholars were not moral probity or even deep knowledge of religious texts, but rather the characteristics of the professional yet open-minded expert technician. They admired scholars who demonstrated quick, logical minds and cogently explained the technical restrictions that shariah imposed. The top shariah scholars have the habitus of high-ranking international professional-services providers: they are perspicacious, congenial problem-solvers. They listen well and think fast. They are "good to work with."

"I feel privileged to have had the opportunity to work with scholars like Sheikh Nizam Yaquby, Dr. Mohamed Elgari, and Dr. Hussein Hamid Hassan," said Paul McViety, an English lawyer who is head of Islamic finance at international law firm DLA Piper, naming three of the best-known shariah scholars in the world. "It's no wonder that they're so much in demand: they're so informative. They won't just tell you something's wrong; they'll go through a whole story to explain why" (McViety 2013). Paul Boots, a Dutch commodities expert who works with high-ranking shariah scholars in Dubai, finds himself impressed too.

> It was really cool working with the shariah scholars. Dr. Hussein was really on top of the fine points of what was going on. He didn't just say 'yeah, yeah, yeah' and sign whatever papers you put in front of him. He was following everything. (Boots 2013)

As these comments show, the respect that financial engineers and lawyers accord leading scholars often seems to stem from a shared love of technical problem-solving that transcends religious difference. Indeed, at the highest reaches of wholesale and corporate Islamic finance, many of these lawyers and financial engineers are not Muslim.

PEDIGREES: HOW DOES ONE BECOME A SHARIAH SCHOLAR?

While there is no single accepted route to becoming a shariah scholar in Islamic finance, the

common denominator for shariah scholars around the world is credentialied expertise in Islamic law (shariah) and Islamic jurisprudence (*fiqh*). Islamic commercial jurisprudence (*fiqh al-muʿāmalāt*), the branch of jurisprudence relevant to economic transactions, is especially valuable. (From a Western frame of reference, the closest parallel to the field of shariah scholars in terms of educational pedigree and work background is the field of legal academia.)

Formal and informal criteria in state-led and market-led jurisdictions

While Middle Eastern governments generally do not impose formal requirements for working as a shariah advisor, the governments of Malaysia and Pakistan do. This reflects a much greater state regulatory role in Islamic finance in Malaysia and Pakistan.[116] In Malaysia, shariah advisors must hold a degree in shariah from an institution recognized by the Malaysian government. They must also have prior work experience in Islamic finance, and must never have been convicted of fraud, securities offenses, or financial malpractice (Securities Commission Malaysia 2009). Reflecting its hands-on role, the Malaysian state also encourages shariah advisors to attend continuing-education workshops. In Pakistan, shariah advisors must have at least five years' experience giving religious rulings, familiarity with the banking industry, and at minimum must have completed the eight-year *dars-e-nizami* Islamic madrasah curriculum for youth. Higher Islamic studies are encouraged (State Bank of Pakistan 2004).

In the Gulf, although states (with the exception of Oman) lean toward a hands-off approach to shariah governance in Islamic finance, becoming a shariah scholar is not necessarily easier. In Saudi Arabia, religious education is widespread and the community of religious scholars wields great influence. Requirements to become a shariah scholar in the Kingdom are informal yet steep:

> In Saudi Arabia, official shariah qualifications [to become a shariah scholar in Islamic finance] are not a must, but unofficial shariah knowledge is a must. [Unofficial requirements include] very, very deep knowledge of shariah that can take from 20 to 50 years of studying directly under one of the most talented and recognized [religious jurists], memorization of the Holy Quran and a few thousand of the Prophet Muhammad's *ḥadīth*, mastery of the rules and tools for issuing *fatwa*, believing in and coming from the Ḥanbalī school of fiqh [the predominant school in Saudi Arabia], and the courage to use this knowledge in [issuing] fatwa, which is [effectively] equivalent to 'signing on behalf of Allah.'
>
> *Badr Albadran, an executive at Saudi Arabia's Al Rajhi Bank* (2014)

[116] and, bucking the Middle Eastern trend, in Oman, where ruler Sultan Qaboos Al Said only legalized Islamic finance in 2011.

So the split between state-led Islamic-finance sectors and market-driven ones correlates with different approaches to certifying shariah scholars. In Malaysia and Pakistan, the state requires official educational and professional credentials to serve as a shariah scholar in Islamic finance, whereas in Saudi Arabia and elsewhere in the Gulf, requirements are informal but nonetheless very steep.

Education

Leading shariah scholars hold undergraduate and graduate degrees from a combination of Islamic and Western institutions of higher learning. Figure 26 shows the institutions of higher education from which 320 shariah scholars around the world earned degrees (including both undergraduate and graduate degrees). Cairo's al-Azhar University, over a millennium old and the world's most renowned center of Islamic learning, appears often on the curricula vitae of major scholars, as do leading universities elsewhere in the Arab world and in Malaysia and Pakistan. But so do universities in the United Kingdom and North America. In the Islamic world, Western tertiary-education institutions carry high prestige. Because shariah scholarship in Islamic finance increasingly demands both classical Islamic learning and an understanding of transnational business and finance, it is not surprising that many shariah scholars have studied in the West.

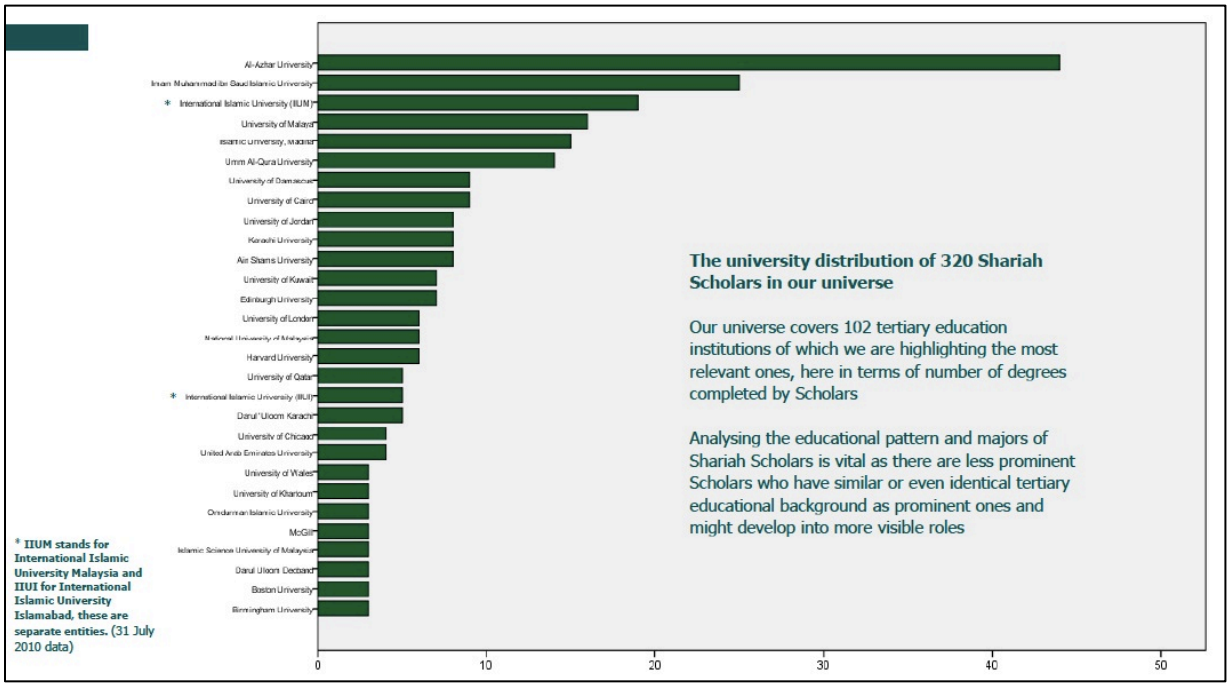

FIGURE 26: UNIVERSITY DISTRIBUTION OF 320 SHARIAH SCHOLARS IN THE FUNDS@WORK DATABASE, 31 JULY 2010 (Ünal 2011)[117]

[117] Attempts to learn the details of how Ünal sampled and surveyed the scholars used in this study have so far been unsuccessful. However, at 320 scholars, Ünal sampled a large percentage — perhaps a majority — of active shariah-board members worldwide as of 2010.

Shariah, fiqh, and other legal studies are the most common area of academic concentration for scholars. Aside from those, as Figure 27 shows, many scholars concentrate in either arts, economics, and finance.

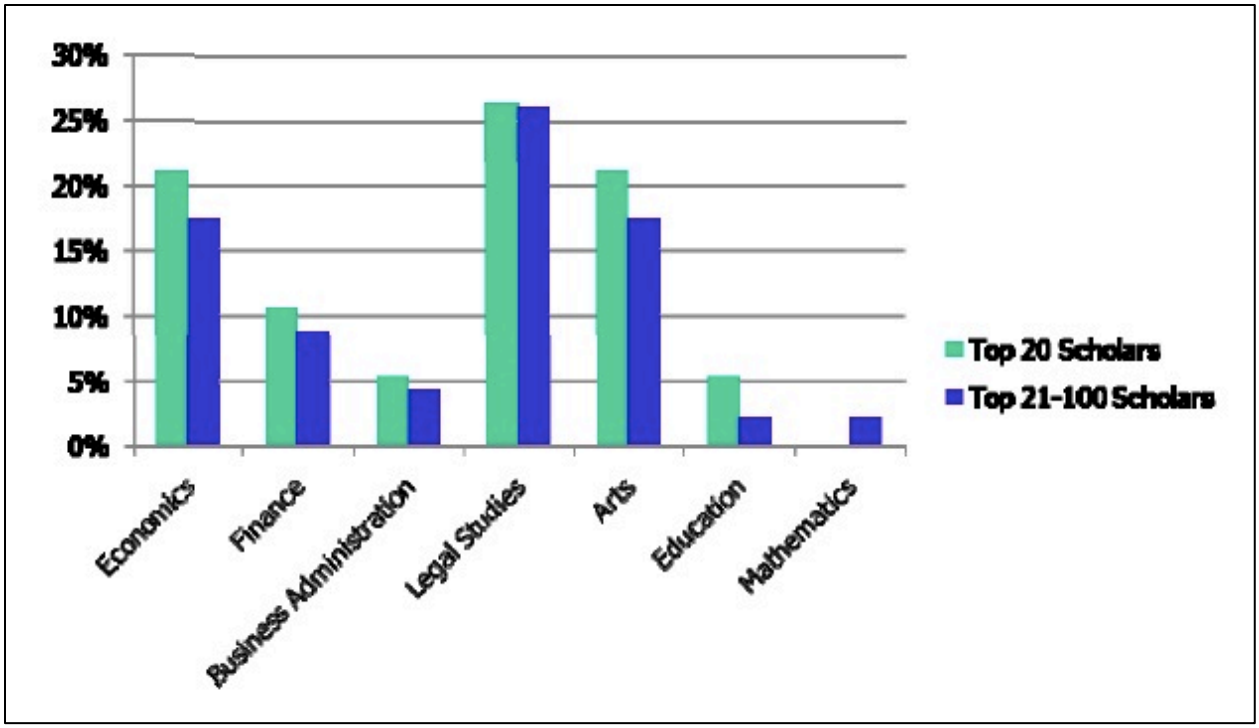

FIGURE 27: AREAS OF CONCENTRATION — OTHER THAN SHARIAH-RELATED FIELDS — FOR ACADEMIC DEGREES EARNED BY THE TOP 20 AND THE TOP 21–100 SHARIAH SCHOLARS (AS RANKED BY BOARD MEMBERSHIPS) (Ünal 2011)[118]

Career history

In addition to educational pedigree, today's leading shariah scholars have a relatively specific range of work backgrounds. In the past, many taught shariah, fiqh, and related fields at Islamic universities and institutes. Some still hold such teaching appointments. Many have published works in fields such as Islamic finance, Islamic economics, Islamic legal theory and principles of jurisprudence (*uṣūl al-fiqh*), Islamic legal methodology, and Islamic inheritance law. Some have also served as imam or *khaṭīb* (sermon leader) at mosques.

A few prominent shariah scholars have worked as judges or justices in national systems

[118] Categories do not sum to 100 percent. An "other" category may be omitted.

of Islamic courts — but as the field of Islamic finance grows more autonomous and active in its own right, the number of scholars with this parallel career experience in the judiciary is likely declining. As the level of financial expertise required to become a successful shariah scholar has increased radically in the past 15 years, and as Islamic finance has become much more lucrative, scholars are increasingly entering Islamic finance directly after completing their studies.

Language

> In Saudi Arabia… [to become a shariah scholar, one must have] very, very deep knowledge of Arabic language — 100 times deeper than [merely] what a native Arabic speaker has. One letter of the alphabet, such as *alif*, may take a few years to master.
>
> *Badr Albadran, an executive at Saudi Arabia's Al Rajhi Bank* (2014)

A strong knowledge of classical Arabic is essential for all shariah scholars because Arabic is the language of the Quran, the *aḥādīth*, and classical legal commentaries. Even outside the Arab world, such as in Malaysia, portions of conference proceedings on Islamic finance are sometimes held in Arabic, especially on shariah-related topics (as opposed to business-related ones). Even for scholars from within the Arab world, extensive study of the Arabic language is crucial because Quranic Arabic, somewhat like Latin to speakers of Romance and Germanic languages, has a complex and rigid grammar quite different from the various regionally specific dialects of colloquial Arabic. Curricula at Islamic schools and universities include many years of Arabic study, but Arab religious jurists' knowledge of Arabic often exceeds that. In Saudi Arabia, as the above quote shows, standards are especially rigorous.

English is increasingly important for shariah scholars too, though not necessarily essential depending on geography. The expansion and internationalization of Islamic finance since 2000, and especially the entry of multinational banks, have increased demand for English-speaking shariah scholars. Prominent scholars from outside the Arab world — such as Malaysia and Pakistan — generally speak very good English. The same is true of many leading Arab scholars, such as Sheikh Nizam Yaquby of Bahrain (who holds a Ph.D. in Islamic law from the University of Wales and a B.A. in economics and comparative religion from McGill University) and Dr. Mohammed Elgari (who holds a Ph.D. in economics from the University of California, Berkeley). However, some leading Arab scholars have middling or limited English skills. The concentration of capital and Islamic financial institutions in the Gulf region makes it possible for these scholars to do most of their work in Arabic.

To some extent, the elevation of Arabic as the language of religious study and English as the language of international business creates a cultural gradient in the industry against native speakers of other languages, such as Urdu and Malay. This is true even though much

of the theoretical work at the birth of Islamic economics in the middle of the 20th century was done in Urdu in the Subcontinent (Kuran 1997); Urdu publication in Islamic economics and finance remains lively today. Moreover, Karachi, Lahore, and Kuala Lumpur — among other cities — host important Islamic universities that are sending growing numbers of graduates into Islamic finance, some of them traveling from abroad to study at these universities. But at the same time, the linguistic and cultural gravity of the Arab world remains powerful in Islamic finance. Saudi Arabia's cultural weight is particularly strong. The Kingdom's position as the home of Islam's two holiest cities (Mecca and Medina) and as financier-in-chief of Islamic revivalism since the 1970s is buttressed by Saudi scholars' reputations for being strict on financial permissiveness.

PERSONAL HISTORIES

Unlike Sheikh Nizam Yaquby and the handful of other scholars listed above, most shariah scholars do not serve on dozens of boards and get thronged by admirers at every conference. That said, being a shariah scholar in Islamic finance has become an attractive career path for bright and hard-working students of Islamic law. Islamic finance offers the chance to put one's religious education to fruitful and pious use, serving the ummah[119] while earning a respectable professional-class living in the burgeoning financial sector. Personal histories from a few of the shariah scholars I met capture this.

Mufti Barkatulla, London

I met with Mufti Abdul Kadir Barkatulla in the basement of the London Central Mosque in Regent's Park on a fall morning. One of the United Kingdom's leading shariah scholars, and also involved in India's nascent Islamic-finance industry, he sits on the shariah boards of several major financial institutions, including Islamic Bank of Britain and Lloyds TSB. He had always appeared serious and august to me in gray beard, gray sherwani, and glasses when speaking before audiences about the finer points of Islamic financial structures. But in this little basement cafe, we sat over samosas on a paper plate and cups of tea. He was self-effacing and warm.

MUFTI ABDUL KADIR BARKATULLA

Despite his high profile in the United Kingdom, Mufti Barkatulla downplayed his relative

[119] The *ummah* is the community of Muslim believers.

importance in the world of Islamic finance. Remarking on renowned scholars from the Gulf I had previously interviewed, he wondered aloud why I might want to interview him too. "Even in the UK, there are many players [in Islamic finance]. I'm one of the humble ones." We spoke about his upbringing in Uttar Pradesh in northern India, the renowned Darul Uloom Deoband Islamic university from which he graduated, and his several years of study in Saudi Arabia and subsequent higher education at London Metropolitan University (B.Sc., economics) and the University of Wales (M.Phil., informatics and religious literature).

Mufti Barkatulla is today not only a shariah scholar, but a judge in the Islamic Shariah Council of the United Kingdom and a leader in the British Muslim community. He gives sermons and manages imams and teachers at major mosques in London, and regularly fields questions from British Muslims — in person and via his telephone help line — on everything from marital disputes to business disputes. After our interview, Mufti Barkatulla gave me a ride to Baker Street station in his small silver Volkswagen.

Mufti Aziz Ur Rehman, Dubai

Mufti Aziz Ur Rehman grew up in Tank district, far up in the Pashtun frontier regions of northwest Pakistan, near the Afghan border. "No education, no hospitals, no roads," he says of the village where he spent his youth. His father and grandfather were both religious scholars who ran a madrasah. "My father — this was the circle of his life," says Mufti Aziz, drawing a circle on the table with his finger and pointing three times within it: "From his house, to the madrasah, to the masjid (mosque)… for 65 years, the same routine."

Mufti Aziz's life path is the rags-to-respectability story of the upwardly mobile Pakistani migrant to the Gulf, but with a pious tilt. He attended secular schools in northwest Pakistan until Grade 10, studying math and science and English, then began his religious education, which continued for another 17 years. The life he now lives in Dubai was once a distant mirage:

MUFTI AZIZ UR REHMAN

> After 10 years of completing my madrasah education [in Swat, Pakistan], I came back home [to Tank] and got married. She was an orphan, from a very poor family, and my relative. At that time, I had no job, no nothing. But Allah *subḥānahu wa taʿālá* [may He be glorified and exalted] has given me an excellent wife, and an excellent life.

With these words, a tear came to Mufti Aziz's eye.

Eventually, the search for work in Islamic studies took him to the UAE. "*Alḥamdulillāh* [Praise God], I know seven languages" — English, Arabic, Persian, Urdu, Pashto, Saraiki, and Punjabi — "but I came [to the UAE] and started my career as a house maid," he explains. He recalls having to clean the home of a man who was always "drinking and dancing the whole night." Mufti Aziz then worked for a spell as a limo driver. "I waited for people at Dubai airport and Abu Dhabi airport with a sign. And now, when I go from the airport to a five-star hotel and there is a limo [driver] waiting for me, I give him respect." He went from limo driver to secretary, then to Islamic-studies teacher at a high school in Abu Dhabi for Pakistani students. He also took a four-year university correspondence course in fiqh (Islamic jurisprudence), waking up at 4:00 am to study eight to ten hours a day while also teaching Islamic studies and driving a taxi.

In 2006 or 2007, while Islamic banking was booming in the UAE, Mufti Aziz found himself teaching students who worked in Islamic finance. "One day," he recounts, "they said, 'Sir, why don't you come into this industry? It needs people like you, and we don't have enough shariah scholars.'" (Islamic-finance practitioners have long lamented the lack of sufficiently qualified shariah scholars.) So he began a degree in Islamic finance at a college in Abu Dhabi, graduating two and a half years later at age 40 and finding a job in the shariah department of a domestic bank. Several years later, after having proven himself, he became shariah supervisor of a non-bank financial institution in Dubai, where he still works. He also lectures on Islamic finance at a nearby business school.

ISLAMIC FINANCE AS AN EPISTEMIC COMMUNITY

Revival of a moribund discipline

The expansion of Islamic finance is changing Islamic education worldwide by creating a new career ladder and epistemic community. Sheikh Nizam Yaquby, the most prominent scholar in the industry, noted that Islamic finance has revived an entire academic discipline by creating job opportunities. "*Fiqh al-muʿāmalāt* (Islamic commercial jurisprudence) used to be the area students didn't care about at al-Azhar and other Islamic universities," Yaquby told me. During the 19th and early 20th centuries, Islamic commercial jurisprudence had largely fallen into disuse because colonial administrations and secular reforms had imported French and British commercial law. But today, Yaquby sees a change: Islamic universities around the world are starting to churn out graduates expert in Islamic commercial jurisprudence. "Now everyone wants to study *fiqh al-muʿāmalāt,*" he said. After all, working in Islamic finance is more lucrative than teaching at a madrasa, which is the traditional career path for graduates of Islamic universities with degrees in fiqh. Jobs in Islamic finance, whether as shariah-board members or in banks' internal shariah departments, also offer prestige, international travel, and the chance to rub shoulders with CEOs.

However, not all universities are handling the Islamic-finance boom in the same way. The contrast between Egypt and Malaysia is especially striking. Egypt's al-Azhar University, founded in 972 CE, has for centuries been the world's most prestigious Islamic educational institution. This is certainly still true, and as Figure 26 above showed, more of today's shariah scholars in Islamic finance hold degrees from al-Azhar than from any other institution. Around the world, a degree from al-Azhar continues to symbolize a first-class Islamic education. However, Al-Azhar's relationship with Islamic finance is contentious. Some leading Azharite scholars argue — against the vast majority of Islamic jurists worldwide — that Islamic law does not prohibit bank interest (El-Gamal 2008:139–147). This implies that Islamic finance is unnecessary, at least in its current incarnation.

In Egypt, jurists with strong domestic academic capital dealt blows to the rising transnational caste of shariah scholars and to the prospects of Islamic finance in the country. In the late 1980s, Egypt's grand mufti Sheikh Muhammad Sayyid Tantawi (1928–2010) issued a fatwa stating that conventional bank interest is not necessarily forbidden. Tantawi was a leading Azharite and would later become al-Azhar's rector. In 2002, the university's Institute of Islamic Jurisprudence doubled down on this position, issuing another fatwa confirming Tantawi's acceptance of interest. In 2004, Ali Gomaa, then the grand mufti of Egypt (2003–2013) and formerly chair of al-Azhar's department of Islamic jurisprudence, issued a fatwa legitimating conventional insurance. Just as Tantawi's fatwa obviated Islamic banking, Gomaa's fatwa obviated the fast-growing *takaful* (Islamic-insurance) sector. All of these rulings kept al-Azhar on the fringes of Islamic finance during the Mubarak years

(1981–2011) (Wilson 2012).[120]

In Malaysia, by contrast, the relationship between centers of domestic Islamic academic capital and the new Islamic-finance expertise is harmonious. Unlike al-Azhar, Malaysia's universities are riding the wave of Islamic finance. The International Islamic University of Malaysia (IIUM), the country's leading Islamic university, now offers tracks in Islamic finance at the bachelor's, masters, and doctoral levels. Among its faculty are several of Malaysia's leading shariah scholars. In 2005, the Malaysian government also established INCEIF, the world's first business school devoted entirely to Islamic finance.

As a result of such efforts, Malaysia — unlike Egypt — has become a magnet for students worldwide who are pursuing careers in Islamic finance. While al-Azhar can offer a prestigious education in Islamic jurisprudence, the current generation of students interested in Islamic finance are increasingly looking for a combination of juristic and financial learning. They differ from today's elite scholars, the graybeards who earned their degrees well before universities offered courses in Islamic finance.

The case of Abbas, a young transnational shariah expert

Abbas[121] exemplifies the new generation of transnational shariah experts educated in Malaysia. Now in his early 30s and working in the shariah department at an Islamic bank in the Gulf, he grew up in a conservative Muslim family in a medium-sized city on India's Malabar Coast. When I meet him at a mall coffeeshop, he is wearing casual western clothes and a short, thick beard. He greets me with a warm, broad smile and speaks with a quiet confidence. Abbas has one brother who works as a doctor in Abu Dhabi and another with an MBA who works in finance in Bangalore, but their father, a businessman, encouraged Abbas from an early age to pursue Islamic studies. His secondary education, undergraduate studies, and first master's degree were through the Nadwa system in India, which hybridizes

[120] However, it is important to note that not all *shuyūkh al-Azhar* (Azharite scholars) share the views of Tantawi and Gomaa that conventional banking and insurance are acceptable. Al-Azhar is an intellectually and socially diverse institution, and the positions of its ulama constantly shape, and are shaped by, new social and economic trends. On the modern history of al-Azhar and its ulama in the cultural and political life of Egypt, see the work of Malika Zeghal (Zeghal 1996, 1999, 2007). Zeghal notes how al-Azhar has long brought together multiple streams of Egyptian and international thought thanks to its "internal diversity and complexity… on the social, economic, political, and ideological levels" (2007:114). *Contra* the received wisdom of modernization theory, in which the Azharite ulama — and ulama across the Islamic world more broadly — are traditionalists whose antiquated learning is being left behind by "modern" education, Zeghal argues that the postcolonial Egyptian state "recentered" the Azharites instead of weakening them. The vocal role that the Azharites have played in post-Mubarak Egyptian domestic affairs has already borne out this conclusion, including in the Egyptian state's Islamic-finance policy.

[121] not his real name

classical Islamic education and contemporary sciences.[122]

Abbas's tertiary education shows how rising forms of Islamic academic capital, exemplified by Malaysia's centers of Islamic-finance training, sometimes prove more attractive than the traditional prestige of al-Azhar. In the mid-2000s, after graduating from Darul Uloom Nadwatul Ulama in Lucknow and hoping to pursue his Islamic studies further, Abbas considered several international options. His first choice was to study in the United Kingdom, and he applied to SOAS in London. But since his entire schooling had been in Arabic and Urdu, his marks in English were not quite strong enough for SOAS. Instead, he earned a scholarship to al-Azhar and headed to Cairo. Although the scholarship provided a plane ticket to Cairo and accommodation, Abbas found to his dismay upon arriving that the paperwork and other administrative requirements for foreign students at al-Azhar were such a "headache" as to be virtually impossible to navigate. Despite staying in Cairo for five months, he was hardly able to attend any classes at al-Azhar. After that experience, he made his way to Kuala Lumpur, where he found pursuing Islamic studies to be a more streamlined experience. He graduated from IIUM with a master's degree in Islamic jurisprudence, developing an interest along the way in Islamic finance and meeting students from around the world. Abbas noted that while the Malaysian professors he encountered might not have quite as "profound" a knowledge of Islamic law as the leading Azharites, "they're good at applying what they know to modern issues." Al-Azhar is "very good in the traditional way, but very disorganized," he lamented. "Plus, they hardly teach any foreign languages [besides Arabic]." By contrast, Abbas's Malaysian education stressed English, and " Abbas moved on to earn a Chartered Islamic Finance Professional (CIFP) certificate at INCEIF, the Islamic-finance university in Malaysia, and quickly landed an internship with the Islamic-finance division of a major multinational bank. His qualifications eventually earned him a plum job at an Islamic bank in the Gulf, where salaries are higher than in Malaysia.

SHARIAH SCHOLARS AND THE BLACK BOXES OF ISLAMIC FINANCE

Islamic financial instruments as black boxes

One of this book's main observations is that since the 1980s, Islamic finance has constituted a new regime of ethical certification. I call this the "shariah-compliance apparatus": an actor-network of expert technicians, abstract rules derived from classical Islamic jurisprudence, algorithms, and other calculation devices. Collectively, the shariah-compliance apparatus certifies the "Islamicity" of a financial product, enclosing ethical and political questions about

[122] One of the three major Islamic revivalist educational systems that emerged in India in the second half of the 19th century, Nadwa strikes a middle path between the more classically oriented Deobandi system and the self-consciously modernizing Aligarh system.

what it means to be Islamic in a black box accessible only to trained technical experts (Latour 1999; MacKenzie 1990).

Blackboxing occurs in conventional financial markets (MacKenzie 2005), but it is especially prominent in Islamic finance because Islamic financial products are internally more complicated than their conventional counterparts. This complexity stems primarily from efforts to avoid interest. Diagrams can show the difference in complexity. Figure 28 shows an interest-rate swap, which is the most widely used type of derivative in the world. It swaps a floating interest rate for a fixed interest rate. Figure 29 shows a profit-rate swap, which is the Islamic version of an interest-rate swap. It is not necessary to understand each instrument's internal mechanics to see that a profit-rate swap is much more complicated internally.

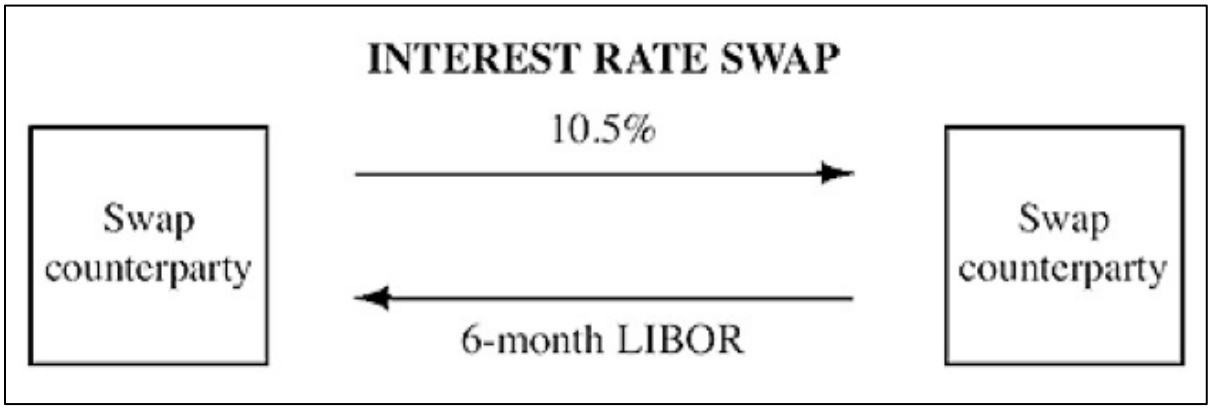

FIGURE 28: STRUCTURE OF A (CONVENTIONAL) INTEREST-RATE SWAP

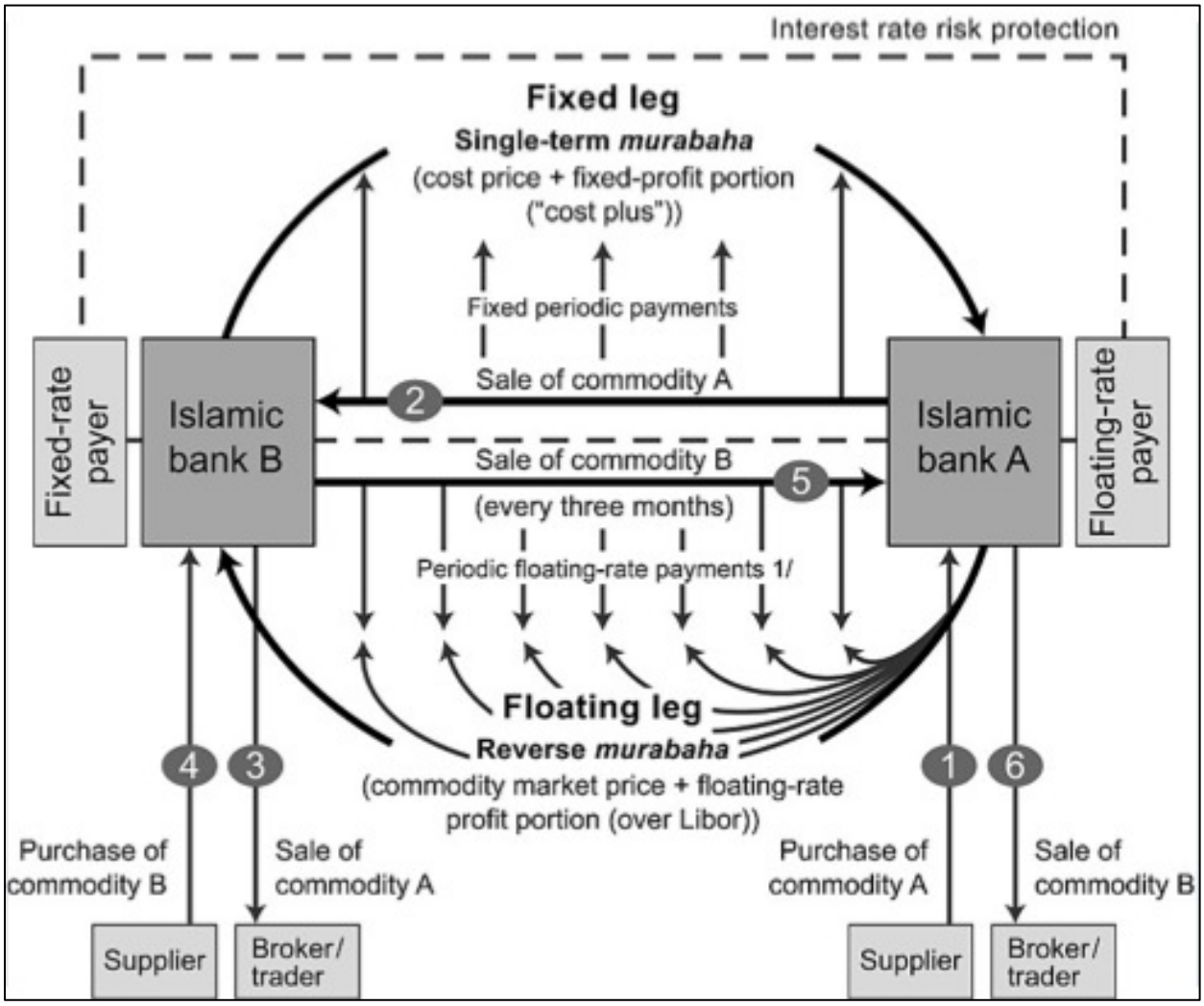

FIGURE 29: STRUCTURE OF AN (ISLAMIC) PROFIT-RATE SWAP

These two products perform the same economic function. But the Islamic version has a much more complicated structure. Only it has been approved as shariah-compliant by shariah scholars (or some of them, anyway).

Blackboxing gives consumers a convenient binary choice between products that are "shariah-compliant" or not. This is much like the choice between fair-trade coffee and ordinary coffee (see Chapter Three). Bruno Latour defines blackboxing as

> the way scientific and technical work is made invisible by its own success. When a machine runs efficiently… one need focus only on its inputs and outputs and not on its internal complexity. Thus, paradoxically, the more science and technology succeed, the more opaque and obscure they become. (Latour 1999:304)

In this sense, Islamic financial products are like mobile phones. One need not understand their inner workings to buy them and use them. One can just compare pricing and features.

Yet crucially, the shariah-compliance apparatus not only *certifies* shariah-compliance; it actually *constitutes* and *defines* shariah-compliance as a new form of expertise, a hybrid of classical Islamic jurisprudence and contemporary financial practice. Thus the marketization of Islamic finance is changing shariah itself.

Shariah scholars are at the center of the shariah-compliance apparatus. They are simultaneously its ethical arbiters and important technical experts in the new science of Islamic financial engineering. They both help design the contents of the black box and certify that those contents are halal. In doing so, they produce new ethical categories (Fourcade and Healy 2007) — new 21st-century ways of being pious.

One way in which shariah scholars facilitate blackboxing is by sitting on shariah boards and thus lending their moral imprimatur to products. As we saw earlier in this chapter, both institutional and retail customers place more trust in an Islamic bank if they see a familiar shariah scholar sitting on the bank's shariah board. This absolves customers of the ethical responsibility to understand how the product works. I asked a young Pakistani Islamic banker working in the United Arab Emirates whether most customers understand how the products they are buying work. He responded thus:

> They simply don't understand. For a very, very large majority of retail customers, the banker puts in the 'Sign Here' stickers [to seal a financing], and the client signs. The client doesn't know what he's signed, but he has his financing, and the bank has its business, so everyone's happy.
>
> Even mid-sized corporates don't care what the bank does with the documentation as long as they get the money. (S. H. (anonymous) 2013)

Habib Ahmed, a professor of Islamic economics at Durham University, compared Islamic financial products to halal meat products, and put the onus on himself and his peers to do the inspecting:

> Most customers go to an Islamic bank because they want some financial services. They go to a bank saying, "We don't ask a lot of questions if a shariah scholar approved it." You don't go to a halal butcher and ask how the meat was slaughtered.
>
> So I think it's up to civil society — including academics, people who know what's going on, unlike the average client — to monitor these things. (Ahmed 2013)

Via the blackboxing process, shariah scholars allow customers to distance themselves from the technical-ethical problems of Islamic finance. In this sense, shariah scholars are a bit like undertakers: they not only take care of the details, but by being the somber face of technical reliability, they keep consumers from having to know or care about the messy issues that might arise in sorting out those details. They provide a comfortable epistemic distance.

Blackboxing makes consumer choice easy

Just as the fair-trade apparatus reduces the complex problem of global economic inequality to a binary choice between regular coffee and fair-trade coffee, the black boxes in which the shariah-compliance apparatus encloses Islamic financial praxis reduces Islamic economic piety to a simple choice between conventional financial products and shariah-compliant ones. By mimicking interest, the shariah-compliance apparatus even helps consumers make an "apples-to-apples" price comparison.

It is worth seeing an example of how similar conventional and Islamic financial products can be from the customer's perspective thanks to Islamic financial engineering. Figure 30 shows the websites for Malaysia's CIMB Bank (a conventional bank) and CIMB Islamic (its Islamic subsidiary). It shows new-car financing rates for both. Nearly everything is identical, including the rates. The only difference is that while CIMB offers *interest* rates, CIMB Islamic offers *profit* rates. This is because whereas CIMB earns *interest*, CIMB Islamic earns a *profit* on the difference between buying the car at one price from the dealer and selling it a higher price to the customer.

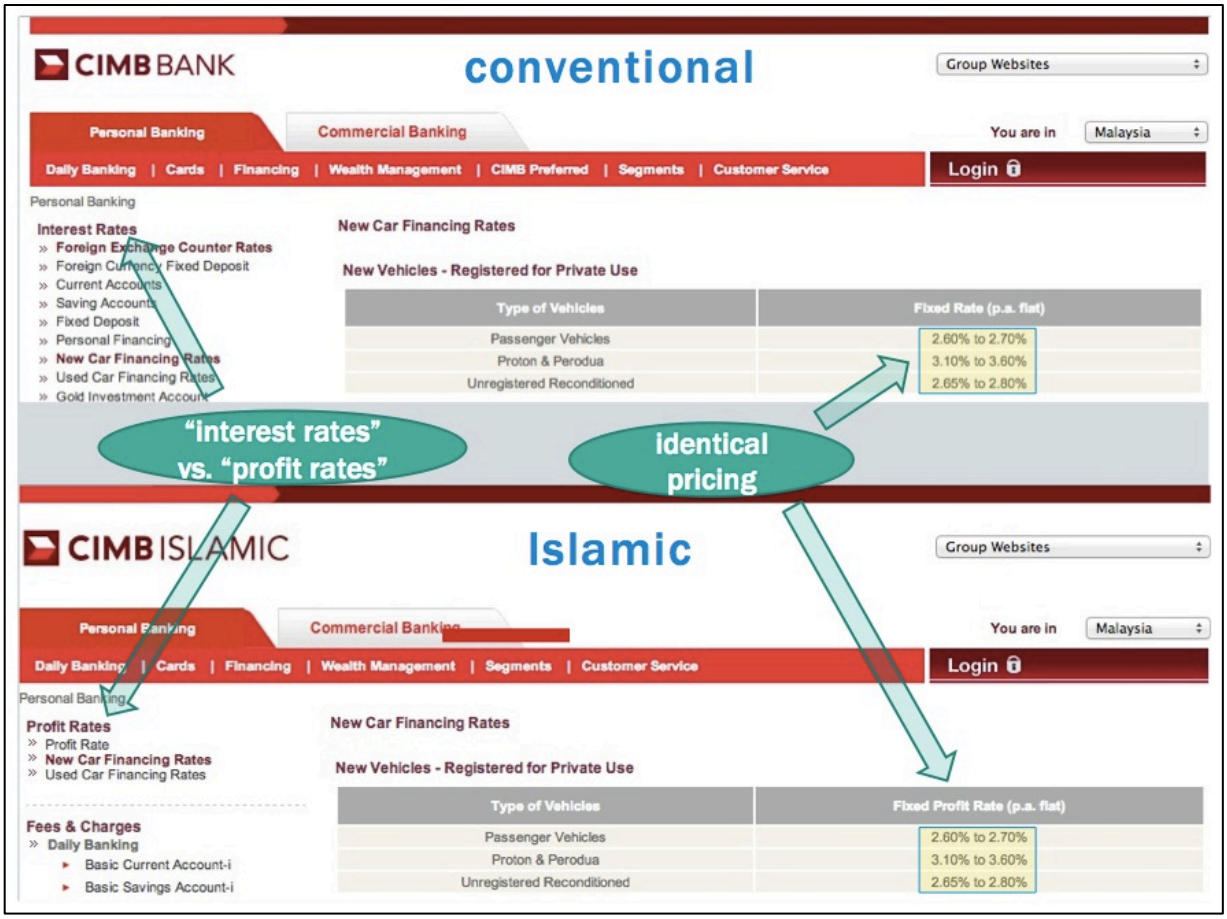

FIGURE 30: NEW-CAR FINANCING RATES FROM THE WEBSITES OF CIMB BANK AND CIMB ISLAMIC

This shows how effective the shariah-compliance apparatus has been in streamlining the cognitive and emotional moment of ethical consumption. The customer need not be concerned about how exactly the Islamic product differs from the conventional one in terms of internal structure. She need not even decide whether it is worth paying a price premium for an Islamic product. CIMB and CIMB Islamic have made the choice as effortless as picking a flavor of ice cream.

The ethical dilemma of blackboxing

Blackboxing creates an ethical dilemma. On one hand, it undermines one of Islamic finance's alleged virtues: transparency. Advocates of Islamic finance assert that it avoids the dangerously opaque sort of financial instruments implicated in the 2007–2009 financial crisis. Rasheed al-Maraj, governor of Bahrain's central bank, makes this case:

> In Islamic banking, there is no black box that needs a genius to unwind it. Many of these conventional products that have been under stress lately are very complex and need special risk management tools. In Islamic banking you will not have this kind of thing. Some of these products would not be sharia accepted. (Marshall 2008)

But on the other hand, putting Islamic financial engineering in a black box gives banks a competitive advantage. If an Islamic bank reveals exactly how it structures a product that avoid usury, other banks could copy it. "Shariah-board meetings are very secret," notes one shariah-department member working in the UAE. "Hardly anyone is allowed in there — only those who have a direct relationship with the issues raised in the meeting" (U. A. (anonymous) 2013). The vast majority of Islamic banks also keep their shariah boards' fatwas secret, guarding them as proprietary formulas. Another shariah-department member based in the Gulf describes a conference lecture by a shariah scholar:

> One very well-known shariah scholar was in a conference discussing a [product] structure [based on the *salam* contract] to be used in an Islamic hedge fund. He kept moving from the right side of the diagram to the left side. Then, a conference participant [sitting in the audience] who was diligently following the presentation said, "you mentioned the structure and kept going from A to C. But we're very interested to know how B works." And the scholar said, "That's what you pay me for." (A. L. (anonymous) 2013)

Some industry observers worry that conflicts of interest may arise when the same handful of elite scholars serve on so many boards (Hassan and Mahlknecht 2011:122), overseeing black-box products in secret meetings. "There's a potential case of conflict of interest, and a case of information leakage or perhaps competition impact," notes Mohamad Nedal Alchaar,

secretary-general of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), one of the industry's leading standard-setting bodies (Baltaji and Anwar 2010). In August 2010, AAOIFI announced that it is considering guidelines on scholars owning shares in the institutions they serve and limiting the number of shariah boards they can join (ibid.).

Not surprisingly, the elite scholars defend their structural position at the top, opposing limits on board membership:

> Capping the number of boards will be devastating to the industry's growth… Sometimes people ask me, are you Superman? How can you sit on so many boards? I tell them it's hard work.
>
> - *Sheikh Nizam Yaquby (Baltaji and Anwar 2010)*

CRITICISM OF THE SHARIAH SCHOLARS AND THE FORM-VERSUS-SUBSTANCE DEBATE

The commodification of ethics?

The aforementioned story is unusual; shariah scholars rarely discuss the relationship between the work they do and the money they earn. Yet in private, and sometimes in public, industry practitioners think about this a lot. Many criticisms of shariah scholars are variations on one theme: that their work is a commodification of Islamic ethics.[123] If scholars are paid — sometimes over $100,000 a year — by each of the institutions they are supposed to be regulating, how can they be expected to uphold Islamic ethics? Are shariah scholars merely "rent-a-sheikhs, willing to give the spiritual nod to just about any financial product for the right price" (Power 2009)?

One industry practitioner who works at a large Islamic bank in the Gulf levied this charge bluntly. "All they care about is *this*," he said, rubbing his thumb and index finger together. When I told him I'd heard that top scholars earn $50,000 to $100,000 per shariah board per year, he responded that scholars also get "bonuses" that can bring their total compensation from a single bank up to $300,000 per year. "They're like those medieval priests who sold absolution by dangling the fear of hell in front of people," he went on, incensed. "'If you buy this, you'll go to heaven. If you buy that, you'll go to hell.'" (A. L. (anonymous) 2013)

[123] For another contemporary instance of debates over the commodification of religious virtue, see Tocheva (2014) on the Russian Orthodox Church's marketing of spiritual services offered in exchange for fees and the bustling market for Church goods and rituals in post-Soviet Russia.

Industry veterans often stress that earlier generations of shariah scholars received little or no compensation. One Dubai-based practitioner who has been in the industry for over two decades recalls working at an Islamic bank in Saudi Arabia in the 1990s.

> The shariah board of [the Islamic bank in Saudi Arabia] never took one penny when I was there. Not one penny. That's why they didn't approve a lot of products — they didn't give a shit about what the CEO wanted them to do, because they didn't take any money. (E. F. (anonymous) 2013)

So why, I asked, did scholars serve on the board back then if they weren't getting paid?

> Because a lot of them were friends of the chairman [of the bank]. Some of them were independently wealthy. And some taught at universities. [The bank] would pay to fly them in, yes — but they didn't get an hourly rate. None of that shit. But today, these guys like [*name of a famous elite scholar*], he gets a $150k or $200k retainer from every bank...
>
> You can't be judge and jury. If you're working for money, then maybe you should be working for the central bank, where they'll pay you. And when Deutsche Bank comes along [and asks you to approve something], you can tell them to piss off.

It is almost impossible to verify when shariah scholars first started getting paid, and how much. And compensation figures to scholars today are closely guarded. But echoing the speaker above, it is a commonplace in the industry that the first generation of shariah scholars in the late 1970s and 1980s was compensated very modestly, or sometimes for expenses only. Given the fledgling status of Islamic banks in that era, this is not surprising. Yet among cynics, it has become part of a narrative of the corrupting power of lucre.

This narrative of ethical decline is compounded by the unique status of Islamic finance among other fields in which Islamic jurists hold traditional authority:

> Out of all the things that scholars in the modern age have been opining on, Islamic finance has suddenly become what occupies their time, makes their money, makes them superstars. You never hear about this in family law or inheritance law.

An exercise in legalism? Shariah scholars, Islamic economists, and the form-versus-substance debate

A second charge often levied against shariah scholars is that they take too formalist and legalist an approach to shariah and Islamic economic ethics. This critique is a salvo in a battle between two approaches to Islamic finance — a battle that has raged since the 1980s, when

shariah scholars first took a central role in the industry. The battle is known as the "form-versus-substance" debate.

At one pole of this debate are those who argue that the *economic substance* of a financial transaction or instrument is inescapably important in determining if it is truly Islamic. Adherents of this position usually take a *consequentialist* stance, believing that the the economic and social consequences of a transaction greatly affect its religious valence. Does the transaction or instrument promise a net gain for society? Is it, at the very least, economically neutral? The early theorists of Islamic economics, particularly those from the Subcontinent, tended toward this position, as did some of the pioneers of its developmentalist non-profit phase of the 1960s and 1970s (see Chapter Two).

Today, the staunchest supporters of this view are economists — including Islamic economists, many of whom see themselves as the torch-bearers of the spirit of the 1960s. Although the Islamic economists were at the forefront of thinking about Islamic banking in the 1970s and early 1980s, they have mostly been left out of the recent commercial success of Islamic finance. The form of capital they possess — academic expertise in improving social welfare using novel schemes for zakat (the Islamic wealth tax) and true partnership finance — carries very little weight in the scholars' world of shariah formalism and the bankers' world of profit-driven finance.

From their subordinate structural position, the economists take a critical stance toward the Islamic-finance industry. They tend to be vigorous adherents of profit-and-loss-sharing (PLS) in Islamic finance, which was the central blueprint of the utopian experiments of the 1960s and 1970s, but which today plays a marginal role in actual Islamic-banking practice (see Chapter Two). They are critical of contemporary Islamic financial practice, which they see as farcical and inefficient exercise in capturing rents from ill-informed customers. They criticize Islamic financial institutions' tendency to copy conventional products while merely "Islamizing" them to comply with the formal requirements of shariah, seeing this as walking backward, away from the dream of an Islamic economy and financial system that is substantively more just and welfare-oriented than the manifestly unstable, unjust system of contemporary finance capitalism. They feel the mission of Islamic finance should be to advance *maqāṣid al-sharīʿah* (the ultimate objectives or final goals of Islamic law), which they take to include social welfare and social justice. To essentialize grossly but not entirely inaccurately, this is the "left" camp of Islamic finance.

At the other pole, in what we might simplistically call the "right" camp, are those who argue that the *legal form* of a financial transaction or instrument is the *sine qua non* for making it truly Islamic. While acknowledging that economic substance and social consequences should not be overlooked, especially if overtly harmful, this camp maintains that formal rules — as interpreted by jurists — are inescapably vital to the Islamic valence of a product. They note that economic and social consequences cannot be known with certainty — whereas God's prohibition of certain forms of human action, such as lending at interest, is

manifest.

Not surprisingly, elite shariah scholars are the standard-bearers of this camp. Although they support the use of PLS and attempts to develop distinctively Islamic financial instruments, they generally defend the industry's progress to date. Without appearing self-interested, they can defend their structural position at the top of the thriving Islamic-finance industry by defending the logic of shariah formalism as the true language of Islamic piety. They feel that the use of formal legal techniques to create Islamic replicas of conventional financial instruments is far superior to the absence of Islamic finance at all: it allows pious Muslims to participate in modern economic affairs, relieving them from the burden of keeping their savings under the mattress. Even if contemporary Islamic finance is not perfect, they feel it is therefore far more pious than conventional finance.

To the scholars, shariah formalism is not only the true language of piety; it is the only scientific and rational language of piety. Form matters to this camp because religious law, and religion itself, are inescapably concerned with legal form. Neglect of legal form is impious because it is irrational and logically unsound. Abdullah Nana, an American imam and shariah advisor based in California, uses an analogy to marriage to make the point:

> A man and a woman live together. They live in the same house; they sleep together, have children together, and live happily ever after. In one case, they go to an imam and get married; in another, they don't. In each case, the couple may be just as happy. But one case is halal and the other haram. In the same way, experts in Islamic finance, looking at the way contracts are structured, see a difference — a substantial difference — between structures that are halal and those that are haram. This is a difference of form, and it matters. (Nana 2014)

And against the "left" camp's charge that present-day Islamic finance fails to advance maqāṣid al-sharīʿah, some members of the "right" camp retort that divining the final objectives of God's law is both impossible and hubristic. They feel that believers should stick to applying those laws that God has seen fit to make clear instead of pontificating unscientifically about what His intentions might have been. To this camp, fiqh (Islamic jurisprudence) is the science of extracting what can be known with certainty from God's law. So if economics — the study of economic consequences — is the "left" camp's scientific beacon, the "right" camp places its trust in the science of fiqh.

I stress that in practice, nearly everyone involved in the Islamic-finance industry falls somewhere between these two poles. Nonetheless, Figure 31 summarizes the two essentialized positions.

FIGURE 31: TWO CONCEPTUAL POLES IN ISLAMIC FINANCE, ESSENTIALIZED

"Left" camp	**"Right" camp**
Economic substance is vital	Legal form is vital
Consequentialist, welfarist	Legalist, formalist
Economics as underlying science	Fiqh as underlying science
Economists as standard-bearers	Shariah scholars as standard-bearers
Criticizes present-day Islamic finance as a farcical exercise in "shariah arbitrage" and rent-seeking	Defends present-day Islamic finance as giving Muslims an alternative to interest-based finance, which is prohibited
Strives for maqāṣid al-sharīʿah	Questions whether maqāṣid al-sharīʿah can be known to humans

How scholars check capital

Despite accusations that they are "rent-a-sheikhs," experience suggests shariah scholars do indeed step in to regulate the forces of capital.

Day-to-day regulation

On a daily basis, this happens when shariah boards tell financial institutions that they must adjust their proposed product structures and investment screens to conform with shariah. These adjustments are not trivial. It took "easily a year and a half, if not more," for Paul Boots and his colleagues at the Dubai Multi Commodities Centre to develop a commodities-trading platform that their shariah advisor, the elite scholar Dr. Hussein Hamid Hassan "was comfortable with" for facilitating commodity-murabaha transactions. In Figure 32, we see Paul sketching out the platform's complex structure.

FIGURE 32: Paul Boots, director of Tradeflow at the Dubai Multi Commodities Centre, explains the complex trading structure his team had to build to meet Dr. Hussein Hamid Hassan's standards for shariah-compliance

"Shariah risk": When shariah scholars shake the markets

Today's Islamic financial institutions welcome this type of day-to-day involvement from shariah scholars. This ensures that their final product will be accepted by what practitioners call "the fraternity" — the international collectivity of scholars in Islamic finance, and especially those at the top. (The fraternity is overwhelmingly male, although in Malaysia it includes an increasing number of female scholars.[124])

Yet individual shariah scholars sometimes also flex their power by criticizing product structures that other scholars have already approved. This creates the risk that investments in an Islamic product that one set of scholars has approved will lose value because other scholars

[124] Women have held prominent positions across Islamic finance in Malaysia, and not only as shariah scholars. Malaysia's powerful central-bank governor is also female, as are several leading executives at Islamic banks.

will later declare it un-Islamic. The industry calls this "shariah risk" (Bälz 2008; Firoozye 2009; Ginena 2014).

Shariah risk is very real. In November 2007, for example, Pakistan's leading shariah scholar, Sheikh Taqi Usmani, declared that 85% of sukuk[125] worldwide are not structured in a truly Islamic way. This sent sukuk yields upward, and global issuance dropped from $48 billion in 2007 to $18 billion in 2008 (see Figure 33). While a large part of the drop was due to the global credit crunch, several of my interviewees felt Usmani had an impact too, shaking markets like an Islamic Ben Bernanke.

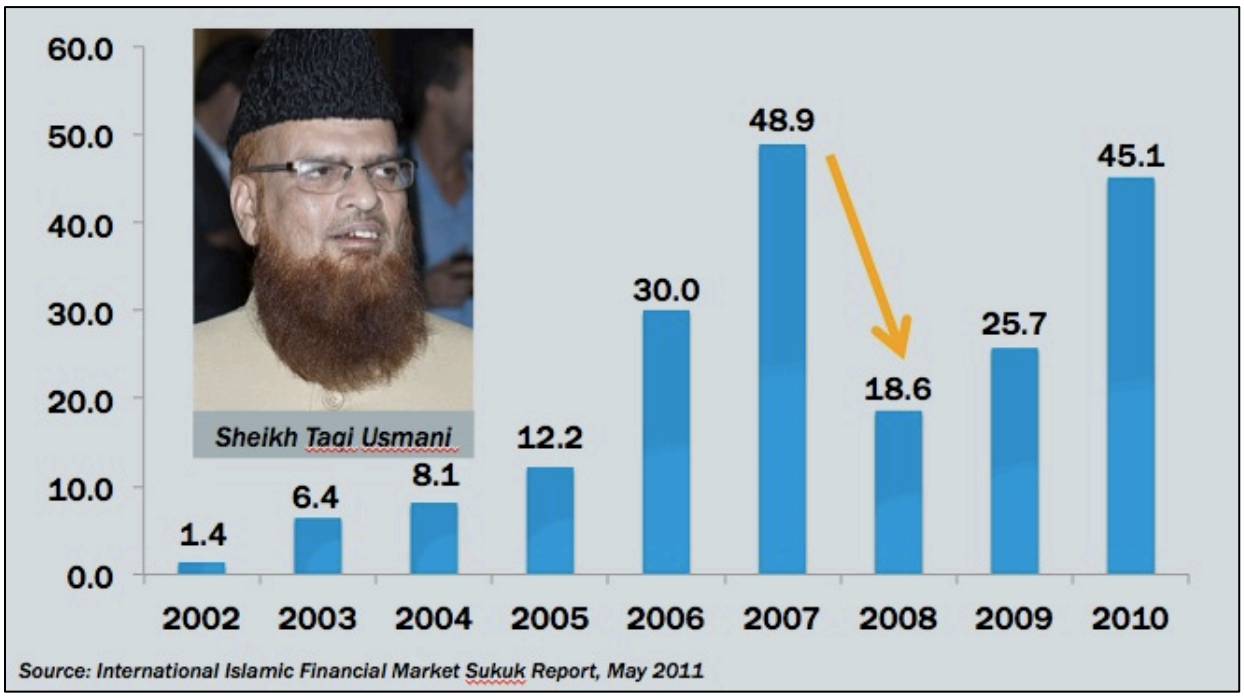

FIGURE 33: WORLDWIDE ISSUANCE OF SUKUK (US $BN), 2002–2010. Sheikh Taqi Usmani's declaration that 85% of sukuk worldwide are un-Islamic came in November 2007.

Young scholars can shake markets too: The 2011 Goldman Sachs sukuk

Surprisingly, it is not only big-name scholars who can shake markets. Even relatively unknown shariah scholars can rattle the industry and push around titans of global finance — and embarrass senior scholars.

[125] Sukuk are Islamic fixed-income instruments. Because they behave like bonds, they are often called "Islamic bonds," although technically they are not bonds. They are asset-backed securities that pay returns on a non-interest-bearing revenue-generating asset such as a lease or a markup sale.

In 2011, Goldman Sachs issued a sukuk based on a relatively controversial structure known as commodity murabaha. The mere issuance of sukuk based on commodity murabaha was already dicey, but then Goldman Sachs went a step further and listed them for trading on the Irish Stock Exchange. Secondary trading of murabaha-based bonds is almost universally banned by shariah scholars.

A 31-year-old Saudi scholar named Mohammed Khnifer quickly cried foul, publishing an article that systematically pointed out how the Goldman Sachs sukuk violated Islamic law (Khnifer 2011). A war of words ensued; Goldman Sachs said it was "entirely confident" that its sukuk was shariah-compliant (El Baltaji 2011).

Matters got worse for Goldman Sachs a few weeks later, when three top-tier scholars whom Goldman Sachs had listed in the sukuk's documentation as having approved the sukuk issuance claimed that they had never done so. The scholars were Mohamed Ali Elgari of Saudi Arabia (the #3 most prolific scholar in the world), Abdullah al-Maneeʿa of Saudi Arabia (#5), and Mohammad Daud Bakar of Malaysia (tied for #7). "I have neither seen nor signed nor given any approval to the American sukuk in question," said al-Maneeʿa to a Saudi newspaper. "[Goldman Sachs's] claim that I was one of the scholars responsible for approving [its sukuk] is illogical," said Elgari (al-Bīshī 2012, author's translation). Goldman Sachs now stood accused of both having played fast and loose with sukuk structuring and having attested the approval of leading scholars on false pretenses. Yet some wondered how a bank as large as Goldman Sachs could have publicly claimed the endorsement of leading scholars without those scholars' knowledge. At the very least, it seemed that some elite scholars might be stretched so thin by their many board memberships that banks were now able to take advantage of their name recognition unscrupulously. Industry analyst Murat Ünal observed:

> The worst thing is that [these scholars] have no idea the company is mentioning their name in the market… The industry depends on their reputation to sell the products and therefore the potential to misrepresent is there. (Davies 2012)

In bringing his allegations of non-shariah-compliant structuring, the 31-year-old Khnifer was not only challenging Goldman Sachs, but effectively also some of the most august members of the fraternity. Goldman Sachs had hired a Dubai-based shariah consultancy called Dar Al Istithmar to structure the bonds. The chairman of Dar Al Istithmar's shariah board was Dr. Hussein Hamed Hassan, the fifth most prolific scholar in the world in terms of boards occupied and a ubiquitous figure on the Islamic-finance conference circuit. Hassan not only defended the Goldman Sachs sukuk, but claimed that he had sent a copy of the structure to the other very senior scholars on Goldman Sachs's shariah board, and that they had never responded — presumably because they had been too busy.

In the end, Goldman Sachs closed down its involvement in the sukuk market, the Dar Al Istithmar shariah consultancy closed down, and some elite scholars were temporarily embroiled in controversy. The power of young Mohammed Khnifer to rattle Goldman Sachs demonstrates the power of technical expertise, even from a young newcomer, to stymie one of the world's pre-eminent bearers of financial capital.

MOHAMMED KHNIFER, the young Saudi shariah scholar who challenged Goldman Sachs — and won

Khnifer's takedown of Goldman Sachs was not only a matter of personal piety, but also a strategic gambit that allowed him to move up in the field of professional shariah scholarship. In the wake of his Goldman Sachs critique, Khnifer gave interviews to the Financial Times, Bloomberg Businessweek, and Thomson Reuters. He parlayed his new fame into prestigious jobs in shariah structuring: he took a position as product structurer with the Islamic Development Bank (IDB) in early 2012, then moved in early 2013 to an investment-banking position within the IDB. His own public LinkedIn page advertises his signal role in the Goldman Sachs fiasco:

> Mr. Khnifer is mostly remembered in the Islamic finance industry as the person who ignited the "Great Debate" over Goldman Sachs' Tawarruq Sukuk, resulting in postponing the issuance for more than 2 years. Consequently, a rift between staff and shareholders led the high-profile Shariah adviser (Dar Alistithmar) of ill-fated Goldman sukuk to cease its operations.
>
> *Mohammed Khnifer's LinkedIn page (accessed August 13, 2014)*

Saudi Arabia seems to be particularly fertile terrain for shariah scholars willing to challenge capitalist practices, especially on technical grounds. This makes sense given the longstanding prestige and influence of religious jurists in Saudi society, politics, and education (Al-Atawneh 2009; Bligh 1985; Kechichian 1986; Steinberg 2005). For example, Saudi shariah scholars are known for issuing their own personal shariah-compliance lists of companies traded on the Saudi Stock Exchange. These lists typically divide listed shares into

three categories: (2) those that are 100% shariah-compliant, (2) those that are mostly shariah-compliant and can therefore be traded but that require some purification (i.e. donation to charity) of gains because some portion of the firms' income comes from unacceptable sources (e.g. some level of interest-bearing leverage) and (3) those that are off-limits. In this way, individual scholars can affect major firms' cost of capital — particularly in Saudi Arabia, where shariah-compliant high-net-worth and institutional investors have great influence on the stock market.

Leading scholars are well aware that they are under the scrunity of their peers. In fact, they cite this when defending their professionalism and their earnings. Sheikh Nizam Yaquby, the most prolific shariah scholar in the world, invoked the specter of mutual monitoring when I asked him whether there is a conflict of interest when top scholars earn millions of dollars a year from the companies they monitor. He responded, "You have to understand that if I did not do my duty and approved a product that was not truly shariah compliant, my fellow scholars would immediately question me. So I cannot be unfaithful to shariah" (Yaquby 2009). Yaquby is implying that a logic of mutual surveillance is at work, based on status, prestige, and the professional identity of shariah scholars as a corporate entity. And mutual surveillance does operate among scholars, as the Khnifer case shows.

Yet challenging an elite scholar outright is not easy. One lawyer with over two decades' experience in the industry described what he observes when shariah boards convene:

> Of course as scholars, they'll argue very fiercely among themselves in private. But there's a pecking order even within that. Juniors will eventually accede to seniors. There's debate, but it's predicated by seniority. (B. B. (anonymous) 2013)

This lawyer was describing debate in the private confines of a shariah-board meeting. In the public forum, direct challenges to senior scholars are extremely rare.

Putting the brakes on unbridled innovation: Islamic hedge funds

Shariah scholars may also restrict types of Islamic financial innovation that go too far in their eyes. While critics accuse them of being overly legalistic and failing to examine the economic and social consequences of the products they approve, sometimes the opposite seems to be the case.

Islamic hedge funds are an interesting example. In the years preceding the 2007–2008 financial crisis, shariah-compliant hedge funds appeared to be the wave of the future. Barclays, for example, worked with prominent US-based shariah scholar Sheikh Yusuf Talal DeLorenzo to develop a shariah-compliant platform for short-selling (Calder 2010) and other typical hedge-fund operations (Slater 2007). But many scholars question the utility of Islamic hedge funds. In the wake of the crisis, scholars have become more wary of untested

instruments that push the Islamic financial envelope. Richard Tredgett, a London-based partner at the multinational law firm Allen & Overy with expertise in Islamic derivatives and Islamic structured finance, finds that the shariah scholars are often hesitant to move in the direction of Islamic hedge funds:

> I think there is a suspicion amongst scholars, certainly the well-known ones that I've dealt with, as to what the aims are, ultimately, of a hedge fund. What are they investing in? Do they serve a socially useful purpose? If it's funding the construction of a factory or the acquisition of a business or real estate, [the scholars] can understand that, and they'll see the benefit… But if it's a hedge fund, then they're sort of thinking, "Hang on, what has that got to do with ethical and shariah-compliant financing?"
>
> And then if you look at the techniques that [the hedge funds] employ, a lot of it is problematic from the shariah perspective. There's a fair amount of speculation involved; they buy and sell things they don't own. And options, trading in options, stuff like that — it creates problems from the shariah perspective. (Hanif and Tredgett 2013)

Today, Islamic hedge funds remain rare and controversial. Part of the problem is skepticism from scholars and Islamic investors; another part is the high transaction costs for complex bespoke Islamic instruments. Even so, a few mavericks see promise. Shariah Capital, a firm based in the United States, operates a long-short commodities hedge fund focused on resources and mining. Sheikh Yusuf Talal DeLorenzo, the firm's chief shariah officer and the best-known American shariah scholar, feels that

> in the future, sharia investors will have the opportunity to enlist high quality [hedge-fund] managers, operating within sharia guidelines, to generate returns competitive with conventional investors. (Reuters 2010)

Perhaps Islamic hedge funds have a future.

Reformers and rationalizers: Responses to the status quo

Shariah governance in Islamic finance has evolved quickly, and it will continue to evolve. The first Islamic bank, founded in 1975, had no shariah board. But by the 1980s, shariah boards were ubiquitous at Islamic banks. By the 1990s, a handful of veteran scholars had formed an international elite that was increasingly indispensable to leading Islamic banks.

Today, with the ten or fifteen most elite scholars at the pinnacle of their fame and earning power after two decades of rapid industry growth, voices calling for reform are

growing stronger. A turning point may be approaching as reformers seek to temper the industry's dependence on a few scholars. Some consider the concentration of power dire:

> You put ten of the [top shariah scholars] in a plane, and they crash — it's over. It's over. Because they sit on all the boards. That's some serious concentration risk.
>
> *Sayd Farook, head of Islamic capital markets, Thomson Reuters* (Farook 2013)

So what is to be done? Below, I explore several possibilities for reform and rationalization.

The Malaysian model: State-led bureaucratization of religious authority

I cannot count the number of times practitioners and observers of Islamic finance around the world — whether from Dubai, Doha, Cairo, Istanbul, London, or New York — have cited Malaysia to me as the shining example of a well-designed national Islamic financial system. They laud the Malaysian state's strong hand in regulating all aspects of Islamic finance, establishing clear laws supporting it, promoting education and training in Islamic finance, actively issuing sovereign Islamic debt, and supporting the architecture necessary for Islamic liquidity management. This was not always true: Middle Eastern practitioners and scholars once looked down on Malaysian Islamic finance for having a more permissive stance toward certain financial practices (such as *bayʿ al-ʿīnah* and *bayʿ al-dayn*) that are strictly disallowed in the Gulf. But over the past decade, as the Malaysian market has matured, Malaysian Islamic capital markets have grown, and the state has pushed banks to phase out these controversial products, the "Malaysian model" of strong state regulation and support has gained luster.

The active role of the Malaysian state extends even to shariah scholarship. The Malaysian central bank and the Malaysian securities commission each have their own shariah boards whose decisions are binding on all Islamic financial institutions in the country. In 2005, Bank Negara Malaysia, the central bank, decreed that each shariah scholar could sit on the board of no more than one Islamic bank and one Islamic insurance company. (Contrast this with the Gulf, where as we have seen, leading shariah scholars sit on nearly 100 boards.) Then in 2013, Bank Negara sent waves through the world of Islamic finance by muscling through the Malaysian legislature the Islamic Financial Services Act, which elevates state rules governing shariah-compliance from guidelines to statutory duties. This means Islamic financial institutions that breach those rules are now subject to severe penalties. Even more strikingly, individual shariah scholars are now subject to fines of up to 25 million ringgit (approximately US$8 million) and eight years' imprisonment if they violate these rules (Hamzah and Vizcaino 2013b). "Shariah scholars can be sued now, can go to court, and can go to jail," said Dr. Mohamad Akram Laldin, a leading Malaysian shariah scholar. "Because at the end of the day, each and every one of us has to be accountable for what we do"

(Laldin 2013).

In short, the Malaysian state is rationalizing and bureaucratizing the relationship between shariah scholars and the banks and customers they serve. It is making this relationship a fiduciary one, akin to the relationship that accountants, lawyers, and doctors have with their clients. It is worth noting that this rationalization both depends on and buttresses a highly technical and formal understanding of what is and is not shariah-compliant.

Malaysia contrasts with the countries of the Gulf region, where — with the exception of Bahrain — states have taken a more hands-off approach in regulating Islamic finance even though it has grown rapidly. Yet when it comes to ownership, the reverse is true: while the Malaysian state does not take ownership stakes in Malaysian Islamic banks, the monarchies and emirates of the GCC tend to do so, either directly or through investment concerns owned by royals.

Pakistan: Pressure from Islamic jurists outside Islamic finance

So far, I have discussed shariah scholarship in Islamic finance as a field unto itself — linked to financial institutions, their customers, and law firms, to be sure, but having internal rules of solidarity and monitoring and a corporate identity among all (or at least most) scholars based on a formal and technical appreciation of shariah. Bolstering this autonomy is the fact that Islamic finance also has its own transnational industry associations and regulatory bodies.

Yet the shariah scholars who make their careers in Islamic finance are also embedded in national (and, to a lesser degree, international) fields of Islamic jurisprudence that reach beyond Islamic finance. This is true in much the same way British legal academics (to pick one nationality arbitrarily) specializing in corporate law are also embedded in a broader field of British law and legal academia. The higher they rise in their specialty, the more notoriety they will also have in the broader legal field. Likewise, when Islamic jurists become internationally prominent (and wealthy) from their work in Islamic finance, they attract attention in their home countries' juristic fields.

Pakistan is an example of a country where shariah scholars involved in Islamic finance face pressures for reform from other Islamic jurists. On August 28, 2008, a long-simmering row within Pakistan's Deobandi[126] community of Islamic jurists came to a head. A group of

[126] The Deobandi school of Sunni Islam is Pakistan's (and South Asia's) second-largest by number of adherents, after the majority Barelvi school. However, the Deobandis, who adopt a more puritanical and legalist practice than the Barelvis (who are much more sympathetic to Sufism (Islamic mysticism), which the Deobandis generally scorn), run a majority of Pakistan's madrasas and Islamic institutions of higher learning. The Deobandi movement in Pakistan received a boost in the 1970s and 1980s thanks to Zia ul-Haq's Islamization process of the 1980s as well as Saudi financial support for Islamic education in Pakistan. Both the Deobandi and the Barelvi schools began in the 19th century as revivalist movements, originating less than 200 miles apart in what is now Uttar Pradesh state in northern India. They quickly spread across South Asia.

leading Deobandi scholars, spearheaded by the jurists of the Banuri Town seminary — one of Pakistan's most prominent — convened in Karachi and issued a collective fatwa against Mufti Muhammad Taqi Usmani's model of Islamic banking (Ghias 2013). This was a clear condemnation of Usmani's involvement in contemporary Islamic finance. To add insult to injury, the first of the fatwa's 29 signatories was Mawlana Salimullah Khan, one of Usmani's few living teachers (ibid.: 103). Usmani and his supporters based at another seminary, Darul ʿUloom Karachi, rebutted with vigorous fatwas of their own. This war of words reflects the uneasy status of Islamic finance and its shariah scholars in Pakistan's broader juristic community.

Usmani, mentioned earlier in this chapter for his own fatwa declaring 85% of all outstanding sukuk un-Islamic, is one of the most prominent shariah scholars in the world of Islamic finance. With Sheikh Nizam Yaquby, he is arguably one of the two most internationally recognized names in the industry. He has published widely read books on the theory of Islamic finance in Arabic, English and Urdu; has served on dozens of shariah boards; established Pakistan's first commercial Islamic bank in 2002; and was chairman of the shariah standards council of AAOIFI, the leading international standard-setting body for Islamic finance. And within Pakistan, he is the face of Islamic banking.

But in Pakistan, Usmani is also very influential beyond Islamic banking. He served for 20 years as a judge on the Shariat Appellate Bench of the Supreme Court of Pakistan. He comes from Pakistan's first family of Islamic jurists: his father was the first grand mufti[127] of Pakistan, and his brother is the current grand mufti. His father also founded Darul ʿUloom Karachi, which like Banuri Town is one of Pakistan's leading seminaries. Usmani is currently the vice president of Darul ʿUloom Karachi. So he is a prominent judge, jurist, and educational administrator.

Depending whom you ask, the conflict between Mufti Taqi Usmani and Banuri Town is part disagreement over Islamic economic ethics and part juristic turf war exacerbated by Usmani's wealth and international renown from Islamic finance. On the ethical side, the Banuri Town fatwa against Islamic banking makes both substantive and formal criticisms of Islamic finance. Substantively, it echoes the complaint of the economists described earlier in this chapter that Islamic finance has strayed from its roots in profit-and-loss sharing (PLS). It attacks some of the core products common today, such as murabaha (markup sale) and ijara (lease), noting that they are "merely stratagems that were conditionally declared permissible and feasible … for a limited time and interim period" (Ghias 2013:107). It finds that by straying from PLS-based instruments such as musharaka and mudaraba, "existing Islamic banking has remained unsuccessful in establishing its Islamic identity distinct from conventional banking" (ibid.: 107). The fatwa also attacks the benchmarking of Islamic "profit rates" to conventional interest rates (ibid.: 110), which I discuss in the next chapter, as

[127] The grand mufti is the highest official of Islamic law in a country.

being mere replication of conventional finance. Since it was in South Asia that the theoretical blueprint for PLS-based Islamic finance was laid between the 1950s and 1980s, it is not surprising that these sorts of substantive criticisms should resonate in Pakistan. But the Banuri Town fatwa also contends that these substantive perversions of Islamic finance are rooted in formally incorrect or weakly justified readings of Islamic legal sources.

Others peer beyond the content of the fatwa and see a turf war between two of Pakistan's leading seminaries, and more broadly, a distaste for Taqi Usmani's international celebrity status in Islamic finance. Banuri Town and Darul ʿUloom Karachi are both leading seminaries from an intellectual perspective. They are just a half hour's drive apart, divided by the Malir River, which splits Karachi. But Banuri Town's buildings and classrooms are humble, whereas Darul ʿUloom Karachi boasts a sparkling campus with manicured lawns and shrubs and state-of-the-art facilities — thanks in part, some say, to Taqi Usmani's earnings from Islamic finance. One high-profile Pakistani shariah expert who works internationally in Islamic finance notes that before the advent of commercial Islamic banking in Pakistan (with Usmani's 2002 launch of Meezan Bank), wealthy Pakistani families who had earned money through trading might approach an Islamic scholar and say, "I think my income is not shariah-compliant." The scholar would suggest purifying the income by contributing it — or a portion of it — to a particular charitable endownment (*waqf*), such as one attached to a madrasa. With the emergence of Islamic banking in Pakistan, these wealthy families now have other options for managing their money in a shariah-compliant way, meaning such scholars have less influence. "When I talk to these scholars, they have huge respect for Taqi Usmani," said this observer — "but they're jealous as well" (D. M. (anonymous) 2013).

International organizations: Transnational bureaucratization of religious authority

Islamic finance has a growing number of transnational industry organizations. These include the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI, founded 1990)[128] and the Islamic Financial Services Board (IFSB, founded 2003).[129] Also vital is the International Islamic Fiqh Academy of the Organization of Islamic Cooperation (OIC Fiqh Academy, founded 1981), which is prominent in Islamic finance even though it deals with non-financial matters as well.[130] AAOIFI and the IFSB include combinations of

[128] AAOIFI's mission is to standardize and harmonize international Islamic-finance practices and financial reporting in accordance with shariah. It is based in Bahrain.

[129] The IFSB's mission is to promote the stability of the Islamic-finance system by issuing global prudential standards and guiding principles for Islamic banking, Islamic capital markets, and takaful (Islamic insurance). It is based in Malaysia.

[130] The OIC Fiqh Academy is not specific to Islamic finance, but to the broader study of contemporary juristic issues facing Muslims worldwide. However, a substantial portion of the OIC Fiqh Academy's juristic rulings

capitalist representatives (i.e. membership groups of Islamic banks) and state representatives (groups of central bankers and state securities regulators). They have issued wide-ranging standards and continue to do so, but are hampered by a total inability to enforce. For example, the OIC Fiqh Academy has condemned the practice of organized tawarruq, a controversial financing device discussed in the next chapter. But it has little power to enforce this ruling, and organized tawarruq remains very widely used, especially in the Middle East.

Shariah audit firms and shariah consultancies: Capitalist bureaucratization of religious authority

Shariah consultancies and advisories began emerging in the 1990s to help Islamic financial institutions with the tricky task of designing shariah-compliant products. (I interned at one in Malaysia for two months.) But could these private shariah advisories also take on a regulatory function, usurping the role that shariah boards now have? A Islamic-finance journalist with three decades' experience in the industry says they could:

> The next logical step in Shariah advisory is … the eventual phasing out of individual scholars sitting on boards and being replaced by Shariah advisory firms or consultancies, which would have a pool of Shariah scholars with the same hierarchy in terms of expertise and management. The registration requirement would also weed out the self-styled amateurs from the real experts…
>
> *Mushtak Parker, December 2010* (Parker 2010)

Perhaps seeing the writing on the wall, some of the elite shariah scholars have launched their own consultancies. Malaysia's Dr. Mohamad Daud Bakar, for example, leads Amanie Advisors, and the Egyptian Dr. Hussein Hamid Hassan is a driving force behind Dar Al Sharia, which spun off from Dubai Islamic Bank.

The Big Four multinational accounting firms — Deloitte, PwC, Ernst & Young, and KPMG — may also come to play this role. All four now have Islamic-finance practices. Although the major Islamic banks today all have internal shariah departments that do the day-to-day work of implementing their shariah boards' stipulations, external shariah audits are becoming more common, and the Big Four are pursuing this business. Interestingly, they may not need deep shariah expertise to enter this field:

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and standards concern Islamic finance. The Academy's members are among the most renowned Islamic jurists in the world.

> External auditors — firms like PwC, KPMG, Deloitte, Ernst & Young — understand a bit about Islamic banking… but they are not experts in shariah. But they don't need to be. They *are* experts in assessing internal control. Is this an organization that is generally likely to comply with the rules set by senior management, or is it an organization where the branches are out of control and doing their own thing? [Does] the internal shariah function [have] a reasonable degree of autonomy and independence? Does it report to local management or to top management?
>
> *Mohammed Amin, former head of Islamic finance at PwC* (Amin 2012)

Mohammed Amin's comments suggest that the Big Four accountancies may become international vectors of organizational isomorphism for Islamic financial institutions, rationalizing their internal systems of shariah governance so that the pronouncements of shariah boards and the dictates of national-level shariah committees get implemented uniformly and efficiently (see DiMaggio and Powell 1983, esp. 151–152 on consulting firms; Meyer 2000).

Conclusion

In this chapter, we have seen that shariah scholars face two main criticisms. The first is that they may be influenced by the money paid to them by the financial institutions they regulate. This charge is most often levied against the 10 to 15 elite scholars — the internationally renowned "rock stars" of the industry — who earn millions of dollars in honoraria and sit on dozens of shariah boards. The second criticism is that shariah scholars promote an overly legalist and formalist stance toward Islamic financial instruments.

Both of these criticisms come most stridently from economists and other members of what I call the "left" camp in Islamic finance. The left camp feels that because of these two conditions, Islamic banks merely replicate conventional finance while straying from the industry's roots in profit-and-loss sharing. Shariah scholars and other defenders of the industry in the "right" camp respond that although the industry is still a work in progress, it allows Muslims to participate in modern economic life without dealing in *ribā* (usury) — a grave sin. Therefore, they say, the world is better with Islamic finance than without it. In general, they believe shariah scholars are doing pious and important work that advances the interests of the *ummah*.

These debates take place in different national contexts. In Malaysia, for example, there is tight integration between the field of Islamic-finance shariah scholarship and the broader field of Islamic jurisprudence. Shariah scholars are generally not criticized simply because they work in Islamic finance. In Pakistan, the relationship is much more contentious. The country's leading Islamic-finance shariah scholar, Sheikh Taqi Usmani, has faced public

censure from fellow Pakistani jurists for his involvement in Islamic finance.

Despite the criticisms they face, shariah scholars in Islamic finance do in fact appear to monitor one another and to keep capitalists in check. Sheikh Taqi Usmani himself, for example, shook the international sukuk market by declaring 85% of all sukuk un-Islamic in 2007. Although his ruling did not have legally binding effect, it drastically changed the behavior of subsequent firms issuing new debt, which turned away from the sukuk structures Usmani condemned. Yet it is not only the most prominent shariah scholars who wield the power to shake markets. Thirty-one-year-old Mohammed Khnifer's criticism of the 2011 Goldman Sachs sukuk not only rattled one of the titans of international finance and forced its debt issue out of the market, but also got egg on the face of some of the elite scholars who endorsed it.

Given such incidents, industry figures are increasingly concerned about the concentration of juristic power in a few individuals, as well as about the lack of uniformity and harmonization in shariah standards across borders. They also worry that a shariah board's rulings are not even enforced uniformly within an individual bank, with some branches or divisions complying better than others. To address these concerns, reformers and rationalizers have taken various steps. Some have sought to harmonize shariah standards transnationally through international industry organizations. Others have sought to bureaucratizing and further institutionalizing the shariah-governance process through external shariah audits by the likes of the Big Four accounting firms. For its part, the Malaysian government has established a national hierarchy of shariah boards, with the central bank's shariah board at the top, and has turned shariah oversight into a fiduciary duty whose breach invites stiff criminal penalties.

Formal rationalization has turned shariah scholars into technicians

What is striking about these reform efforts is that by formally rationalizing shariah governance, they entrench the dominance of a formalist and legalist understanding of Islamic economic ethics. They also entrench and expand the shariah-compliance apparatus. As states and markets impose ever-more-stringent requirements for monitoring shariah-compliance, the market generates new lines of business: external shariah auditing, as we have seen in this chapter, or new monitoring technologies that we will examine in the next chapter, including sophisticated commodities-trading regimes and iPhone apps that tell users which stocks are shariah-compliant. Ironically, reform efforts are making shariah-compliance bigger and bigger business. And some of today's leading shariah scholars are taking advantage of this by launching their own shariah advisories, as discussed above. The beautiful consonance between the interests of capital and the legalist approach to shariah becomes stronger.

This expansion and technical formalization of shariah-compliance has increasingly

turned shariah scholars into technical experts. As rules and monitoring systems proliferate, and as formalism becomes entrenched in auditing systems and state-enforced rules, shariah scholars grapple less with abstract moral questions and more with the minutest of technical issues. Shariah scholars no longer debate, as they did in the 1970s and early 1980s, whether instruments like murabaha that replicate conventional interest-bearing debt are truly Islamic. That question has been settled in the affirmative; replication is now the industry standards. Instead, shariah scholars discuss the fine points of how to structure an Islamic cross-currency swap using shariah-compliant contracts, or what the appropriate warehousing conditions are under which the electronic buying and selling of palladium contracts or palm-oil contracts at the push of a button can underlie an Islamic unsecured loan.

As shariah scholars increasingly become technicians, they gain a powerful new defense against charges that they are ethically compromised or that they stand in the way of substance-oriented welfarist Islamic finance. "What's wrong with getting paid for issuing a fatwa or reviewing the sharia compliancy of a financial instrument?" asked Sheikh Dr. Hussein Hamid Hassan, the sixth-most prolific scholar in the world in terms of board seats. "We're just like auditors, lawyers. Each one of us has years and years of experience in sharia law. We do our job and get paid for it" (Davies and Sleiman 2012).

Ultimately, treating shariah governance as a strictly technical matter serves the interests of capital. If shariah scholars are professional technical experts, then shariah itself is a technical realm. This largely evacuates questions of corporate social responsibility from the bailiwick of shariah governance. I once asked Dr. Hussein whether whether shariah-board members should encourage Islamic banks to be environmentally sound and to encourage banks to lend to the poor. He replied:

> Environmentalism and social responsibility are good things that Muslims should support. But that is not our job as shariah-board members. That's the job of the corporate board. Our responsibility is to ensure that the bank adheres to shariah. (Hassan 2013)

CHAPTER FIVE

Ethical contests

Introduction: The fluidity of fiqh

Islamic jurisprudence (*fiqh*) is not a rigid system, but one that changes over time and space. It is culturally, historically, and politically contingent. This chapter demonstrates the fluidity of Islamic jurisprudence by examining ethical contests over two practices very common in the Islamic-finance industry today: bayʿ al-ʿīnah (which I call "two-party markup sale") and tawarruq (which I call "four-party markup sale"). I contrast these briefly with modern murabaha ("three-party markup sale"), which was discussed in depth in Chapter Two.

To those unfamiliar with Islamic finance, all three of these practices will seem ethically equivalent. They are all combinations of asset sales that Islamic banks use to mimic interest-bearing loans without actually dealing in interest. None of them is equity-based, like the mudaraba and musharaka partnerships promoted by the founders of Islamic finance in the 1960s and 1970s. All are debt-based.

Yet within Islamic finance today, these three practices carry markedly different ethical valences. Two-way markup sale is strictly prohibited in the Middle East, yet allowed in Malaysia — but is being phased out even there under pressure from the state and from shariah scholars who consider it ethically questionable. Three-way markup sale, although controversial in the 1970s, is used everywhere today and considered completely ethical by virtually all scholars in the industry. And four-way markup sale is used around the world, especially in the Middle East, but has been condemned by some shariah scholars and is coming under ethical pressure on various fronts.

What makes some ways of replicating interest more "Islamic" than others? If Islamic jurisprudence were a rigid system, we could look to classical texts and unchanging legal mores for a straightforward answer. But instead, I argue that the trajectories of these three interest-mimicking practices illustrate the interplay of factors ancient and new: longstanding differences among the Sunni juristic schools (*madhāhib*) that prevail in the Middle East and Southeast Asia, path-dependent adoption of different market practices in different regions in the 1970s and 1980s, different degrees of state intervention in each area, and evolving capitalist interests in the context of financialization and globalization. Islamic law, and the economic ethics embedded in it, are not static. Islamic jurisprudence evolves.

The interest-mimicking practices discussed in this chapter began their lives as stopgap solutions. Shariah scholars and practitioners accepted two-way markup sale, three-way markup sale, and four-way markup sale in the 1970s and 1980s — but only provisionally, as

temporary substitutes for idealistic risk-sharing instruments such as mudaraba and musharaka. They felt that these contracts were not ideal, but that Islamic banks should be allowed to offer them until the Islamic-finance industry was commercially stable. Better for Muslims to use interest-mimicking Islamic instruments than to deal in interest itself, they said. Something Islamic was better than nothing.

But as these interest-mimicking instruments spread throughout the market, they became entrenched. Banks found them profitable and customers got used to them. Some of these instruments, like three-way markup sale, ascended out of ethical purgatory and are now considered completely acceptable — indeed ethically commendable — by the industry's shariah scholars. But others, like two-way markup sale and four-way markup sale, remained controversial.

Another dilemma then arose: when and how should these controversial instruments be phased out and replaced with ethically superior instruments that customers might find less palatable? There is never a definitive answer. Different stakeholders in the world of Islamic finance — states, transnational agencies, individual shariah scholars, academics, bankers, and customers — fight for instruments to survive or be phased out. And it is in these ethical contests that the changing meaning of the word "Islamic" in "Islamic finance" is forged.

Three ways to replicate interest Islamically

This chapter discusses three ways that Islamic financial institutions mimic the effect of interest-bearing loans: bayʿ al-ʿīnah, murabaha, and tawarruq. For simplicity's sake, I call these two-party markup sale (2-MS), three-party markup sale (3-MS), and four-party markup sale (4-MS) respectively. I describe them briefly here. Murabaha (3-MS) was discussed at greater length in Chapter Two.

Bayʿ al-ʿīnah (2-MS)

Bayʿ al-ʿīnah, or two-party markup sale (2-MS), involves just two parties: a financier ("B"), such as a bank, and a customer ("C") who wants to borrow cash. Imagine that C wants a loan of $500. B sells some asset that it owns to C for $600 on deferred-payment terms (i.e., to be paid back over some fixed future period). C then immediately sells the same asset back to B for $500 on spot terms (i.e., the money changes hands immediately). This is economically equivalent to a $500 loan carrying $100 interest. The asset has moved from B to C and back to B merely for the purpose of facilitating a financial transaction. The nature of the asset does not matter much; it can be, for example, a table.

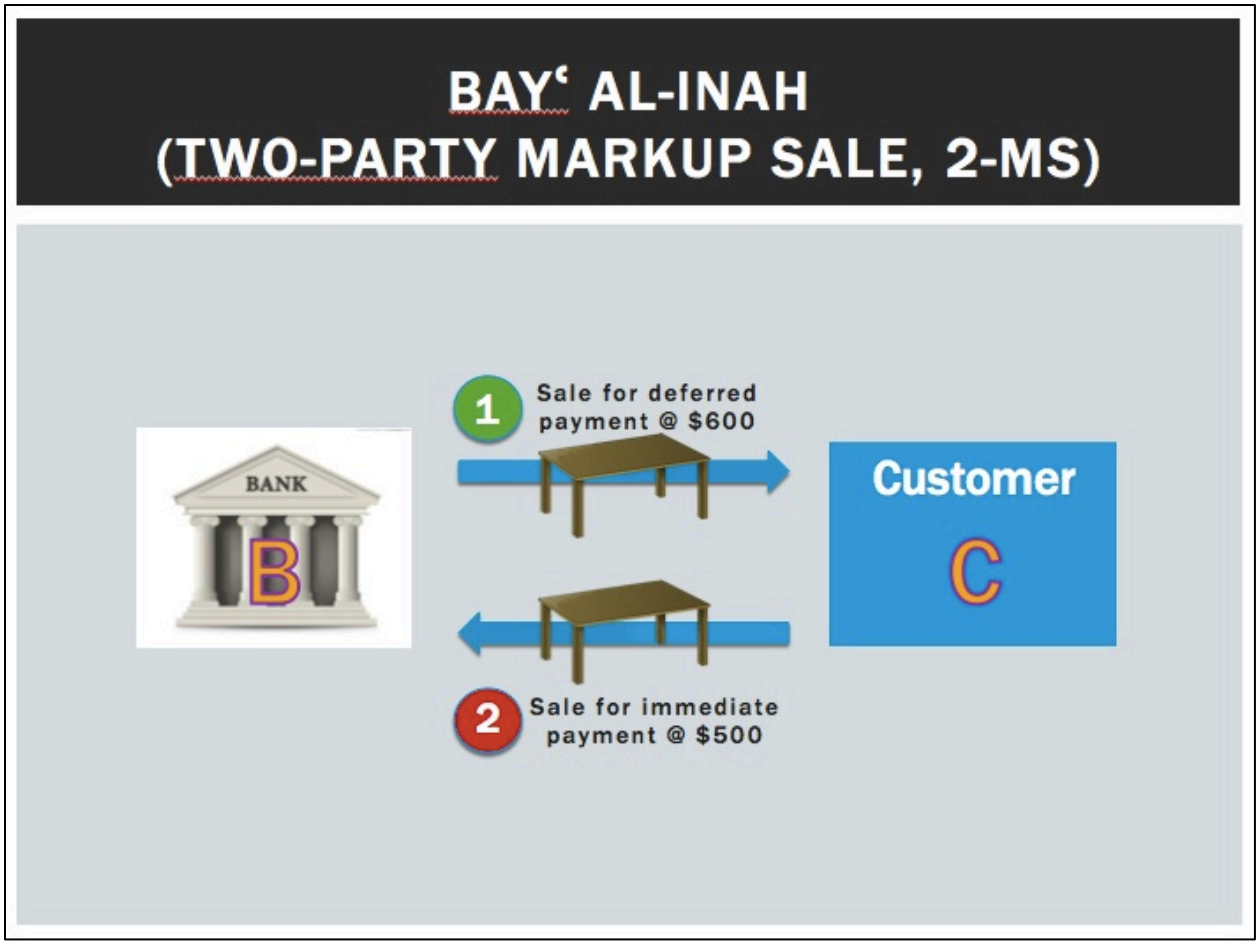

FIGURE 34: BAYʿ AL-ʿĪNAH (2-MS)

2-MS is strictly prohibited in the Middle East, yet allowed in Malaysia — but is gradually being phased out even there under pressure from the state and from shariah scholars who consider it ethically questionable.

Murabaha (3-MS)

Whereas bayʿ al-ʿīnah (2-MS) is a way of getting cash in hand, modern murabaha (three-party markup sale, or 3-MS), as discussed in Chapter Two, is a way of financing the acquisition of an asset (e.g., a car or a home) that the customer will actually use. Three parties are involved: the original seller of the asset, the financier, and the customer who wants to acquire the asset. Imagine that a customer ("C") wants a Toyota that costs $30,000. The Toyota dealer ("S") sells the car to the financier ("B," an Islamic bank) for $30,000 on spot terms. B now owns the car. But minutes later, B immediately re-sells the car to C on deferred-payment terms for $35,000. C now owns the car and owes B $35,000.

FIGURE 35: MURABAHA (3-MS)

3-MS, although initially controversial in the 1970s when it was introduced (see Chapter Two), is considered completely acceptable by virtually all shariah scholars in the industry. It is the most widely used contract in Islamic finance.

Tawarruq (also known as commodity murabaha[131]) (4-MS)

Tawarruq (four-party markup sale, or 4-MS) serves the same economic function as bayʿ al-ʿīnah (2-MS): it replicates an interest-bearing cash loan. However, it involves four parties: a commodity seller, a financier, a customer, and a commodity buyer.

Imagine that a customer ("C") wants a cash loan of $2 million. She approaches a financier ("B," an Islamic bank) to arrange this. First, B buys $2 million worth of some commodity, such as copper, from a commodity seller ("A") on spot terms. B then immediately sells this copper to C for $2.1 million on deferred-payment terms. C then immediately sells the copper on to a commodity buyer ("D") on spot terms. Assuming these transactions are completed swiftly, the market price of copper will not have changed much, so C should receive approximately $2 million for the copper. The end result is that C now holds $2 million in cash and owes B $2.1 million.

[131] The terms "tawarruq" and "commodity murabaha" are often used interchangeably. I will use "4-MS" to refer generically to both. Tawarruq comes from the Arabic verb stem w-r-q and translates loosely as "cashification" or monetization. This refers to the act of generating cash from a commodity sale, as described below. Technically, commodity murabaha refers only to the part of tawarruq where one party sells a commodity to another party at a declared cost and declared profit on deferred-payment terms. Tawarruq refers to the entire process described below, in which that commodity is then sold on to a third party in order to generate cash. However, in the actual Islamic-finance market today, all commodity murabaha is carried out in the service of tawarruq, and all tawarruq involves commodity murabaha; this is why the two terms are used interchangeably. (I thank Blake Goud for clarifying.)

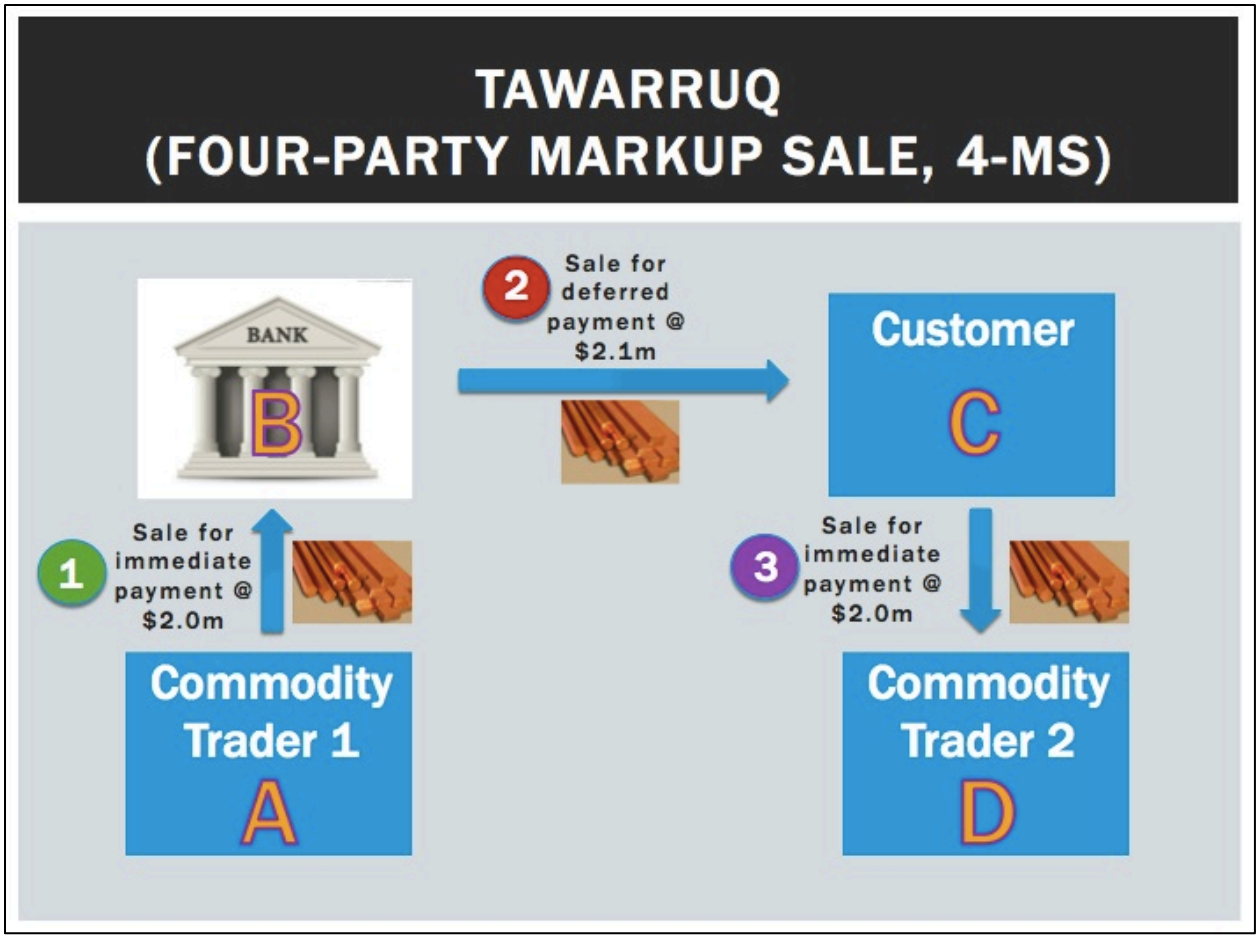

FIGURE 36: TAWARRUQ (4-MS)

4-MS is used around the world, especially in the Middle East, but has been condemned by some shariah scholars and is coming under ethical pressure on various fronts.

In the rest of this chapter, I discuss ethical contests over 2-MS and 4-MS. I touch briefly on why 3-MS is so widely accepted.

THE ETHICAL CONTEST OVER BAYʿ AL-ʿĪNAH (2-MS)

A primordialist understanding of Islamic jurisprudence would argue that ancient and unchanging legal practices determine what counts as Islamic and what does not. I argue that such a view does not fit the reality of Islamic finance today. That said, *longue durée* institutions do matter to a certain extent, and none more than the schools of Islamic jurisprudence (*fiqh*).

The schools of Islamic jurisprudence

The fact that 2-MS is permitted in Southeast Asia, but not in most of the rest of the Islamic world, is partly a function of differences among Islam's major juristic schools. These schools crystallized as distinct traditions of legal thought in the ninth and tenth centuries CE (Hallaq 2005; Melchert 1997; Coulson 1964) and are named after important legal scholars who lived primarily in the eighth century CE and the first half of the ninth. The continuity and evolution of the juristic schools have shaped Islamic legal practice in different geographies.

From a global perspective, Islamic jurisprudence (*fiqh*) is highly decentralized. There are four major schools of jurisprudence in the Sunni tradition: the Ḥanafī, the Mālikī, the Shāfiʿī, and the Ḥanbalī. Each prevails in different parts of the Sunni world.[132] The largest Shiʿite school is the Jaʿfarī.

The distinctions and divisions among the schools are not entirely neat. To begin with, there are places in which more than one school is prominent, such as Egypt. Even within each jurisprudential school, different jurists arrive at different and sometimes contradictory legal opinions. In cases of dispute, it is up to the individual Muslim to decide which jurist's opinion to follow.[133] There is also juridical overlap among the schools of *fiqh* in that jurists from one school sometimes cite decisions by jurists from other schools as precedent. Moreover, ordinary Muslim believers who adhere to one school may sometimes adhere to, or take into consideration, the rulings of a jurist from a different school. To make matters more complicated, there is no single international institution that standardizes decision-making around the world. (The International Fiqh Academy of the Organization for Islamic Cooperation, based in Jeddah, Saudi Arabia, has taken steps in this direction.) There are also national systems of Islamic law, precedent, and courts in many Muslim countries, although again, jurists often cite precedent from outside their national system.

Crucially, schools of Islamic jurisprudence are not sects. They do not represent different systems of theology, cosmology, or religious ontology. They are not clerical establishments or religious orders. Rather, they are intellectual traditions: corpuses of legal theory, precedent, and heuristics. Just as secular legal academics in France and Britain can have

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[132] The Ḥanafī school originated in Iraq when the 'Abbasid dynasty was based in Baghdad and enjoyed state support. It predominates today in the former lands of the Mughal and Ottoman Empires: India, Pakistan, Bangladesh, Afghanistan, Central Asia, the Caucasus, Iraq, Cyprus, Turkey, and the Balkans. In Syria, Jordan, Palestine, and Israel, Hanafi law is practiced with Shafi'i rites. The Mālikī school originated in Medina but today predominates in Mauritania, the Gambia, Senegal, Nigeria, Morocco, Algeria, Tunisia, Libya, Kuwait, Bahrain, and the UAE. The Shāfiʿī school originated in Cairo but today predominates in Indonesia, Malaysia, the Philippines, Thailand, Singapore, Sri Lanka, the Maldives, western Yemen, the Horn of Africa, and Sudan. The Ḥanbalī school, always the smallest of the four schools, was on the verge of extinction until revived by Ibn 'Abd al-Wahhāb, founder of the Wahhabi movement, in the late 18th century. It is therefore predominant only in Saudi Arabia today (An-Naim 2002).

[133] This is especially true in the Sunni tradition, in which fatwas are generally considered non-binding.

different stances while respecting the legitimate differences of legal theory and practice that separate their jurisdictions, jurists of all the major Islamic schools acknowledge the validity of the others, recognizing that the differences among them are legitimate intellectual differences among moral and rational thinkers and superior or inferior ways of being Muslim.

This mutual respect and implicit parity among juristic schools has been important in contemporary Islamic finance because scholars and bankers have used it to justify innovation and geographic difference. The fact that some practices are accepted by Shāfiʿī scholars in Malaysia and not by Ḥanbalī scholars in Saudi Arabia, or vice versa, cannot easily be mobilized as a reason to say Islamic bankers or customers in one region are better Muslims than those in another.

Juristic differences over 2-MS: The Shāfiʿī school vs. the rest

Of the four major Sunni schools,[134] only the Shāfiʿī school allows 2-MS. Though it originated in Cairo, the Shāfiʿī school predominates in Islamic Southeast Asia, where it arrived along the Indian Ocean trade routes that brought Islam. Thus, 2-MS has received the approval of many shariah scholars in Malaysia, Indonesia, and Brunei. Within the Shāfiʿī school, opinions are not uniform: the school's eponymous founder, Imām al-Shāfiʿī (767–820 CE), considered 2-MS permissible (*mubāḥ)*, whereas some other great Shāfiʿī jurists such as al-Nawawī (1233–1277 CE) considered it discouraged (*makrūh*) though not unlawful. The three other Sunni schools, meanwhile, are unanimous that 2-MS is unlawful (*ḥarām*).

Why do many Shāfiʿī jurists permit 2-MS when jurists of other schools do not? There are numerous and complex differences among the juristic schools, so any claims that one school or the other is generally "the most liberal" or "the strictest" are oversimplifications. But when it comes to 2-MS in particular, Shāfiʿī scholars are the most tolerant because they diverge from their peers in other schools over two issues: contestation over a particular *chain of transmission* relating to 2-MS and contestation over the importance of an actor's *intention*.

Chain of transmission (*isnād*) refers to the historical chain of individuals who are attested to have orally transmitted important records of the sayings and deeds of the Prophet Muhammad and his companions until the time they were eventually written down approximately two centuries later. These transmitted records are tremendously important in Islamic jurisprudence, for jurists of all schools use them as supplemental textual bases in deciding how to apply Islamic law to all manner of issues, whether in criminal law, commercial law, family law, worship and rites, or any other field of Islamic law.[135] Because

[134] the Ḥanafī, the Mālikī, the Shāfiʿī, and the Ḥanbalī

[135] During the classical period, scholars amassed great compendia of thousands of such records to serve as the basis for the practical development of religious jurisprudence. Over the years, a secondary historical forensic science developed to assess the reliability of different chains of oral transmission, judging whether particular

the Quran itself is often short on legal detail, these records of ancient sayings and deeds are crucial in guiding jurists.

Some such records attest that 2-MS is unlawful, but major Shāfiʿī jurists have disputed the reliability of these records. One such record attests that Zayd bin Arqam, a companion of the Prophet Muhammad, engaged in 2-MS: he (through his *umm walad*[136]) sold his slave on deferred-payment terms for 800 dirhams and then bought the slave back for 600 dirhams. According to the record, the Prophet Muhammad's wife ʿĀishah was then asked about Zayd bin Arqam's transaction and deemed it a "very bad sale" (Shaharuddin 2012:501). Respecting this account of ʿĀishah's condemnation, the Ḥanafī, Mālikī, and Ḥanbalī schools consider 2-MS unlawful. However, many Shāfiʿī scholars do not accept this particular record as historically reliable. Moreover, in the view of the eponymous Imām al-Shāfiʿī himself, ʿĀishah's opposition to the sale could not overrule Zayd's acceptance of it because they were both companions of the Prophet (al-ṣaḥābah) and were thus on equal juristic footing (Shaharuddin 2012:502). As a result, Shāfiʿī scholars tend to allow 2-MS (if sometimes grudgingly), while scholars of other schools prohibit it.

A second difference between the Shāfiʿī school and the other schools concerns the intention of the two parties involved in 2-MS. To the casual observer, it may seem obvious that both parties to 2-MS are trying to circumvent the ban on usury (*ribā*). But does this make 2-MS unlawful? The classical jurists of the Ḥanafī, Mālikī, and Ḥanbalī schools held that it did because it blatantly uses a legal stratagem (*ḥīlah*) to achieve an Islamically unlawful end: dealing in usury (Shaharuddin 2012:503). However, Imām al-Shāfiʿī himself — revered even outside the Shāfiʿī school as one of the greatest legal minds in Islamic history — took a different approach. He examined each of the two sales within 2-MS — the deferred-payment sale from B to C and the spot sale from C to B — and ruled that as long as each complied with the essential elements (*arkān*) of a contract, there was no basis to prohibit either one. Al-Shāfiʿī reasoned thus: if one sale is acceptable, and a second sale is acceptable, then carrying them out in sequence should be acceptable. He felt that divining the intent of the two parties to circumvent the law in this situation was a slippery slope.

Thus the legality of 2-MS is part of a much broader debate in Islamic commercial jurisprudence about the extent to which jurists should attempt to divine the intent of parties entering into a contract (Powers 2006, especially 97–121; Messick 2001; Johansen 1996). Stressing the diversity of Islamic juristic opinions through history about the intent behind a sale, Powers notes:

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records could be trusted based on each human link in the chain. Different jurists and juristic schools came to judge the reliability of different chains of transmitters differently.

[136] An *umm walad* is a female slave with whom the master has a child. By becoming an *umm walad*, a female slave gains an enhanced degree of legal status (though not manumission) in classical Islamic legal theory.

> Selling grapes is perfectly legal, whereas making wine is prohibited. So what of selling grapes when the buyer intends to make wine? Likewise, the selling of a sword is permitted, but what if the buyer intends to kill with it? … Jurists disagree over… where to draw the line between intentional effects that matter and those that do not. (2006:111)

And when it comes to bayʿ al-ʿīnah (2-MS) today, we find the same diversity of opinions:

> Some Islamic scholars have classified bai inah as a back-door legal excuse to legitimise riba [usury]… They insist that bai inah is ethically flimsy as the sale and purchase of the asset is a fake sale and just a means of masking riba. The conflict boils down to differences of opinion… the schools of thought on Shariah law are not homogeneous. (Abdullah and Chee 2010:202)

This question of where to probe intent as a condition for piety, and where instead to bracket it, is neither trivial nor arcane. It is at the heart of ethical contests in contemporary Islamic finance.

Trouble in the courts

We have seen above that geography — via the juristic schools (*madhāhib*), which have over a millennium of tradition behind them — helps determine which financial products are accepted by scholars at a particular time and place. However, geography and juristic school are not completely determinative. If they were, the Islamic acceptability of a financial instrument would hardly change over time in a given location. Yet in the second decade of the 21st century, 2-MS has gone from being widely used in Malaysian Islamic finance to coming under severe ethical criticism and being increasingly phased out by Malaysian Islamic banks. What is causing this shift?

The answer, broadly speaking, is the Malaysian state. But this is not a simple story of a monolithic state imposing its monolithic ethical stance on Islamic banks. Rather, a process of ethical contestation played out in one branch of the state, the judiciary, causing market instability that led another branch, the financial regulatory apparatus, to intervene.

2-MS has been the most controversial issue in Malaysian Islamic finance for a long time. Between the birth of Malaysian Islamic finance in the early 1980s and around 2002, the Islamic-finance industry was still small, and judicial involvement and awareness was limited. Malaysian civil courts generally did not take on the shariah-compliance of Islamic-finance contracts as a matter for them to decide, leaving this to the banks' shariah boards (Hasan and Asutay 2011; Markom et al. 2013).

But from 2003 to around 2009, as Islamic finance expanded rapidly, the civil courts

became more activist with regard to Islamic finance. 2-MS was a major issue; 90 percent of the Islamic-finance cases registered in Malaysian courts during this period related to it (Muhammad 2010). Departing from a standard common-law approach, judges in civil courts became more familiar with the workings of Malaysian Islamic banking and began to examine whether they were "contrary to the religion of Islam" (Hasan and Asutay 2011:45). Controversy came to a head in 2008, when High Court Justice Datuk Abdul Wahab Patail ruled in a number of cases that home financings based on 2-MS were invalid. Patail's reasoning was that the sales involved in 2-MS were not bona fide sales and that 2-MS was simply a way of dealing in usury under another name. If a contract was invalid under shariah, he argued, then it was not a valid Islamic financial contract for the civil courts to enforce. But at the time of the ruling, the majority of Islamic home financings in Malaysia were based on 2-MS (Abdul Razak, Mohammed, and Taib 2008).

The courts' rulings threw Malaysia's Islamic-finance market into turmoil. It was unclear what defaulting Islamic-home-finance borrowers legally owed the banks, if anything. Moreover, Islamic banks and their shariah scholars suddenly appeared unethical for having approved and relied on 2-MS for so long. "The judge's comments in the judgments call into question the very integrity of Islamic banking practitioners here, including Shariah advisers," said one Malaysian lawyer with extensive experience in Islamic finance (Singh 2008b). "Not surprisingly, the affected banks are reported to be appealing the decisions." The next year, in 2009, Justice Patail's rulings were overruled by the Court of Appeal. This re-established 2-MS as a valid sale transaction from the perspective of Malaysian commercial law. With these back-and-forth rulings, the market lacked clear guidance.

Facing chaos in the marketplace, the executive branch's financial regulatory apparatus — led by the central bank — stepped in to restore order. The Central Bank of Malaysia Act of 2009 made it mandatory for Malaysian courts to refer to the shariah board of Bank Negara Malaysia, the Malaysian central bank, in all matters concerning Islamic finance (Laws of Malaysia 2009:Part VII, Ch. 1; Hasan 2010). The state sent a clear message: individual judges in secular courts, for whom knowledge of classical Islamic jurisprudence and contemporary Islamic finance was not a job requirement, would no longer be able to impose their own potentially uninformed interpretations of Islamic economic ethics on the industry. This not only began to calm the market, but also cemented the position of shariah scholars — especially those on the central bank's shariah board — as the sole ethical arbiters of the Islamic-finance industry (Hasan and Asutay 2011:48–49). Islamic-finance shariah scholarship was increasingly a state-supported form of technical ethical expertise.

2-MS is convenient for banks but embarrassing to Malaysian Islamic finance

Having replaced the unpredictability of the courts with its own forward-looking agenda, Malaysia's powerful central bank, led since 2000 by the long-serving Governor Zeti Akhtar Aziz (Malaysia's first female central-bank governor — "cool, intellectual, and respected for

toughness" (Dudley 2004)), has taken a gradual but firm approach to phasing out 2-MS. But whether opposition to 2-MS comes from the courts or the central bank, the question remains: If Malaysia is a Shāfiʿī jurisdiction in Islamic jurisprudence, why phase out a financial practice that Imam al-Shāfiʿī himself — arguably the most influential Islamic jurist in history — declared acceptable? The answer is a fascinating study in how Islamic economic ethics change.

Phasing out 2-MS goes against capitalist interests because it has been so central to Malaysian Islamic finance. "The whole [Malaysian Islamic-banking] industry was practically built on [2-MS]," said an industry executive in 2008 (Singh 2008a). "And it still features prominently in many transactions." According to one observer of Malaysian Islamic banking, financing based on 2-MS used to compose "nearly 80% of the overall financing portfolio of some [Malaysian Islamic] banks" (Alfatakh 2014).

2-MS is convenient for banks. The transaction costs associated with selling an asset and then immediately buying it back from the same customer are tiny: very little IT infrastructure or accounting infrastructure is required beyond what a conventional bank uses to make loans. And because the transaction happens so quickly, banks can use the same assets over and over to arrange 2-MS loans for different customers. Malaysian Islamic banks sell and buy back all manner of assets on their books, including "table[s], chairs, pieces of land, ATM machines, computers, company shares, subdivided properties, and many others" (Alfatakh 2010). All of this means moving away from 2-MS is a large and costly step for banks.

Unfortunately for the banks, members of the Islamic-finance community describe 2-MS as an embarrassment to Malaysian Islamic finance. One observer says it "has always been treated as the ugly stepsister of [Malaysian] Islamic Banking" (Alfatakh 2010). Those ashamed of it make a range of ethical arguments. One is rooted in a historical narrative: 2-MS was introduced to Malaysian Islamic banking as a stopgap measure in the 1980s to allow the fledgling Islamic-banking industry to compete with conventional ones by offering cheap and simple financing products (Singh 2008b). Some shariah scholars argued back then that necessity (*ḍarūrah*) and the public interest (*al-maṣlaḥah al-mursalah*) justified its use. In their eyes, letting customers use 2-MS was at least better than pointing them toward a conventional interest-based bank. But now that the Islamic-banking sector holds a quarter of Malaysia's banking market (Samat 2013),[137] many feel the time has come to eliminate 2-MS. This argument demonstrates a reflexivity and historical memory within the Islamic-finance community. It distinguishes Islamic finance as an ethical project whose self-conscious sense of historical unfolding must transcend commercial expediency. According to this line of reasoning, if ethical progress is possible in Islamic finance, it is incumbent on

[137] Malaysia's Bank Islam reported that as of December 2012, the Islamic-finance industry accounted for 23.8% of total assets in Malaysia's banking system, 25.8% of total financing, and 25.6% of total liabilities (Samat 2013:23). It also predicted that by 2020, Islamic finance would account for 40% of total financing in Malaysia.

Muslims — including shariah scholars, bankers, state regulators, and even customers — to strive for it.

Other complaints about 2-MS have to do with its structure. Critics feel 2-MS is too close for comfort to a conventional interest-bearing loan. They say it is a legal stratagem (*ḥīlah*) or trick used to achieve an unlawful end (usury). Moreover, the wide range of assets traded in 2-MS, ranging from ATMs to tables and chairs, "border[s on] the comical" (Alfatakh 2010). Critics also note that the use-value of these traded assets is irrelevant to the transaction: the customer has no need for the bank's ATMs, tables, or chairs, and makes no use of them. She does not even touch them; physically speaking, they stay in the bank's possession. These assets being bought and sold "move" only in an accounting sense. They are employed only for their exchange-value. In the mind of critics, this makes 2-MS less ethical and less Islamic than other Islamic financial products. (As we shall see below in discussions of 3-MS and 4-MS, the use-value of the assets underlying an Islamic financial transaction has become a new litmus test for how Islamic it is.)

Angry professors and suspicious customers: 2-MS brings pressure on the Malaysian state

Ethical discontent within the Islamic-finance community translates into pressure on the Malaysian state. In a 2011 article, for example, two law professors from the International Islamic University of Malaysia accuse the Malaysian government of sin and venality for failing to uproot 2-MS from Malaysian Islamic finance:

> The persons in authority (the Government of Malaysia, Bank Negara, and Shariah Advisory Committee/Body) … have the means and ability to replace the Malaysian style of [2-MS] in house financing with better products, but they do not resort to them. This is sinful. (Aljunid and Dahlan 2011:357)[138]

Having established the central bank's shariah board as the leading ethical authority in Malaysia on Islamic finance, the state was now on the hook for continuing to allow 2-MS. One of the two law professors who wrote the critical article, Nuarrual Hilal Mohamed Dahlan, was later quoted in a newspaper article directing his anger at the central bank's shariah board. "The current immunity of the Shari'ah Advisory Council of BNM [Bank Negara Malaysia] is not warranted," he said. They may [be] abusing their position and

[138] The authors continued: "This is akin to the requirement that to perform the obligatory prayer (*solah fardu*), one shall have to stand up (*qiyam*). If he has the ability to stand up (*qiyam*) without any difficulty or hardship, but instead he chooses to pray by sitting down, his prayer is rejected… Similarly in house financing, the persons in authority have the ability and means to use better Islamic products, such as *musharakah* and *ijarah* in house financing to avoid the occasion of riba' [usury] by way of helah [legal stratagem] (as in [2-MS])… however, they choose [2-MS]. The reason for this may be economic and/or maximization of profit factors."

privilege" (Abdul Alim 2011).[139] This scathing criticism highlights one of the perils associated with a highly centralized and state-driven approach to Islamic finance: the Malaysian state must try to do what is best for Malaysia's Islamic banks while also satisfying other stakeholders in the ethical project of Islamic finance.

Indeed, as public awareness of Islamic finance increases, it is not just university professors who complain about the structure of 2-MS: customers become unhappy too. Several studies have shown that Malaysian retail customers are dissatisfied with products based on 2-MS, considering them less shariah-compliant than products based on alternative structures such as diminishing partnership (Abduh and Abdul Razak 2012; Abdul Razak et al. 2008; Amin 2008; Taib, Ramayah, and Razak 2008). In Malaysia, it seems that *customers are starting to peer inside the black box as they learn more about Islamic finance.* This threatens to undermine consumer confidence in the whole Malaysian Islamic-finance sector, increasing pressure on the state to act.

Globalization increases pressure on the state to regulate

Another source of ethical pressure on the state is globalization. In 2005, three foreign Islamic banks — including Saudi Arabia's Al Rajhi and Kuwait Finance House, the world's two largest — entered the Malaysian market after receiving licenses the previous year. The Gulf-based banks operating in Malaysia do not offer products based on 2-MS, and part of their brand appeal relative to their Malaysian competitors is what some customers perceive to be a higher standard of shariah-compliance. (Anecdotally, one Malaysian lawyer who works in Islamic finance confided to me in 2010 that her own bank account is with Al Rajhi because she feels "their shariah standards are stricter," not least because they avoid products like 2-MS that she considers questionable (A. R. (anonymous) 2009).) Faced with both foreign competition and public controversy, some Malaysian Islamic banks began to phase out home-financing products based on 2-MS, starting with RHB Islamic in 2008 (Singh 2008c). From the opposite perspective, Malaysian Islamic banks' reputation for engaging in practices not considered shariah-compliant in the Middle East is one reason why they have been almost completely absent from the lucrative Gulf Islamic-banking market. 2-MS may have kept profits from the globalization of Islamic banking flowing in only one direction.

The global cultural geography of Islam matters here. Even in Malaysia, critics of 2-MS stress that none of the other Islamic juristic schools besides the Shāfiʿī accept 2-MS. The fact that the rest of the Islamic world (outside Southeast Asia) shuns 2-MS makes its widespread use in Malaysia a national embarrassment. It also dampens the pride that many in Malaysia's Islamic-finance community feel about their country's worldwide reputation for a

[139] By "immunity," Dahlan is referring to the fact that the central bank's shariah board now seems to sit above any shariah authority in the country in that it enjoys binding authority over other shariah boards and in that Malaysian civil courts must refer to it in Islamic-finance cases as well.

sophisticated and well-regulated Islamic-finance sector. I met several Malaysians working in Islamic finance who expressed, privately and off the record, a sense that some members of the Islamic-finance community in the Gulf looked down their noses at Malaysian Islamic finance. "They think their way of doing things is better," said one Malaysian researcher. Whether real or imagined, this perception makes the 2-MS controversy sting even more.

The state kills off 2-MS

Eventually, between 2012 and 2014, the Malaysian central bank effectively strangled 2-MS to death. It did not do this by formally banning 2-MS. Instead, after several years of making noises encouraging Malaysian banks to move away from it on their own (as RHB Islamic did), it signed 2-MS's death warrant in November 2012 when its shariah board announced that the two legs of 2-MS should avoid "interconditionality." This meant that banks could no longer contractually require, as a condition for entering into the transaction, that a customer sell back to the bank the asset that she just bought from it (see Figure 37).

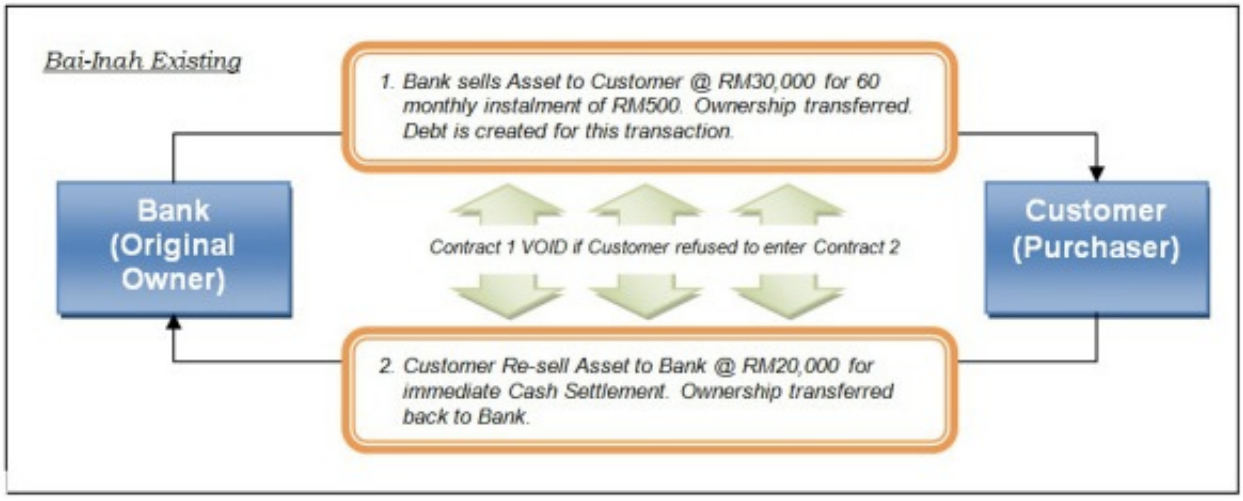

FIGURE 37: 2-MS AS MALAYSIAN ISLAMIC BANKS GENERALLY PERFORMED IT BEFORE THE MALAYSIAN CENTRAL BANK BANNED INTERCONDITIONALITY

In other words, if an Islamic bank sells an ATM to a customer for 55,000 ringgit on deferred-payment terms with the expectation that the customer will immediately sell it back to the bank on spot terms for 50,000 ringgit, the customer now has the option simply to keep the ATM or sell it to someone else. While it may be hard to imagine ordinary bank customers hawking ATMs on the open market, the possibility is fearsome enough to make 2-MS an untenable commercial risk for Malaysia's Islamic banks. (In 2014, the central bank clarified and tightened this rule with further documentation.)

Shamsiah Mohamad, a member of the central bank's shariah board, effectively admitted that she and her colleagues on the board were killing off 2-MS:

> Most of the Islamic financial institutions have a problem complying with the new ruling. The rules are too tight… The interconditionality is hard to meet — first leg and second leg, the two can't have links. (Hamzah and Vizcaino 2014)

Mohamad also acknowledged that even if Malaysian Islamic banks were to avoid interconditionality, the central bank wouldn't "encourage 2-MS because it's not a kind of contract that all mazhabs [Islamic schools of jurisprudence] agree on."[140] This shows again that juristic localism is giving way to a syncretic and convergent global approach, even in a region — Southeast Asia — dominated by a single juristic school. "The death of [2-MS] will be good news for our Middle Eastern colleagues," writes one Malaysian product-development expert in Islamic finance. "One less controversial contract to talk about" (Alfatakh 2012).

In sum, the globalization of banking markets, the perceived opprobrium of Muslims around the world, and outcries from domestic stakeholders in Islamic finance all contributed to bring the state's vice-grip on the neck on 2-MS, a profitable Islamic financial practice in Malaysia. This is a case of Islamic economic ethics evolving before our eyes. While capitalist interests shape such evolution, they do not completely determine it. This story also shows that the growth and globalization of the Islamic-finance industry do not always make shariah's application more lax. In this case, it became more strict.

But while the expansion of Islamic finance does not necessarily correlate with laxity or stringency in the *application* of shariah to finance, it does correlate with its *formal rationalization*. As Islamic finance grows, the application of shariah to finance becomes ever-more technical, rule-bound, and bureaucratic. Globalization is causing convergence among regions, but always in the direction of more formal rules. In the past several years, even some Gulf countries have moved toward centralizing shariah supervision of Islamic finance under a single state shariah board (Hamzah and Vizcaino 2014). In the case of 2-MS in Malaysia,

[140] *Mazhab*, spelled with a "z," is a transliteration often used in Malaysia of what I transliterate from Arabic as *madhhab*.

we saw secular judges meddling unpredictably in ethical debates about 2-MS put in their place by the Malaysian central bank. The state made its own panel of expert shariah scholars the highest ethical authority on Islamic finance, gave that authority binding power under penalty of imprisonment, and set a gradual but clear course toward eliminating an ethically controversial instrument by elucidating the technical standards for its acceptable use. The shariah-compliance apparatus expands.

THE UNIVERSAL ACCEPTANCE OF MODERN MURABAHA (3-MS)

Early acceptance of 3-MS becomes path-dependent

As discussed in Chapter Two, modern murabaha (3-MS) was introduced to Islamic banking in 1976 in the PhD thesis of Sami Hamoud, a Jordanian banker and economist. Hamoud drew on the writings of Imam al-Shāfiʿī in justifying the use of 3-MS (Maali and Napier 2010).[141] He also founded Jordan's first Islamic bank in 1978 (see Chapter Two).

At first, some shariah scholars considered 3-MS Islamically dubious because it was clearly a way to mimic interest-based financing. However, Hamoud and others argued that it was both religiously acceptable and essential for Islamic banks if they were to survive competition against conventional banks. Thanks to early approval by leading shariah scholars at conferences in the 1970s and 1980s, 3-MS became entrenched. It quickly became the most widespread financing instrument in Islamic finance, and still is.

Those who still criticize the use of 3-MS tend to be economists and "outsiders" to the business operations of Islamic finance rather than "insiders" such as shariah scholars and practitioners of Islamic finance. Today, even opponents of 3-MS tend to argue that the problem with 3-MS is that it is used so widely, not that it is used at all (Asutay 2012; Hasan 2007; Iqbal and Molyneux 2005; Jan 2011; Nagaoka 2007; Yousef 2004).

An emerging litmus test for "Islamicity": Use-value

I asked one industry commentator why 3-MS is less controversial today than 4-MS even though both mimic interest. He stressed what I call the "use-value litmus test," which in the eyes of shariah scholars and the Islamic-finance community makes 4-MS feels more like a legal stratagem or "trick":

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[141] Hamoud did not follow the Shāfiʿī school exclusively when laying out the operating principles for his bank, Jordan Islamic Bank, and the special government act establishing it. He intentionally drew on opinions from different schools as well, such as the Mālikī, in order to provide a solid juristic foundation for Islamic banking. He took this syncretic approach even though Jordan is historically a Ḥanafī jurisdiction (Maali and Napier 2010).

> The reason [4-MS] is viewed as a trick and [3-MS] is not … is because the commodity being used [in 4-MS] is not ever used or needed by the party receiving the financing. (Goud 2014)

Does being Islamic mean being embedded in the real economy?

The quote above suggests 3-MS feels acceptably "Islamic" to this respondent because the item being bought and sold, such as a car, will actually be used by the customer. In 2-MS, some item from the bank's balance sheet (such as an ATM) is traded back and forth, but the customer will never use it. Likewise, in 4-MS, the asset traded is typically a commodity such as copper, copper, or palladium that the customer will never use. In 2-MS and 4-MS, the assets are merely vehicles for facilitating a cash loan.

This gets at the ontology of Islamic finance. As the next chapter explains, the pioneers and theorists of the 1970s and 1980s argued that risk-sharing was what made Islamic finance Islamic. But an alternative narrative has emerged in the past two decades: that *embeddedness in the real economy* is what makes Islamic finance Islamic. Zeti Akhtar Aziz, governor of Malaysia's central bank, puts it thus:

> A core underpinning of Islamic finance is the tenet that requires Islamic financial transactions to be supported by genuine productive economic activity. (Aziz 2013)

The embeddedness narrative is appealing for several reasons. First, it capitalizes on growing popular concern that conventional finance builds towers of dubious financial assets on dubious financial assets, leading to systemic instability. The 2007–2008 financial crisis reinforced this belief. Insisting on a structural connection to the buying and selling of real non-financial assets is therefore intuitively compelling. Second, it is a standard that allows Islamic banks to set themselves apart from conventional banks while allowing them to continue selling interest-mimicking products. And third, it is easy to explain to customers.

THE ETHICAL CONTEST OVER TAWARRUQ (4-MS)

The acceptance of modern murabaha (3-MS) by Islamic jurists led shortly thereafter to the acceptance of tawarruq (4-MS), which allows Islamic banks to replicate unsecured interest-bearing cash loans. Whereas 3-MS seemed to be somewhat at odds with the substantive economic vision of Islamic finance's founders, 4-MS flew in its face completely because it effectively lent cash in exchange for nothing. However, 4-MS had the potential to plug a gaping hole in the Islamic financial infrastructure that put Islamic banks at a competitive disadvantage to conventional banks: the lack of an interbank liquidity-management

instrument. This served as an ethical justification to use it. 4-MS has become one of the most common contracts in Islamic finance today, especially at the level of wholesale and interbank finance, where tens and hundreds of millions of dollars regularly move using it. It remains deeply controversial in the industry, and reformers have made noises about phasing it out. After it came under attack in 2009, some of the most powerful shariah scholars in Islamic finance spoke out in defense of it.

Classical 4-MS vs. organized 4-MS

People involved in the debate over 4-MS distinguish between two types of it: "classical" 4-MS[142] and "organized" 4-MS.[143] Many feel that classical 4-MS is Islamically acceptable but organized 4-MS is not.

Classical 4-MS is a relatively simple transaction that some classical Islamic jurists approved in medieval scholarship. Organized 4-MS, also known as "banking" 4-MS or "modern" 4-MS, contains various safeguards and guarantees that protect the creditor (e.g. the Islamic bank) and make 4-MS economically equivalent to a conventional cash loan. It is therefore particularly controversial.

Figure 38 shows how classical 4-MS works. A customer ("C") needs cash. She buys some item on credit from "B," say for $2.1 million. She then sells the same item immediately on spot terms to someone else ("D") for $2.0 million. In this case, C does all the legwork herself: for example, she finds the final buyer (D) for the item she bought from B.

[142] *al-tawarruq al-fiqhī*, literally "juristic tawarruq"; this is also known as *al-tawarruq al-fardī*, "individual tawarruq"

[143] *al-tawarruq al-munaẓẓam*; this is also known as *al-tawarruq al-maṣrafī*, or "banking tawarruq"

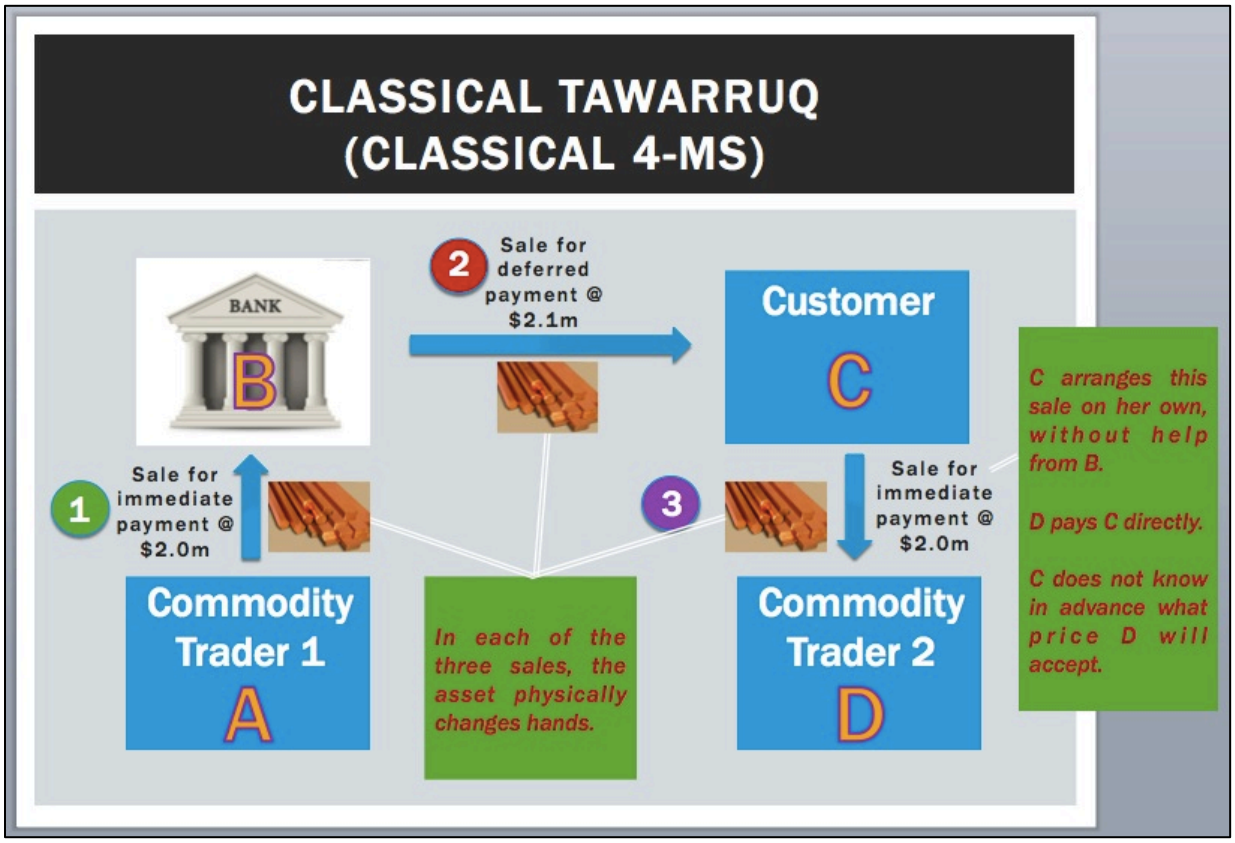

FIGURE 38: CLASSICAL TAWARRUQ

In organized 4-MS, all details are arranged in advance to streamline the process of getting cash to the customer, reduce transaction costs, and effectively eliminate the risks of price fluctuation and non-completion of the transaction by any party. Organized 4-MS depends on electronic commodities-trading technologies and is thus a function of the information age.

Figure 39 shows how organized 4-MS works. Here, the creditor B (e.g. the Islamic bank), does all the legwork of "organizing" the transaction. This makes life much easier for the customer C and more predictable for everyone, reducing commercial risk and transaction risk. A typical organized 4-MS transaction proceeds as follows:

- Customer C approaches Islamic Bank B and signs paperwork agreeing to a 4-MS transaction.
- As contracted in the paperwork, Islamic Bank B buys commodities on spot terms from a commodities broker ("A"). For example, B might buy $2 million worth of copper from a broker on the London Metal Exchange (LME). Islamic Bank B never takes physical delivery of the copper, which remains in one of the LME's warehouses around the world.
- Islamic Bank B sells the copper to Customer C for $2.1 million on credit. Again, the copper remains in an LME warehouse. The sale takes place in the bank's accounting books.
- Acting as an agent (*wakīl*) on behalf of Customer C, Islamic Bank B sells the copper to another commodities broker ("D") for $2.0 million. Islamic Bank B then credits the $2.0 million to Customer C's bank account.
- Because Broker D and Broker A are both large-volume traders registered with the LME, they are typically able to net out the copper between each other's accounts. The copper never has to move from A's warehouse to D's warehouse.
- Customer C eventually pays Islamic Bank C $2.1 million in installments over some predetermined period, just as in a conventional loan.

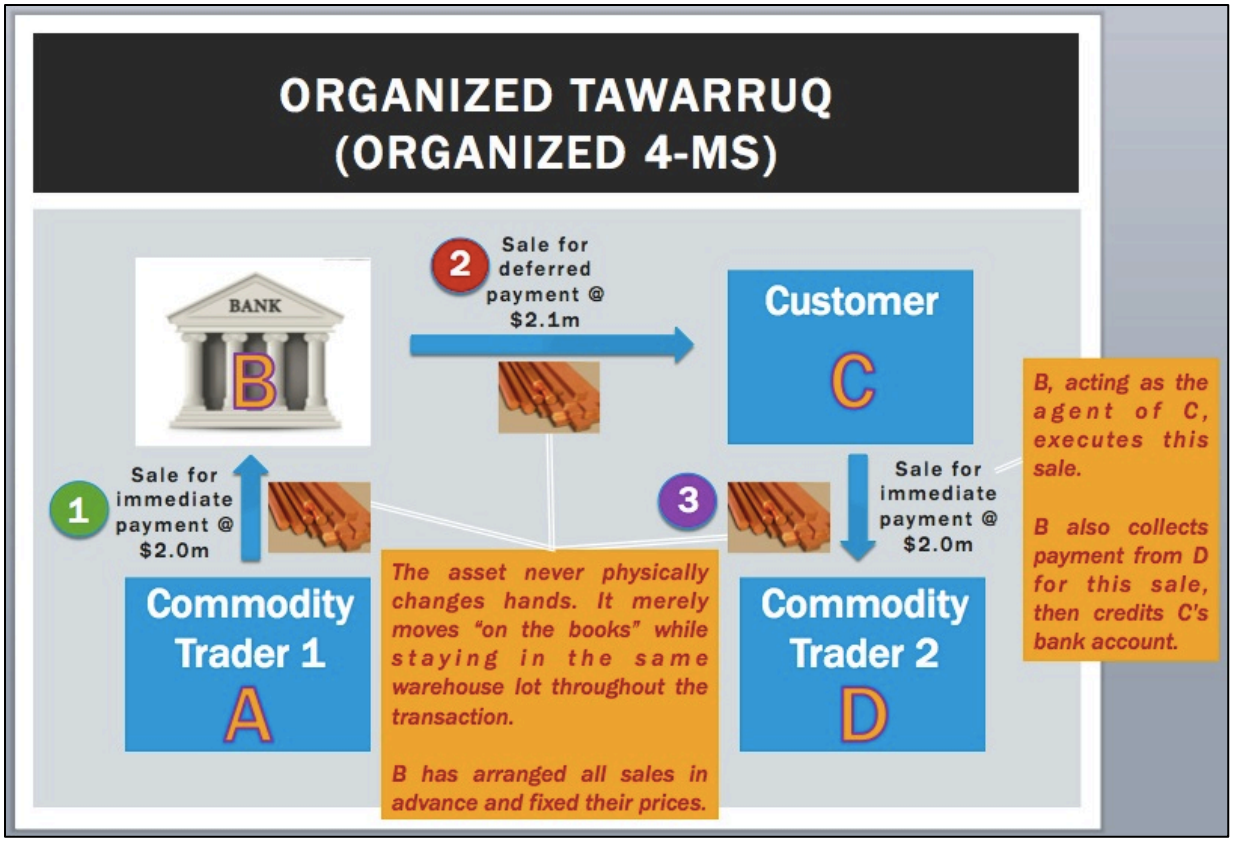

FIGURE 39: ORGANIZED TAWARRUQ

All of these steps take place quickly — in an hour (Khan 2010) or even less. The outcome is that Customer C has effectively taken a cash loan from Islamic Bank B. The copper was traded electronically three times, but never moved physically.

Figure 40 summarizes some of the main differences between classical 4-MS and organized 4-MS.

FIGURE 40: SUMMARY OF DIFFERENCES BETWEEN CLASSICAL 4-MS AND ORGANIZED 4-MS (S. Khan 2010; Tijani 2013)

Classical 4-MS	**Organized 4-MS**
B plays no role in C's sale of the asset to D	B, acting as C's agent, arranges and executes the asset sale from C to D
C receives cash directly from D	C receives cash from B, who collects from D on C's behalf
The asset physically moves	The asset almost never moves physically, being traded only "on the books"
C may not know in advance the exact price at which D will buy the asset	B has fixed all sale prices in advance

Interbank lending and the entrenchment of 4-MS

Today, 4-MS is very widely used in Islamic finance, especially in the Gulf region. Yet it seems to fly in the face of the idea proposed by early Islamic bankers in the 1970s and 1980s that Islamic finance should not replicate conventional interest-based lending. So how did this "work-around" become so widespread?

4-MS first became popular not as a way of making cash loans to bank customers, but as a way for banks to lend to one another. Naturally, when Islamic banks first came into existence, there was no Islamic interbank lending market.[144] (Even today, the weakness of

[144] The task of interbank lending, known as "liquidity management" and carried out by the treasury department of a bank, is a fundamental part of banking that happens away from the view of customers. In the conventional financial world, banks are constantly lending money to one another on what is called the interbank lending market.[144] It allows banks to engage in "liquidity management" — the practice of making sure that they meet the mandated reserve requirement every day and meet their depositors' demands while efficiently earning a return on any surplus they have over that reserve requirement. The interbank lending market is vitally important to each bank's operations, and to collective stability; one of the reasons why the 2008–2009 financial crisis spread across banks and borders was because the interbank lending market froze up.

the Islamic interbank lending market is a perpetual headache for Islamic-finance industry.) Without recourse to some Islamic lending instrument similar to an interest-based loan (i.e. a risk-shifting instrument), Islamic banks faced a huge disadvantage in liquidity management relative to their conventional competitors. In order to meet the government reserve requirement, they had two undesirable options: they could always keep on hand a large surplus of cash above the reserve requirement, which would make them less efficient than their competitors; or they could borrow and lend on the conventional interbank market, which would mean engaging behind the scenes in the sinful interest-based activity that it was their mission to avoid.

One of the reasons 4-MS became so popular in the late 1970s and early 1980s among the pioneering Islamic banks is that it is the simplest and cheapest Islamic instrument for liquidity management. By arranging interbank 4-MS, banks can avoid being stuck between the two undesirable options above: they no longer have to maintain large cash surpluses nor deal in interest-bearing interbank loans. It is very easy for two Islamic banks to structure an overnight 4-MS just as they would structure an overnight loan. This is so easy, in fact, that some conventional banks also do overnight 4-MS business with Islamic banks.

The utility of 4-MS as a liquidity-management instrument shows how the rise of the risk-shifting model of Islamic finance and the decline of the risk-sharing model was largely a matter of survival. The Islamic banks of the 1970s and 1980s faced a dilemma: compromise on their utopian vision of a risk-sharing economy or disappear in the Darwinian marketplace. Islamic bankers, against the wishes of some Islamic scholars and also the industry's early visionaries, self-consciously decided to adopt murabaha widely even though it was a risk-shifting instrument. In order to survive, they made their industry more like conventional finance than the visionaries had ever expected it to be.

Western banks and commodity brokers in the spread of 4-MS

As mentioned above, Islamic banks and their clients often trade base metals on the London Metal Exchange (LME) to facilitate 4-MS transactions.

When I began my research, I wondered: Why the LME? How did the LME — as opposed to other commodities marketplaces — become so important in Islamic finance?

To answer this question, I met with Stella Cox, the managing director of DDCAP Group, a London-based firm[145] that helps financial institutions facilitate shariah-compliant

[145] DDCAP's London office is in Belgravia, home to some of the city's most expensive residential real estate — a few minutes' walk from Buckingham Palace Gardens, among streets lined with Porsches and Bentleys. The boutique firm's posh address speaks to its success in facilitating shariah-compliant transactions via the LME on behalf of a fast-growing Islamic-finance industry. DDCAP's other office is in the Dubai International Financial Centre (DIFC).

financial transactions via the LME. A thirty-year veteran of the Islamic-finance industry who sits on the boards of a number of its leading international industry organizations (including the International Islamic Liquidity Management Corporation), Cox's technical expertise is so respected that she is known among Muslims in the industry as "the Sister."

A fact rarely mentioned in historical accounts of the Islamic-finance industry is that Western investment banks have been involved with it almost from the time of its birth in 1975 (which was when Dubai Islamic Bank was established). This was only natural because Western banks had a history of serving the Gulf's commercial elite. Kleinwort Benson, Stella Cox's employer in the late 1970s and a leading London merchant bank at the time, already enjoyed relationships with leading Saudi, Emarati, and Qatari merchant families "going back absolute decades" (Cox 2013). When the Islamic-banking movement, buoyed by high oil prices, emerged in the Gulf in the second half of the 1970s and the early 1980s, it was led by these trading families and by the two aforementioned wealthy Saudi pioneers: Prince Muhammad bin Faisal Al Saud and Sheikh Saleh Kamel.

As the price of oil skyrocketed in the late 1970s, Western banks promoted the creative use of murabaha in order to service the nascent demand for Islamic finance.

> Led by the Saudis, and principally by … Sheikh Saleh Kamel, [these leading Gulf merchant families] came to Kleinwort in the late 1970s and said, 'Ok — you've been a great relationship bank for us [over the decades], but … now we're going to be shariah-compliant' (Cox 2013).

Seeking to retain its lucrative business with the merchant families at a moment when the region was awash with new wealth, a few of Kleinwort Benson's partners and associates taught themselves all they could about Islamic banking. A merchant bank since the eighteenth century, Kleinwort Benson had extensive expertise in structuring boutique trade finance. Its bankers were quick to realize that they could use murabaha to keep doing the same merchant-banking business they were already doing with their wealthy Gulf clients, but in ways that complied with those clients' new appetite for shariah-compliant contracts.

London grew into an international hub for Islamic interbank operations because in the 1970s and 1980s, banking markets were still overwhelmingly a national affair, especially in the developing world. At the time, most countries with Islamic banking had only one Islamic bank: Dubai Islamic Bank in the UAE, Bank Islam in Malaysia, Al Rajhi in Saudi Arabia, Kuwait Finance House in Kuwait, and so on. With no domestic partners with whom to exchange shariah-compliant overnight loans, it was virtually impossible to set up an Emarati Islamic interbank market, a Malaysian Islamic interbank market, a Saudi Islamic interbank market, or a Kuwaiti Islamic interbank market. So to solve the ethical problem of liquidity management, the Islamic banks came to London, where Western banks were happy to help them develop shariah-compliant solutions to the liquidity problem. Cox

explains:

> We had Islamic banks emerging in their national markets … but they were pretty isolated…. They had no interbank infrastructure to fall back upon whatsoever. So they came to London — a global financial center, a center for liquidity. (Cox 2013)

Once they came to understand murabaha, Western banks helped spread its use as an interbank liquidity solution. Cox describes how Kleinwort Benson and a few of its Western competitors, such as Citibank and ANZ Bank, began providing interbank services to the emerging Islamic banks. For liquidity-management purposes, "murabaha again became a contract that the bank could get comfortable with, because effectively, there are parallels between [conventional] interbank contracts … and murabaha" (Cox 2013).

In 2009, debate over 4-MS erupts

By the early 2000s, 4-MS had moved from being only an interbank instrument to being offered to retail and corporate customers. It thus moved from "behind the scenes" to a more visible, customer-facing position. 4-MS became very popular in the Gulf region, and especially in Saudi Arabia.[146] A 2010 estimate put the global market for organized 4-MS at over $100 million (Liau 2010).

In April 2009, the ethical controversy over 4-MS broke into the open, pitting a group of elite jurists mostly outside Islamic finance versus elite jurists within Islamic finance. Outside criticism came from the International Islamic Fiqh Academy of the Organization of Islamic Cooperation (OIC), which ruled that organized 4-MS is a "deception" and impermissible. This ruling "has potentially huge implications for Islamic financial institutions," noted Zulkifli bin Hasan, a Malaysian shariah scholar, "since [4-MS] is widely offered in the market" (Hasan 2011). The Fiqh Academy is a collection of over fifty of the world's leading scholars of Islamic jurisprudence — one from each of the OIC's member countries. Most of its members hold very high positions in their countries' official Islamic institutions: the Saudi representative is preacher at the Holy Mosque in Mecca and supreme advisor in the Saudi Royal Diwan, the Egyptian the country's former grand mufti,[147] the Malaysian the chairman of the National Fatwa Council, the Iranian a prominent ayatollah and diplomat, and the

[146] Dr. Mohamed Ali Elgari, a leading shariah scholar, stated that "tawarruq was introduced in 1993" (Laldin et al. 2009), presumably referring to its introduction into corporate and retail Islamic banking (as opposed to interbank lending, which happened earlier). Dabu (n.d.) suggests that Saudi banks began to use it between 2000 and 2002.

[147] The grand mufti is the highest authority of Islamic law in a country, as officially recognized by the state.

Qatari a high-ranking judge and member of the Supreme Judicial Council.[148] Most members of the Fiqh Academy, however, are not heavily involved in Islamic finance (with some notable exceptions).[149]

In response, some of the most visible shariah scholars in Islamic finance began speaking out publicly in defense of 4-MS. This included Nizam Yaquby of Bahrain (tied as the #1 most prolific scholar in Islamic finance by board positions held — see previous chapter), who said, "Tawarruq [4-MS] from my perspective has been carefully researched" (Liau 2009). Also in support are Abdul Sattar Abu Ghuddah of Saudi Arabia (tied with Yaquby as #1) (Laldin et al. 2009), Mohamed Ali Elgari of Saudi Arabia (#3) (Laldin et al. 2009; al-Mazrūʿī 2010), Abdul Aziz al-Qassar of Kuwait (#4) (al-Qaṣṣār 2009), Abdullah al-Maneeʿa of Saudi Arabia (#5) (al-Mazrūʿī 2010), Mohammad Daud Bakar of Malaysia (tied as #7) (Laldin et al. 2009; Liau 2009), and others. Islamic finance was defending itself. But not all of the elite scholars defended 4-MS. Hussein Hamid Hassan of Egypt (#6) opposes the use of 4-MS "based on its misapplication by Islamic and conventional banks" (Al-Sharq Al-Awsaṭ staff 2007, author's translation). The banks whose shariah boards he chairs, such as Dubai Islamic Bank, do not use it.

Economic arguments against 4-MS

The debate over 4-MS has continued to rage. Arguments against it speak either to its *economic outcomes* or to its *flawed structure*. One economic argument is that it makes borrowing too easy. It thus proliferates debt in modern society and exacerbates a problem the Islamic economy is precisely intended to cure. Mohammad Nejatullah Siddiqi, the doyen of Islamic economists, notes that easy credit in recent decades has led to "mountains of credit card debts and other consumer debts," "skyrocket[ing]" government borrowing, and Third World indebtedness. This trend, he argues, has been spurred by liquidity from oil booms and the dissipation of social mechanisms enforcing "due care" in borrowing, such as proper collateral and social obligation. Allowing 4-MS makes the problem worse:

> The Islamic prohibition of interest serves as an effective check on the above trend… [But 4-MS] sabotages this unique feature of Islamic finance by introducing lending as a means of doing business. It makes it easy to borrow. It puts IFIs on par with conventional financial institutions, both under competitive compulsion to lend in order to make use of surplus liquidity. (Siddiqi 2007)

[148] This refers to Salih bin Abdullah al-Humaid of Saudi Arabia, Ali Gomaa of Egypt, Abdul Shukor Husin of Malaysia, Mohammad Ali Taskhiri of Iran, and Thaqeel bin Sayer al-Shammari of Qatar. These figures were members as of 2014.

[149] There are exceptions: Muhammad Taqi Usmani of Pakistan and Ajeel Jasem al-Nashmi of Kuwait, for example, are two of the most prominent shariah scholars in Islamic finance.

Increased debt will fuel "gambling-like speculation" and will redistribute wealth toward the rich. 4-MS will act like a virus, overcoming the Islamic economy's natural defenses against money creation, inflation, instability, and inequality:

> All proposals about money management in an Islamic economy … keep money supply linked to the needs of the real sector of the economy. This is seen as the most effective way of keeping inflation under control. The introduction of [4-MS] into the body of Islamic economy is sure to act like a virus destroying its immune system that which would protect it from increasing indebtedness leading to speculation, monetary fluctuations, instability and inequity.

4-MS is also just like interest-based lending in that "it penalizes entrepreneurs and rewards rentiers" (Siddiqi 2007). Worse, it does so by imposing even higher transaction costs than an interest-bearing loan because of the need for Islamic structuring. "All you're doing with [4-MS] is charging more," argues economist Mahmoud El-Gamal (El-Gamal 2014).[150]

Arguments that 4-MS is not shariah-compliant

In addition to making consequentialist arguments, critics of organized 4-MS argue that it is not shariah-compliant because of its structure and execution. Whereas consequentialist arguments tend to come from economists, arguments about structuring tend to come from jurists — such as the members of the International Islamic Fiqh Academy — and other experts in shariah.

The most basic such argument is that 4-MS is concealed usury. It provides cash now for more cash later. According to this reasoning, the fact that two sales occur makes no difference. Mohammed al-Mukhtar al-Salami, head of the shariah board of the Islamic Development Bank and former grand mufti of Tunisia, said in 2010 that 4-MS merely achieves "through two windows" what an interest-bearing loan achieves through one (al-Hamzānī 2010, author's translation). Salman Khan, an expert in Islamic financial structuring at Abu Dhabi Islamic Bank, argues that in 4-MS, the metal or other commodity being traded is just a "prop" (S. Khan 2010). There is no ultimate genuine user of the commodity — unlike in 3-MS, where a car or home being traded will actually be used. These are all ways of saying 4-MS is not a truly Islamic transaction.

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[150] El-Gamal went on in the next sentence to cite Ibn Qayyim al-Jawzīyah (1292–1350 CE), a great Ḥanbalī jurist, who (like his famous teacher Ibn Taymīyah) opposed the use of 4-MS because it merely increased transaction costs while still effectively dealing in usury (El-Gamal 2014). Ibn Qayyim said: "Ribā [usury] on the ground is easier and less harmful than two parties engaging in ribā at the top of a tall ladder that is hard to climb" (*fa-inna al-ribā 'alá al-arḍ as'hal wa aqall mafsadah min al-ribā bi-sullam ṭawīl ṣa'b al-tarāqī yatarābá al-mutarābiyān 'alá ra'sihi*).

A subset of critics believe classical 4-MS is an Islamically acceptable structure but organized 4-MS is not. This includes the International Islamic Fiqh Academy. Unfortunately, classical 4-MS does not really exist in the Islamic-finance industry; all 4-MS today in the industry is organized. These critics argue that by "organizing" 4-MS, Islamic banks cross the line from engaging in trade to dealing in usury.

One common complaint about organized 4-MS is that Islamic banks *should not sell commodities on behalf of their customers* (in Figure 39 above, that B should not arrange the sale from C to D). But this would mean that a customer seeking an Islamic cash loan would be responsible for selling tons of metals on the London Metal Exchange, for example, in order to get her cash — something most bank customers are unprepared to do.

Some critics also assert that the buyers and sellers involved in 4-MS should actually take *physical delivery* of the commodities instead of simply moving them electronically from one accounting book to another. They note that in organized 4-MS, the commodities being bought and sold simply sit in an LME warehouse somewhere — perhaps Antwerp, Rotterdam, Yokohama, Singapore — and because each 4-MS transaction happens in a matter of minutes, the same commodities are "recycled" again and again for use in many 4-MS transactions in a single day (S. Khan 2010:18). This in itself is shameful enough, they feel, for it makes a mockery of the idea that trade is happening; and they recall that crucial dictum from the Quran (2:275): *God has permitted trade but prohibited ribā* (usury). Worse still, they allege, the Islamic banks and commodities brokers do not even keep proper track of the commodities that are being bought and sold. It thus becomes impossible to match a particular 4-MS transaction to a particular lot of copper or nickel in a particular location in a particular warehouse. This is a clear violation of Islamic law. Moreover, if no one knows precisely what real asset is being bought and sold, how can Islamic finance claim that it is rooted in the trade of real assets?

These concerns about physical delivery highlight an equation between physical substance, economic substance, and spiritual substance that is becoming one of the tacit ethical principles of modern Islamic finance. Physical substance is a matter of careful warehousing, of the meticulous tracking of commodities, and of the possibility that real humans can check on such warehousing and tracking. Economic substance is a matter of accounting: ownership must transfer from one party's books to another, for example. Together, physical substance and economic substance become the litmus tests for spiritual substance: being a truly Islamic financial instrument (in the eyes of those who hold this view, anyway) as opposed to merely financial sleight of hand.

Arguments in defense of 4-MS

Facing this vociferous wall of criticism, many elite shariah scholars have shot back to defend 4-MS. They make a range of arguments:

Many past jurists allowed it. Opinions of jurists through history vary, but defenders of 4-MS are able to cite a wide range of classical and modern jurists before them who considered classical 4-MS Islamically lawful.[151] Medieval and modern jurists have written hundreds of pages on the permissibility of classical 4-MS and come to a wide range of conclusions that depended on their era, the circumstances of those who sought to use it, their juristic school, and their own reasoning (for detailed review, see al-Suwailem 2003; Aleshaikh 2011; Bouheraoua 2009).[152] Some found classical 4-MS Islamically acceptable (*jā'iz*) or neutral (*mubāḥ*); some found it detestable (makrūḥ), and therefore recommended abstaining from it though they did not consider it unlawful; and some considered it unlawful (*ḥarām*).

Appeals to classical learning are powerful because they ground the ethical soundness of 4-MS in close technical reading of authoritative literature. Abdullah al-Manee'a, the #5 most prolific scholar in the world, makes such an argument:

> It is well known that tawarruq [4-MS] was allowed by a great number of learned jurists from the various schools of Islamic jurisprudence — provided that it be carried out in accordance with the conditions for, and elements of, a [valid] sale, with any obstacles to its legal validity removed. (Al-Sharq Al-Awsaṭ staff 2007, author's translation)[153]

It is, of course, today's shariah scholars who are the technical experts qualified to determine whether the classical jurists' exacting conditions are being met. The ethical becomes the technical, but via deep hermeneutics in a respected scholarly tradition.

Nonetheless, some renowned scholars who defend 4-MS acknowledge that it is imperfect:

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[151] Classical Ḥanbalī jurists appear to have use the term "tawarruq" (4-MS) as early as the third Islamic century (Aleshaikh 2011:30).

[152] Classical tawarruq was practiced at the time of the Prophet Muhammad and for centuries thereafter, but great classical experts in Islamic jurisprudence from across the four major Sunni schools were divided as to its permissibility. All jurists of the Shafi'i school and most of the prominent jurists of the Hanbali school deemed tawarruq permissible, as did Abu Yusuf (731/32–798), the most illustrious disciple of Hanafi school founder Abu Hanifa (699–767). These supporters adduced several arguments in favor of allowing tawarruq, including the oft-quoted Quranic statement "God permits trade and prohibits riba" and the legal maxim "The starting assumption for all statements, actions, contracts, and conditions is permissibility." Classical jurists who rejected tawarruq included all those of the Maliki school, some members of the Hanafi school such as Muhammad ibn al-Hasan al-Shaybani (749/50–805, another one of Abu Hanifa's disciples), and important later scholars of the Hanbali school, including Ibn Taymiyya (1263–1328) and his disciple Ibn Qayyim al-Jawziyya (1292–1350).

[153] The Arabic original is as follows: *La yakhfá an aṣl al-tawarruq qad ajāzahu jumhūr ahl al-'ilm min al-madhāhib al-fiqhīyah al-muta'addidah idhā kāna mustakmalan li-shurūṭ al-bay' wa-arkānihi wa-kānat muntafiyah 'anhu mawāni' ṣiḥḥatihi.*

> From the Islamic law perspective, [4-MS] is allowed but that is not the ideal. It does not really help in creating real economic activities. Basically you are giving cash.
>
> *Mohamad Akram Laldin, an internationally prominent Malaysian shariah scholar* (Liau 2010)

This lukewarm stance from shariah scholars toward products like 2-MS and 4-MS creates a curious ethical space without clear parallel in conventional finance. There is rarely a "purgatory" for financial products in conventional regulatory systems: a product is either usually either legal or illegal. (One wonders how the conventional financial community might interpret a statement from the US Securities and Exchange Commission, or for that matter one of the Big Three credit-rating agencies, that collateralized debt obligations are "allowed but not ideal.")

The industry depends on it. Some shariah scholars argue that 4-MS should not be banned because the Islamic-finance industry depends heavily on it and would suffer greatly. "Many banks will close down without [4-MS]," said Mohamad Akram Laldin, the prominent Malaysian shariah scholar, in 2010 (Liau 2010). Scholars point to the concepts of *al-maṣāliḥ al-mursalah* (the public interest) and *ḍarūrah* (necessity) in justifying the use of organized 4-MS, at least for the time being.

It serves a legitimate need. Some scholars simply feel that cash-in-hand financing is a legitimate need that Muslims will inevitably have, and that 4-MS is a boon because it fills this need Islamically. Nizam Yaquby, the most prominent shariah scholar in Islamic finance, put it thus:

> We always say that Islam has the solution for everything, but when it comes to financing is there no solution? … The *fuqahā'* [classical jurists] have stated that in the desert when you want to take ablution [before prayer] and you don't have water, even then you don't have to borrow money to buy water. Instead, a solution is provided in the form of *tayammum*; ablution with sand. There is a need for financing, people want and need cash, and so Islamic banks must have a solution. (Laldin et al. 2009)

Similarly, the leading Malaysian scholar, Mohammad Daud Bakar (tied at #7 most prolific in the world), notes that 4-MS is the best contract for building derivatives and other risk-management instruments. "We have to have more products," says Bakar (Laldin et al. 2009).

The fact that it is done quickly does not make it haram. As mentioned above, foes of 4-MS complain that when the same asset sits in a warehouse and is "recycled" in a matter of minutes to be used for different 4-MS transactions many times in the same day, it makes a mockery of the idea that Islamic finance is based on trade. But defenders of 4-MS argue that transaction speed does not matter. Nizam Yaquby compares 4-MS to Amazon.com:

> The argument was raised that in [4-MS] deals conducted in Islamic banks was completed in a very fast manner [*sic*], so it is not real and is therefore haram. However, today we can on a computer do so many things within seconds, including buying a book and paying for it on Amazon.com. Does this mean it is haram? (Laldin et al. 2009)

We must give Islamic finance a chance to evolve. Some defenders of 4-MS argue that even if 4-MS is not perfect, we must be patient. Rome was not built in a day. Mohamed Ali Elgari, the world's third-most prolific shariah scholar by board positions, compares developing Islamic finance to constructing a building:

> It is important not to forget the strategy of Islamic banking is evolutionary… Islamic banks are not perfect. As long as we are working within halal activities we have a model we can improve on. If we continue Insha'Allah [God willing] we can one day be happy. But we cannot build something and then say break it down. If we have something which is not perfect we have to improve on it until the building is complete. (Laldin et al. 2009)

Instead of banning 4-MS outright, manage its use. Responding to those who fear 4-MS is taking over the industry, Nizam Yaquby notes that regulations could be applied to restrict its use. "For example, do not allow more than 40% of the activities or instruments used by the bank to be [4-MS]," he argues (Laldin et al. 2009).

ETHICAL QUESTIONS, TECHNICAL ANSWERS

We will see in this section that *the Islamic-finance industry is developing technical solutions to the ethical questions surrounding 4-MS.* These solutions are designed to improve 4-MS's shariah-compliance. They address the formal side of Islamic economic ethics. They do not, however, address economic or consequentialist concerns. From a substantive economic perspective, 4-MS continues to replicate conventional interest-bearing loans.

What happens when an Islamic financial product faces ethical questioning? In the case of 2-MS, which was used only in Southeast Asia, the Malaysian state acted forcefully and phased out the product. The situation with 4-MS is different, however: it is entrenched in the Gulf region, where regulators are less interventionist than in Malaysia when it comes to Islamic finance. "All Islamic banks, without exception, use tawarruq [4-MS]," noted Mohamed Ali Elgari (the world's #3 scholar) matter-of-factly (al-Mazrūʿī 2010, author's translation).[154] And even in Malaysia, the state's elimination of 2-MS has created demand for 4-MS, which the central bank's shariah board allows. So states appear less likely to try to phase out 4-MS than 2-MS, at least in the near future. (Oman is an exception.[155])

Instead, both private and public entities are coming up with technical improvements on 4-MS. They use scrupulous electronic technologies to ensure that the commodities allegedly being traded truly exist in warehouses, are trackable, definitively change hands from an accounting perspective, and are bought and sold by different traders. They also represent nationally specific convergences of state developmentalism, formalist Islamic finance, and the commodities sector.

As mentioned earlier in this chapter (see "Arguments that 4-MS is not shariah-compliant"), one of the central emerging ethical principles of Islamic finance is an equation between physical substance, economic substance, and spiritual substance. We will see here that the cutting edge of Islamic finance involves building a technical apparatus to assure the physical substance and economic substance of Islamic financial transactions, and thus to guarantee its spiritual substance. This technical machinery stands behind and legitimates the Islamic finance industry's system of ethical certification. It is the infrastructure that undergirds the suprastructure of rulings by the shariah scholars. It is the nuts and bolts of the ECCA.

Crude palm oil in the service of Islamic finance: Malaysia's Bursa Suq Al-Silaʿ

Bursa Malaysia, the main Malaysian stock exchange, sits in a huge neoclassical edifice in Kuala Lumpur with nine-story-high columns. The building gives a sense of solidity and rigidity, as stock-exchange buildings should. But inside, as I listened to Bursa Malaysia staff explain their new computerized platform for trading crude palm oil (CPO) to facilitate 4-MS transactions, my head was spinning.

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[154] Elgari's original statement in Arabic: *Jamīʿ al-bunūk al-islāmīyah bi-lā istithnāʾ taʿmal bi-l-tawarruq.*

[155] Oman prohibited 4-MS outright in 2012 (James 2012; Vizcaino 2012). But Oman only introduced Islamic banking in 2011, after decades of having banned it. Its government is following Malaysia's lead in granting the Omani central bank and its shariah board wide powers to regulate the industry from the top down. So Oman does not have the problem of Islamic banks that are already dependent on 4-MS.

The introduction in August 2009 of Bursa Malaysia's web-based, multi-currency 4-MS platform, called Bursa Suq Al-Silaʿ (BSAS; *suq al-silaʿ* is Arabic for "commodities market"), coincided well with multiple trends: growing questions about how 4-MS was being carried out, the global financial crisis and consequent attention toward Islamic finance as an alternative paradigm, the phasing out of 2-MS in Malaysia and shift toward 4-MS instead, and the globalization of Islamic finance.

Raja Teh Maimunah,[156] then global head of Islamic markets at Bursa Malaysia, explains the rationale for introducing BSAS:

> The industry had suffered some reputational issues regarding rogue trades whereby commodities purchased for this purpose were either encumbered, ie, they cannot be freely dealt with, the same commodities were being sold to several parties simultaneously, or, in some cases, simply didn't exist. (Lee 2011)

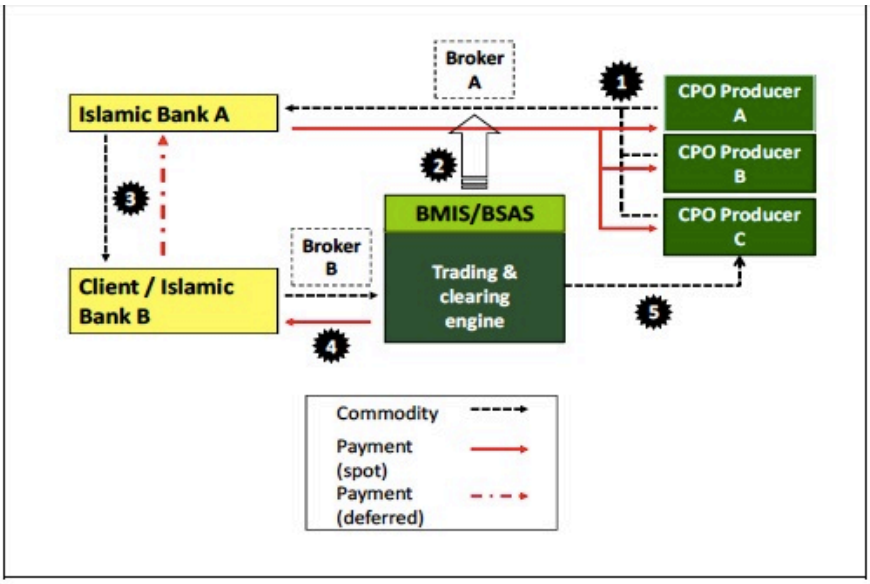
Figure 41 shows the BSAS system. 4-MS using BSAS is similar to 4-MS using the London Metal Exchange, except for the crucial difference that the BSAS computerized trading and clearing engine intercedes between commodities providers (producers of crude palm oil), brokers, Islamic banks, and their customers. The BSAS engine accepts bids and offers for CPO trades each morning, randomly connects buyers and sellers, monitors delivery of CPO from suppliers, tracks the tanks that contain the CPO associated with a particular 4-MS transaction, acts as a counterparty to mitigate all parties' credit risk, and credits and debits the financial accounts of those involved in trading (Bursa Malaysia staff 2009). Randomization is important because it ensures that the initial seller of CPO is not also the initial buyer — a crucial shariah requirement.

BSAS represents a curious nexus between the financial economy and the real economy. The larger the volume of (financial) 4-MS transactions taking place, the larger the amount of (real) CPO that suppliers must store in tanks connected to the system. In order to fend off accusations that the same CPO is being "recycled" over and over very quickly for 4-MS transactions, or that the CPO being traded is not "actually" there, Bursa Malaysia must therefore convince major producers of palm oil to participate in the system and to store substantial volumes of their product each morning in the requisite warehouse tanks (Dusuki 2010). It also conducts random shariah audits to ensure that the palm-oil suppliers actually possess the real physical commodity that they sell to the banks (and are not short-selling — i.e., selling palm oil they do not actually have) (Lee 2011). All of this attention is paid to the material supply of CPO into the BSAS system *even though no one involved will actually be*

[156] Now CEO of Hong Leong Islamic Bank, Raja Teh Maimunah is another of Malaysia's highly prominent women in Islamic finance.

consuming any CPO.[157] Indeed, Bursa Malaysia chose to use CPO because it is one of Malaysia's major commodity exports: Indonesia and Malaysia are by far the world's largest producers, and Bursa Malaysia itself has been the world's largest hub for trading CPO futures since 1980. Thus BSAS represents a convergence between state efforts to develop Islamic finance and Malaysia's commodities sector.

[157] There are some parallels here to carbon markets (Lohmann 2009; MacKenzie 2009). Like the market for carbon emissions, the market for 4-MS depends on a combined technical-and-accounting apparatus. For 4-MS, this includes BSAS in Kuala Lumpur, DMCC Tradeflow in Dubai, and DDCAP and the London Metal Exchange in London; for carbon trading, it includes the United Nations' Clean Development Mechanism scheme, which issues national emissions credits, as well as the national and sub-national emissions bureaucracies that facilitate and supervise carbon trading. In both cases, the apparatus converts fluid substances (such as palm oil and CO_2 emissions) that must be carefully measured and tracked into the abstract and standardized raw material (from an accounting perspective) for the construction of financial instruments — whether 4-MS loans or, in the case of carbon markets, carbon futures. I think Marion Fourcade for this insight.



The discussion based on Diagram 3 is depicted in Box 2 below:

BOX 2: Illustration and discussion of Bursa Suq al-Sila' (BSAS) based on Diagram 3

1. Before the market opens:
   - bids by banks and offers by CPO suppliers are lined up; orders will be randomized upon market opening.
   - When the market opens at 10.30 am, trade starts with order matching by the BSAS engine.
   - The CPO Supplier sells the commodity straight to an Islamic Bank (via Broker A).
2. Bursa Malaysia Islamic Services (BMIS) ensures the performance (delivery) of CPO suppliers, in order to avoid strict Know-Your-Customer (KYC) appraisal by Islamic banks.
   - At this stage, trade confirmation is sent to all parties.
   - Islamic Bank A pays the price by crediting the BMIS account.
3. Islamic Bank A sells the commodity to its client or another Islamic bank by a deferred *murābaḥah* contract.
   - Trade is reported to BSAS for change of ownership in depository.
4. Client or Islamic Bank B sells the commodity to BMIS via an agent of Islamic Bank A or directly (may use Broker B).
   - BMIS pays party B by instructing Islamic Bank A to debit its account in favor of B.
   - Commodity ownership transfers to BMIS.
5. Sale by BMIS to CPO supplier is on a random basis, and matching is based on bids by suppliers replicating the real market.
   - Once ownership is back to a supplier, all unencumbered commodities may or may not be re-offered into the BSAS market for other trades.
   - Last purchase order: 5.30 pm; market closes at 6.00 pm.

Source: Bursa Malaysia's Presentation on Bursa Malaysia Suq al-Sila' (BSAS)

FIGURE 41: BURSA MALAYSIA'S SUQ AL-SILA' SYSTEM FOR TRADING PALM OIL ELECTRONICALLY TO FACILITATE 4-MS FINANCING TRANSACTIONS (Dusuki 2010)

Sitting on $1 billion of diamonds: Dubai's DMCC Tradeflow and the synergy between commodities trading and Islamic finance

"We're sitting on at least $1 billion worth of diamonds," said Paul matter-of-factly. We were on the 50th floor of Almas Tower in Dubai's Jumeirah Lakes Towers district, a shimmering new complex of commercial and residential high-rises among man-made lakes and manicured lawns. *Almās* means "diamond" in Arabic, and Almas Tower is the center of Dubai's burgeoning diamond trade. Armed guards patrol the building's lobby, and its thick floors support dozens of floors of safes and strong rooms with reinforced steel walls. Inside those rooms, specialists grade and sort the bags of diamonds that merchants buy from mining companies like De Beers and Rio Tinto.

Because of a happy symbiosis between the commodities trade and Islamic finance, Almas Tower is also home to a new effort to make 4-MS more shariah-compliant. I was there to meet with Paul Boots, an energetic, polished Dutchman in his thirties who is the architect of the Dubai Multi Commodities Centre's Tradeflow system. Tradeflow is a web-based platform that allows the electronic trading of warehouse warrants for commodities. Tradeflow went live in 2013.

Although originally developed to help companies in the commodities industry to secure financing, Tradeflow turned out to be ideal for Islamic financial institutions executing 4-MS. When commodities traders put their commodities — such as diamonds, steel, or tea — in a warehouse in Dubai, Tradeflow issues them an electronic warrant. A warrant is basically a tradable receipt. The traders can then approach a bank and use this warrant as collateral to get a loan. Alternatively, they can trade the warrant to anyone who wants the commodities. The warrant includes specific information about the commodities: their amount, type, quality, and exact warehouse location.

Conveniently, it is exactly this kind of specific information about an asset's physical location and characteristics that shariah scholars demand when Islamic financial institutions arrange 4-MS trades. One of the shariah scholars' biggest criticisms of existing 4-MS solutions — such as those executed through the London Metal Exchange — is that it is difficult to track the exact location and type of the underlying assets being traded, or even to verify that they still exist. Shariah scholars worry that Islamic banks are trading ghost-like electronic apparitions of commodities, and not real commodities themselves. They also worry that the same commodities are being used for different transactions, making a mockery of the idea that trade underlies 4-MS. Tradeflow aims to solve that problem. So like Bursa Malaysia's Suq al-Silaʿ, though with different mechanics, Tradeflow is competing to be the infrastructure that Islamic financial institutions choose to make their 4-MS trades more reliably shariah-compliant — and thus to keep their shariah scholars happy.

Like many Western expats in Dubai, Paul has an adventuresome, entrepreneurial streak. While studying finance and business at Babson College in Boston in the early 2000s, he founded a laundry startup on campus. He then used his connections to land a job in Brussels

with Euroclear, a securities clearinghouse that is also part of the infrastructure of global capital markets. Two years later he was in the diamond business, setting up the Dubai Multi Commodities Centre's Antwerp office and promoting Dubai as an up-and-coming global diamond hub. The Dubai Multi Commodities Centre (DMCC) is a Dubai government agency whose mission is to increase Dubai's GDP by attracting foreign investment in the commodities business: in short, to spur Dubai's economic growth by making it a global hub for as many kinds of commodities as possible. In 2002, Dubai's imports and exports of diamonds totaled around $5 million. "This is now up to around $40 *billion*," said Paul (Boots 2013). Dubai is now one of the world's top three diamond hubs: rough diamonds are traded in Antwerp and Dubai, then go to India to be polished.

The story of Tradeflow shows how the shariah-compliance apparatus is expanding on the back of the growth, globalization, and financialization of the global commodities trade — and state efforts to promote it. When Paul Boots was first designing the precursor to Tradeflow in the mid-2000s, Islamic finance was not on his mind. But in Dubai, commodities and Islamic finance were both hot, and by 2010, Paul found himself talking to the Islamic-finance sector:

> We had no idea [that Islamic banks would be interested]! They said, "At the moment, we call our brokers in London, or we go to Malaysia. But if you guys can offer us something here, with commodities that are in Dubai or the UAE, and that our shariah scholars can actually go to the warehouse and inspect, and on a platform that's locally hosted, with a government entity…" They were like, "This would be perfect! This would be like bringing it home!" (Boots 2013)

Paul and his team approached Dubai Islamic Bank and its spin-off shariah consultancy Dar Al Sharia. They worked for a year and a half to design a way to make Tradeflow support 4-MS that would satisfy Hussein Hamid Hassan, the senior shariah scholar at Dubai Islamic Bank and Dar Al Sharia. Today, a growing number of firms in the Gulf and beyond are using Tradeflow to facilitate 4-MS.

Conclusion

A few lessons emerge from this chapter. First, *fiqh is fluid*. Islamic jurisprudence and the economic ethics expressed through it change over time and space. The diversity of fiqh was already embedded in Islamic history through the heritage of the juristic schools, but in the 20th century, in the hands of modernists, revivalists, and Islamic economists it took on new and syncretic form. In 21st-century liberal Islamic finance, fiqh continues to evolve by accommodating ingenious new ways of avoiding interest. In Malaysia, where 2-MS was a

pillar of Islamic finance for three decades, and in the Gulf, where 4-MS continues to be widespread, different local solutions emerged as a result of both centuries-old differences in juristic school, different roles played by courts and central banks, and the involvement of Western banks in local banking.

Second, in an era since the late 1970s when finance has been dominant (Arrighi 1994; Davis 2008; Fligstein 1987, 2001; Krippner 2005)], *Islamic economic ethics evolve to accommodate capital*. The history of Islamic finance since the 1970s has been a history of progressive accommodation of the needs (or wants, depending on your perspective) of capital. The early Islamic banks of the 1970s and 1980s needed (or wanted) to be able to deal in unsecured loans for purposes of interbank liquidity management, and later to attract retail and corporate customers. Although this was controversial at first among industry pioneers and shariah scholars, Islamic banks worked with amenable shariah scholars to find a way.

Third, *the formal rationalization of Islamic financial practice is creating new, highly technical ways of being pious*. Even if the expansion of Islamic finance sometimes imposes stricter shariah restrictions on banks and sometimes looser ones, the shariah-compliance apparatus always moves toward formal rationalization and greater technical detail. This means new ethical valences of Muslim piety are emerging that are measured and monitored electronically. For example, as vendors such as Stella Cox's DDCAP worked with shariah scholars and bankers to execute commodity murabaha in ever-more-precise ways, formal exactitude increasingly became the litmus test for economic piety as expressed in the industry. In the second decade of the 21st century, the intensely technical process of developing Malaysia's Suq Al-Silaʿ and Dubai's Tradeflow to satisfy shariah scholars' demands takes this trend even further.

Fourth, *Islamic finance increasingly occupies a curious intersection between the real and financial economies*. In the lingering wake of the 2008–2009 financial crisis, embeddedness in the real economy is one of Islamic finance's selling points to the world. In order to achieve this embeddedness, Islamic financial institutions must buy and sell real assets. To do this, the Islamic-finance industry has piggybacked on the growth and globalization of the commodities trade. As we have seen with DDCAP in London, Suq Al-Silaʿ in Kuala Lumpur, and Tradeflow in Dubai, the infrastructure for 4-MS has grown fortuitously out of the global commodities infrastructure. 4-MS involves only *virtual* trading: commodities change hands electronically, but never move physically. Yet shariah scholars require that they *could* move physically if they had to. So 4-MS depends on a certain "virtual materiality" of commodities trading.[158] Is this finance embedded in the real economy, or the real economy being financialized?

[158] The virtual materiality of Suq Al-Silaʿ and Tradeflow is arguably a curious inversion of the materially produced virtuality of derivatives markets (MacKenzie 2007).

Fifth, and most paradoxically, *formal rationalization sometimes increases restrictions on capital rather than loosening them*. One might suspect that as the Islamic-finance industry expands and formal rationalization proceeds apace, Islamic banks would gain the power to do whatever they want. But this has not been the case. On one hand, shariah scholars do help banks design clever solutions to avoid interest. But on the other hand, they — and other stakeholders, such as customers, judges, and regulators — push back. They insist that banks follow increasingly minute details to make their transactions shariah-compliant: tracking copper trades to make sure they really happened, for example.

Islamic jurisprudence sometimes evolves in a direction favorable to capital — but not always. Islamic jurisprudence does not simply dance to the bankers' tune, even when billions of dollars are at stake. While market forces and state interests do shape the changing ethical valences of these three interest-mimicking practices, the Islamic-finance industry also has something of a *conscience collective*: norms and ethical goals of its own that sometimes clash with the interests of markets and states.

What is particularly striking about this shared ethical consciousness of Islamic finance is that it is forward-looking. Islamic finance has a sense of its own historicity — where it is coming from, where it is going, and how far it must go to get there — even if its envisioned future, the lodestar toward which it is oriented, changes somewhat with time. This self-conscious historicity expresses itself most powerfully in what I call, with apologies to Langston Hughes, Islamic finance's "dreams deferred": ethical improvements on conventional finance that pioneers and reformers envision, but that pragmatists argue must be held in abeyance for the time being because they will lead to financial ruin for Islamic banks in light of present market conditions.

Final lessons

In sum, this chapter is a study in ethical change. The recent history of interest-mimicking instruments in Islamic finance shows how the boundaries of what Islamic law allows and disallows are formed through contestation, negotiation, and compromise. Digging beyond what may appear to the outsider to be casuistic and legalistic hair-splitting, this chapter excavates the evolving ethical logics behind these practices. In Islamic finance, Islamic law (as interpreted by shariah scholars), state regulation, and capitalist interests do not have straightforward and unchanging ethical stances, but in fact co-produce one another in a never-ending dance of negotiation and re-negotiation.

Shariah formalism and liberal finance, it turns out, are perfect bedfellows in an era of electronic finance. The formal science of shariah-compliance and the expansion of the shariah-compliance apparatus have largely pushed to the side the utopian vision of the 1960s and 1970s: that Islamic finance will bring about economic outcomes different from conventional finance. On the other hand, they are giving Muslims new ways to express and

understand their piety, and new connections to the past. As we saw in Chapter One, the use of legal structures to circumvent the ban on interest is not new to Islam; indeed, it is very arguably *part* of Islam, and part of a venerable tradition across the three Abrahamic faiths. So perhaps what we are seeing in 21st-century Islamic finance is not a new turn toward legalism, but a return to it. The alliance of fiqh and capital makes this possible.

Appendix to Chapter Five: Why Islamic banks trade metals

Why do banks use *metals* as the underlying commodity for 4-MS? As discussed above, Islamic financial institutions also use palm oil and other commodities. But metals, traded via the LME, are particularly popular. Below, I discuss shariah considerations and profitability considerations that make metals contracts appealing for Islamic financial institutions.

Shariah considerations

A major reason for using metals is to meet sharia requirements. First, most metals (except gold and silver) fall into a class of goods acceptable to sharia scholars. Scholars reference the following saying of the Prophet Muhammad, recorded in *Sahih Muslim* (one of *al-kutub al-sitta*, the six canonical hadith collections):

> Abu Sa'id al-Khudri (Allah be pleased with him) reported Allah's Messenger (may peace be upon him) as saying: Gold is to be paid for by gold, silver by silver, wheat by wheat, barley by barley, dates by dates, salt by salt, like by like, payment being made hand to hand. He who made an addition to it, or asked for an addition, in fact dealt in usury. The receiver and the giver are equally guilty. (Muslim 1976: Book 22, Hadith 96)

Here, jurists interpret "ask[ing] for an addition" as referring to a form of riba called *riba al-fadl* ("usury of excess"). This is the usury that arises when trading the same amount of the substance for a different price, or a different amount at the same price, or a deferred payment in exchange for a spot payment. Gold and silver are ruled out because they are money equivalents, so trading gold for gold or silver for silver in this way is tantamount to *riba* (usury). The other goods mentioned — wheat, barley, dates, and salt — are all relatively homogeneous, relatively non-perishable staple foodstuffs that, like gold and silver, were highly fungible in the Prophet's day. Injunctions against usury also apply to them, and potentially to other commodities comparable to wheat, barley, dates, and salt. The use in 4-MS of contracts for agricultural commodities in general may be unacceptable. Metals (other than gold and silver), on the other hand, are safer from a sharia perspective. Although the five major schools of Islamic jurisprudence interpret this hadith slightly differently, there is general consensus that metals other than gold and silver are acceptable for trading via any type of markup the merchant wants to apply. Hence, sharia scholars endorse commodity metals as a sharia-compliant basis for 4-MS.

Second, LME contracts are useful from a sharia perspective because they meet the Islamic condition of asset specificity. An LME warrant is a document of title enabling the bearer to take possession of one lot of a specified parcel of metal at a specified LME warehouse. It states how many metric tons of a certain metal the bearer owns, what brand and shape the

metal are, and in what warehouse the metal is stored. Such specificity is crucial to the avoidance of *gharar* (uncertainty or deception): asset-based transactions must involve a *specific* asset whose material characteristics and location can be ascertained beyond any doubt. The computerization of commodities trading has made the specification process cheaper and faster.

Profitability considerations

In addition to addressing the sharia scholars' concerns, the mechanics of organized 4-MS — and the particular metals traded — also reflect the bankers' desire to keep transaction costs low. LME warrants are highly liquid and widely traded, including on OTC markets. The LME offers contracts for aluminum, cobalt, copper, lead, molybdenum, nickel, steel, tin, and zinc. But among these, the Islamic bankers prefer aluminum, copper, and nickel because they have large contract sizes and higher prices per warrant, meaning fewer warrants need to be bought to complete each transaction. This reduces net transaction cost.

Finally, Islamic bankers also use the material structure of LME warehousing worldwide to reduce their financial risk. Instead of buying the cheapest LME warrants for a given metal, they often buy warrants for lots that are trading at a *premium* to the market price based on their warehouse location — because these warrants are less likely to fluctuate in price. There are over 700 LME-approved warehouses around the world, and the warrants for metals stored in certain warehouses trade at slightly higher prices than others because they are closer to the small minority of purchasers who intend to take delivery. For example, one lot (25 metric tons) of Grade "A" copper cathodes might trade at $7,871.10 per ton at a Dubai warehouse, $7,871.70 in Rotterdam, and $7,872.05 in Busan. In this case, the Islamic bank would buy the Busan lot. Even though the Islamic banks will only be holding the metal for the seconds or minutes during which the 4-MS is transacted, they are still concerned about price fluctuation.

CONCLUSION

> The loss of the moral community is the quintessential triumph of modernity. How this community can be revived under the clutches of the modern project is perhaps the most central and urgent question of all.
>
> Wael Hallaq (2011:27)

This Conclusion returns to the manuscript's original question: Why is there a thriving *Islamic* finance in the 21st century, but no other religious-finance industry of commercial significance — no major sector called "Christian finance," "Hindu finance," "Buddhist finance," or "Jewish finance"? Why is *Islamic* finance possible? What is special about Islam?

RATIONALIZATION WITHOUT SECULARIZATION

The short answer is that the Islamic-finance industry has successfully rationalized Islamic economic ethics without secularizing them. Islamic finance has managed to be market-friendly — translating classical Islamic jurisprudence into systematic and predictable formal rules that financial institutions can use to design and regulate products — while continuing to be Islamic in the eyes of shariah scholars, regulators, and many consumers.

Islamic finance thus challenges classical sociological models, which predict that economic rationalization should go together with secularization.[159] Since the 1970s, pressures for

[159] In *Religious Rejections of the World and Their Directions*, Max Weber argues that as societies modernize, the value spheres of social life (*Wertsphären* — e.g. the economic, the religious, the political) become increasingly distinct from one another (Weber 1946a).

What causes this separating of value spheres over time? In the work of Weber and others, two causal factors appear. The first is *functional differentiation*, at the institutional level, among different sub-systems of modern society (Weber 1946b; Schluchter 1985; Luhmann 1977; Dobbelaere 1999; Bruce 2001). As societies modernize, the "value spheres" of social life (e.g. the economic, the political, the religious, the aesthetic, the erotic, the intellectual) become increasingly distinct from one another. For example, in modern society, the organizations responsible for economic activity (such as corporations) become more and more specialized and distinct from organizations responsible for political activity (such as political parties), religious activity (such as temples, mosques, and churches), aesthetic activity (such as symphony orchestras and art galleries), and so on.

The second causal factor behind the separation of value spheres is the *internal process of substantive rationalization* that occurs within each sphere (Weber 1978; Schluchter 1985; Brubaker 1984; Kalberg 1980). Modernization entails a working-out and distillation of the fundamental logic underlying each social sub-system.

In the religious sphere, for example, this substantive rationalization is manifested by worship moving away from an emphasis on magic, and later away even from legalism, toward a direct, unmediated relationship

economic rationalization have not secularized Islamic finance, but rather done the opposite: bound religious law ever closer to economic behavior. In today's Islamic banks, shariah is applied more minutely than ever before to financial practice. The industry has produced a dense forest of formal rules, governance institutions such as the shariah board, market technologies, and discourses legitimating the application of classical Islamic jurisprudence to finance. Indeed, this "shariah-compliance apparatus" arguably constitutes a tighter

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between the individual and God. Religious imperatives increasingly take the form of abstract moral principles, not concrete ritual prescriptions. In order to remain legitimate and internally consistent, religious rules must demonstrate a direct relationship to the ethos that makes religion distinct from other sub-systems: the fraternal ethic of goodwill toward one's fellows. In the economic sphere, by contrast, rationalization proceeds with the honing of calculative techniques — like double-entry bookkeeping (Carruthers and Espeland 1991), or the computerization of commodities exchanges (Garcia 1986; MacKenzie and Millo 2003). In the name of efficiency, these techniques increasingly orient all action and rhetoric within the field toward the pursuit of profit and extract ever-greater profit per unit of time and labor (Ritzer 1975, 1983). In order to remain legitimate, economic practices must be justifiable in the name of the fundamental ethos of the economic sphere, which is the self-interested maximization of profit.

As internal substantive rationalization proceeds in each sphere, the fundamental values or ethe underlying each sphere become more evident to humans. In the political sphere, the fundamental ethos is the ethic of responsibility; in the economic sphere, the impersonal pursuit of profit; in the intellectual, the valorization of empirical science; in the erotic, sexual love; in the religious sphere — at least for salvation religions — it is the fraternal ethic; in the aesthetic sphere, the pursuit of beauty. Over time, within each sphere, individual behavior and institutional arrangements not justifiable in terms of the fundamental ethos become superfluous. They atrophy and die. This distills all substantive orientation within a value sphere down to its fundamental ethos, which in turn makes the inherent clash between the fundamental ethe of the various spheres as stark as day. In the end, as Weber writes in "Science as a Vocation," "the various value spheres of the world stand in irreconcilable conflict with each other" (Weber 1946b:147).

Functional differentiation and internal substantive rationalization reinforce each other. As corporations, churches, political parties, and families each come to manage different functions independently from one another, the inherent contradictions between the fundamental ethos of each sub-system becomes starker. The idea of using a church to make money comes to seem repulsive; the idea of running a corporation according to the principle of *caritas* comes to seem absurd.

In the specific case of the relationship between religion and the economy in modernity, Weber finds that rationalization of the modern capitalist economy is at odds with an ongoing role in it for religions of salvation (Weber 1958:331). Weber and other scholars have argued that rationalization — viz., the application of calculative logic to achieve efficiency, control, and consistency in managing human affairs — has been a powerful force in driving religion out of the economic sphere. In general, we expect economic rationalization to go together with secularization.

A classic example of this is the retreat of the church from its overarching role in the regulation of commercial and financial transactions in medieval and early modern Christendom. Weber offers the disappearance of the Catholic usury prohibition as an example of how "the needs of economic life make themselves manifest" (Weber 1978:577–578). From the Reformation onward, anything standing in the way of economic needs — that is, anything interrupting efforts to make the pursuit of profit more efficient and reliable — was progressively shunted out of economic practice (Tawney 1963).

In a modern capitalist economy, one of the most vigorous and consistent sources of pressure for economic rationalization is competition among firms. So as societies modernize, and particularly as inter-firm competition intensifies, we should expect to see any residual role for religion evacuated from economic practice.

integration of religious law (Muslim or otherwise) with finance than has existed at any time in history.

Of course saying that the evolution of Islamic finance exemplifies rationalization without secularization tells us what it is a case of, but not how and why it came to be that way. The preceding chapters have sought to answer the "how" question. Below, I will synthesize their findings. Then, at the end of the Conclusion, I will begin to sketch out an answer to the "why" question: Why was the rationalization of economic ethics possible in Islam without the disappearance of their religious character? In other words, why is *Islamic* finance possible?

From the usury ban to utopian developmentalism (1960s and 1970s)

In the middle of the 20th century, rules governing economic behavior still enjoyed credence in Islam — most famously the ban on *ribā* (usury), which many jurists and ordinary believers interpreted as including lending at any non-zero level of interest. As discussed in Chapter One, the Islamic usury ban had survived into the 20th century thanks largely to the survival of religious jurists as a distinct and respected social group. Religious jurists had for centuries been the carriers of a formal and rule-bound approach to economic ethics. The jurists simultaneously upheld the importance of observing religious law in everyday life while also helping believers achieve their commercial and financial goals in spite of it. To circumvent the ban on usury, for example, medieval jurists in all three Abrahamic traditions sanctioned the use of legal stratagems that mimicked interest — stratagems similar to those that today's Islamic banks use. But by the 19th century, religious jurists had lost social distinction and the power to regulate economic life in most Christian and Jewish denominations (aside from orthodox Judaism). In Islamic societies, however, they retained their prestige and relevance into the mid-20th century as respected teachers, advisors, and traditional intellectuals. (This was true in many Islamic societies even as the actual application of shariah to daily life was largely restricted to personal law — marriage, divorce, and so on — due to colonial rule and legal reforms in the 19th and 20th centuries.)

The survival of the Islamic usury ban and other Islamic rules governing economic behavior was crucial because it provided an ethical grammar for modern Islamic finance, which emerged in the second half of the 20th century. Non-profit welfarist projects in Islamic finance appeared in the 1960s in Egypt and Malaysia in a spirit of postcolonial developmentalism (see Chapter Two). Then, with the death of Nasser and the end of the "Arab Cold War" came the decline of postcolonial Arab socialism, a huge petrodollar influx to the Middle East, and the rise and internationalization of Islamic revivalism. These forces contributed in the 1970s to the emergence of the first for-profit Islamic banks. Islamic banking transformed into a market-driven sector in direct competition with conventional banking. The pioneers of Islamic finance in the 1960s and 1970s were idealistic "moral entrepreneurs" — including development economists, merchants, oil-rich princes, and

business leaders — primarily interested in spreading a new gospel of interest-free finance and building an alternative society free of the depredations of debt. These moral entrepreneurs, as well as academics in the new field of Islamic economics, drafted blueprints for a financial system that minimized the use of debt by relying on equity partnerships and profit-and-loss sharing (PLS). A PLS-based financial system, they imagined, would simultaneously eliminate the sin of usury and its cancerous social effects: immiseration of the poor, unjust enrichment of the wealthy, and unproductive dispensation of capital.

From utopian developmentalism to liberal Islamic finance (late 1970s to 1990s)

Two market-driven acts of rationalization in the late 1970s proved fateful, transforming this utopian Islamic financial alternative into a niche within mainstream finance. One was an organizational rationalization: the rise and spread of the shariah board (see Chapter Four). The shariah board established a clear locus for shariah governance of financial firms and cemented religious jurists (shariah scholars) as the lone ethical arbiters of Islamic finance. It also anointed classical Islamic commercial jurisprudence (*fiqh al-muʿāmalāt*), an intellectual tradition that had flowered a millennium earlier, as the correct ethical grammar for determining what does and does not count as "Islamic" finance. The jurists enjoyed a monopoly on deep knowledge of the classical *fiqh* literature, making them indispensable to the Islamic banks. By the 1990s, having a shariah board that assesses the shariah-compliance of a financial institution and its products according to the ethical grammar of classical Islamic jurisprudence had become a *sine qua non* for being considered an Islamic financial institution. Yet this was not always the case; the first commercial Islamic bank, Dubai Islamic Bank, had no shariah board when it was founded in 1975. Crucially, the shariah board also became a powerful marketing tool for Islamic financial institutions. Well-known shariah scholars enjoyed the trust of customers, particularly in the oil-rich Gulf region. Thus the shariah board linked banks — not only those in the Islamic world, but increasingly Western multinationals attracted to Islamic finance — to traditional forms of symbolic capital. At the same time, the institutionalization of the shariah board created a new career track for students of Islamic law.

The second fateful rationalization that began in the late 1970s was the turn toward mimicry of conventional interest-bearing instruments. The ascendance of the jurists and of classical Islamic jurisprudence as the defining science of Islamic finance had sidelined other visions of what made finance Islamically ethical: most of all, the consequentialist vision of the Islamic economists, who felt finance could only be truly Islamic if it measurably improved the social and economic welfare of Muslims. To the economists, simply replicating conventional finance using Islamic forms was unacceptable. However, the rise of the shariah board established as the litmus test for "Islamicness" the notion of shariah-compliance (also discussed in Chapter Six): individual compliance with the formal requirements of Islamic law, as opposed to orientation toward collective socioeconomic

ends. This opened the door for financiers to do what they had done for centuries since the medieval era with the jurists' imprimatur (as shown in Chapter One): use legal stratagems to mimic the substantive effect of interest while technically staying within the form prescribed by religious law (or at least the jurists' reading of it).

The turn toward mimickry of interest was a "rationalization" in both senses of the word. In the Weberian sense, it made Islamic finance more efficient and systematic. It established clear formal rules about what kinds of instruments were acceptable, eliminated the murky problem of determining whether Islamic banks or instruments were doing social good, and reduced transaction costs by permitting instruments such as murabaha that cheaply mimicked interest-bearing products. But it was also a rationalization in the other sense: it relied on an excuse for setting aside the social mission of Islamic finance envisioned by its founders. Islamic bankers, shariah scholars, and government regulators alike agreed in the late 1970s and 1980s that interest-mimicking instruments were necessary if the fledgling Islamic banks were to survive into adulthood. Without such instruments, customers would turn to conventional banks for home loans, car loans, personal loans, and other basic needs. Without debt products, Islamic banks would also lack an interbank market. To maintain liquidity and satisfy regulators, they would therefore have to keep unusually large reserves of cash, making them less competitive than conventional banks. In these various ways, the stark realities of competing against conventional banks seemed to stack the deck against truly "alternative" PLS-based Islamic finance. Moreover, in the words of one longtime industry observer, "these governments in the 1970s wouldn't have allowed a radically new system of banking anyway" (T. E. (anonymous) 2013): many regimes, especially in the Middle East and North Africa, were suspicious of the banks' rumored ties to Islamists and skittish about any truly novel economic schemes.

The setting-aside of Islamic finance's social mission in the late 1970s and 1980s was ostensibly temporary, but the spread of interest-mimicking instruments became permanent. The "murabaha syndrome" spread (Yousef 2004): murabaha and other interest-mimicking instruments quickly came to account for over 80% of the financing offered by Islamic banks, and in many cases over 95% (see Chapter Two). In practice, profit-and-loss sharing became a marginal part of Islamic banks' business. By the 1980s, PLS-based finance was a dream deferred: an ethical lodestar that the entire Islamic-finance community presented to the world as its fundamental difference from conventional banking and as the idealized theoretical form of Islamic finance, but something that hardly existed in practice.

Globalization, financialization, and the boom years of Islamic finance (late 1990s to present)

Both of these rationalizations — the advent of the shariah board and the turn toward interest-mimicking instruments — set the stage for the rapid ascent of liberal Islamic finance in the 1990s and 2000s. Islamic finance now operated according to relatively clear rules, and banks understood what they had to do to compete in this new sector: convince name-brand

shariah scholars to sit on their shariah boards, invest in designing shariah-compliant products that mimicked popular conventional financial instruments, and otherwise operate just like a conventional bank. "Ninety percent of what it takes to run an Islamic bank is the same as what it takes to run a conventional bank," remarked one management consultant in 2004 (M. W. (Anonymous) 2004).

The systematization of Islamic economic ethics and the elevation of shariah scholars as ethical arbiters also allowed Islamic finance to expand into new sectors. With the scholars' stamp of approval, Islamic financial institutions could construct almost every type of product available in conventional finance. From primarily trade finance and retail banking in the 1970s and 1980s, Islamic finance spread into insurance, project finance, and syndications in the 1980s; equity markets and leasing in the 1990s; and mutual funds, sukuk (fixed-income instruments sometimes called "Islamic bonds"), derivatives, and other structured products in the 2000s. Islamic finance rode the wave of financialization, profiting from the expansion of capital markets, structured finance, and risk-management products such as derivatives. It also benefited mightily from oil prices, which after the year 2000 rose in real terms to heights not seen since the 1970s. This not only shunted capital to the Gulf, but also created a new stratum of financially sophisticated high-net-worth Muslim investors eager for Islamic products. Since 2000, Islamic financial assets worldwide have grown exponentially.

Rationalization also led to greater mixing between conventional finance and Islamic finance. In Malaysia and the Gulf, conventional banks began opening Islamic "windows," branches, and divisions in the 1990s. In the 2000s, many leading banks in the Gulf converted entirely from conventional banks into Islamic banks. And as the tide of neoliberal globalization in the 1990s and 2000s eliminated restrictions on cross-border transactions and national financial markets, titans such as Citibank, HSBC, Standard Chartered, and Deutsche Bank expanded their Islamic divisions, coming to dominate international Islamic investment banking and establishing strong positions in corporate finance. The new financial openness also allowed leading Islamic banks from the Gulf, such as Kuwait Finance House and Saudi Arabia's Al Rajhi, to launches branches abroad.

As global markets liberalized and Islamic finance expanded into complex wholesale sectors such as syndicated finance, capital markets, and derivatives, a new science of Islamic financial engineering emerged in the 1990s and 2000s. This was a hybrid of multiple forms of knowledge: classical Islamic jurisprudence from medieval *fiqh* compendia, secular regulatory know-how, and conventional financial engineering from Wall Street and the City of London. A new epistemic community emerged that put shariah scholars, lawyers, investment bankers, commodities specialists, and other technical experts in dialogue (see Chapter Four). By the late 2000s and early 2010s, Islamic instruments and techniques were appearing whose names might have hardly been decipherable 15 years earlier: shariah-compliant credit-default swaps, Islamic tranching, and sukuk issuances based on intangible underlying assets such as mobile-phone airtime and petrochemical marketing rights.

The growth of Islamic financial engineering accelerated the imbrication of conventional finance and Islamic finance. The producer-services firms[160] that topped league tables in their respective branches of conventional finance came to top the same league tables in the new Islamic haute finance. The vast majority are based outside the Islamic world, as Figure 42 shows. Demand grew for shariah scholars who understood finance and could "talk to the suits" because they embodied the habitus of international business. Likewise, demand grew for lawyers and bankers who understood shariah and knew how to "talk to the sheikhs" with deference and respect. At the same time, training programs, credentialing regimes, and university courses in Islamic finance mushroomed. Yet virtually all of this was predicated on producing interest-mimicking Islamic analogues of conventional financial instruments in ways that would earn the shariah scholars' approval. This is where Islamic finance stands today.

IFN 2013 Law Award	Law Firm	Headquarters
Best Overall Law Firm	Allen & Overy	UK
Private Equity	King & Spalding	USA
Project & Infrastructure Finance	Latham & Watkins	USA
Cross Border	Norton Rose Fulbright	UK
Mergers & Acquisitions	Allen & Overy	UK
Insolvency & Restructuring	Allen & Overy	UK
Asset & Fund Management	SJ Berwin	UK
Banking & Capital Markets	Allen & Overy	UK
Takaful & re-Takaful	Norton Rose Fulbright	UK
Energy & Natural Resources	Vinson & Elkins	USA
Real Estate & Property	Allen & Gledhill	Singapore
Corporate & Commercial	Norton Rose Fulbright	UK
Offshore Finance	Maples & Calder	Cayman Islands
Litigation & Dispute Resolution	Al Tamimi & Co	UAE
Structured Finance	Zaid Ibrahim & Co	Malaysia

FIGURE 42: THE BEST ISLAMIC-FINANCE LAW FIRMS IN THE WORLD, according to last year's *Islamic Finance News* Law Awards. Most of them are large global firms headquartered in the United Kingdom and United States. Only two are based in the Islamic world. (IFN staff 2013)

[160] Producer services are services that allow firms to conduct their business more efficiently. Examples include legal services, accountancy, management consulting, and janitorial services. See Sassen (2001) for an analysis of the role of producer-services firms in core cities of the contemporary global economy.

THE RESPONSE TO RATIONALIZATION

Critique and resistance

The rationalization of Islamic economic ethics enabled the great success of liberal Islamic finance. And let us be clear: pursuit of profits was the most powerful factor behind this rationalization. The appointment of shariah boards allowed the Islamic banks of the 1970s and 1980s to raise capital and attract customers. The turn toward interest-mimicking instruments let them offer lucrative products, manage treasury risk, and compete more effectively against conventional banks. The expansion into new and exotic realms — including some, such as fixed-income securities and derivatives, once declared off-limits by scholars — was driven by neoliberal financialization and the desire to tap rising 21st-century Muslim wealth.

Nevertheless, the forward march of liberal Islamic finance has also faced resistance and internal critique. Although interest-mimicking instruments have long dominated Islamic finance, some are particularly controversial because critics consider them unethical and un-Islamic. In Chapter Five, we saw that bayʿ al-ʿīnah, a cheap and easy financing technique with a dominant position in Malaysian Islamic finance, was phased out between the mid-2000s and 2014. Malaysia's Islamic banks, facing pressure from academics, customers, activist judges, and eventually state regulators, were effectively forced to give up this profitable Islamic financial practice. We also saw that tawarruq, a financing and liquidity-management practice based on the trading of commodities, has triggered a firestorm of debate despite being popular around most of the Islamic world.

At the same time, a new discourse of critique and reform is emerging (see Postface below). Since the 1990s, "shariah-compliant" has been the main term used to describe Islamic financial products. "Shariah-compliant" has come to mean "in conformance with the formal rules of shariah" as interpreted by shariah scholars. To be shariah-complaint, a product must avoid interest, avoid un-Islamic sectors (such as alcohol and pork), and meet a number of other negative sanctions. However, since the 2000s, reformers have called for a turn toward "shariah-based" instruments. Being shariah-based has come to mean adopting a higher ethical standard beyond merely avoiding that which is un-Islamic. Reformers are arguing that producing formally sin-free shariah-compliant instruments is an insufficient ethical goal for Islamic finance. Aiming to set a higher bar, some draw an analogy to food: being halal does not make a hamburger healthy. "Now… we have an Islamic Big Mac," joked one British shariah scholar. "And if you eat enough of those, you'll get Islamic diabetes and have an Islamic heart attack. Appending the word 'Islamic' in front of anything will not make it better."

Ethical reforms — but only of a technical kind

The industry tends to respond to those critiques that invite formal and technical solutions. For example, Malaysia's Bursa Suq Al-Silaʿ and Dubai's Tradeflow, introduced in 2009 and 2013 respectively, are two complex electronic tracking mechanisms for ensuring that the commodity trades underlying tawarruq are executed in a meticulous manner (see Chapter Five). These assuage some of the concerns that shariah scholars have about tawarruq's shariah-compliance.

Likewise, Thomson Reuters responded to longstanding controversy over pricing Islamic products according to LIBOR (a conventional interest rate) by launching in 2011 the Islamic Interbank Benchmark Rate (IIBR), a profit rate that averages the profit rates charged by leading Islamic banks. A profit rate is the Islamic analog of an interest rate; it appears when Islamic financial products issue interest-mimicking instruments. Because Islamic financial institutions compete with conventional financial institutions, IIBR is almost always nearly identical to LIBOR. However, supporters of IIBR argue that it is a more fundamentally Islamic price of money than LIBOR because it is more separate from conventional finance.[161]

Substantive economic criticisms of Islamic finance get much less response from the industry. The welfarist vision of Islamic finance that appeared in the 1960s and 1970s — a

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[161] The question at stake here is this: Can a number be profane? Islamic bankers and shariah scholars have debated for over a decade about whether they can use LIBOR — a set of numbers that serve as interest-rate benchmarks in the world of conventional finance — to set the price of borrowing in their own industry. Some argue that LIBOR is tainted with the sin of interest. Others respond that it is simply a set of numbers, and therefore cannot be sinful. As the CEO of one Malaysian Islamic bank insisted, "There is no such thing as Islamic mathematics! There is only mathematics" (Parker 2011).

The ethical debate over LIBOR in Islamic finance is a function of the industry's rapprochement with conventional finance. Islamic financial engineers have developed Islamic versions of many LIBOR-linked conventional financial instruments, including shariah-compliant variable-rate loans and shariah-compliant adjustable-rate mortgages. In the past decade, they have also developed shariah-compliant derivatives, including "profit-rate swaps" — the Islamic version of an interest-rate swap. These rapid technical advances in Islamic financial engineering have raised a thorny question. What floating interest rate should Islamic financial institutions use as the reference underlying these shariah-compliant instruments? If an Islamic variable-rate financing charges LIBOR + 3%, does the reference to LIBOR annul its shariah-compliance? Seizing a market opportunity in criticism of LIBOR's use in Islamic finance, Thomson Reuters — the same firm that calculates LIBOR — launched the Islamic Interbank Benchmark Rate (IIBR) in 2011. It is an Islamic version of LIBOR. Just as Thomson Reuters polls leading conventional banks about interest rates each day to calculate LIBOR, it now also polls leading Islamic banks about profit rates each day to calculate IIBR.

Such ontological debates over the nature of financial entities have governance implications not only in Islamic finance, but in conventional finance as well. When ATMs first appeared in the early 1970s, regulatory debates rages as to whether they could be placed in grocery stores. Was an ATM a bank branch? If so, then regulations prohibited it from sitting in a commercial establishment. Today, consumers are accustomed to ATMs in grocery stores. (I thank Jim Wilcox for this insight about ATMs.)

vision based on profit-and-loss sharing, with the goal of producing a more equitable society — is steadily disappearing. Some critics, especially Islamic economists, continue to advocate it; but they are marginal to the business of Islamic finance today.

From a political threat to a technocrat's dream

By being so resolutely technical, Islamic finance has managed to become politically non-threatening. In the 1970s and 1980s, many states in the Islamic world feared that Islamic finance was a platform for Islamists or a threat to established financial interests. Some suppressed Islamic finance, while others banned it outright, including Iraq, Syria, Libya, Morocco, and Oman. Ayatollah Muhammad Bāqir al-Ṣadr, one of the pioneers of Islamic economics, was tortured and executed by Saddam Hussein in 1980. But as the shariah-compliance apparatus has grown in the 1990s and 2000s, Islamic finance has become universally accepted, even by authoritarian regimes nervous about Islamism. The shariah-compliance apparatus reassures governments that permitting Islamic finance in their country will not usher in a revolutionary Islamic economic system. Instead, Islamic finance is an on-ramp for foreign capital, especially from the Gulf. It is a technocratic challenge, not a political one. Today, not one government in the Islamic world still bans Islamic finance. Even the governments of Uzbekistan and Syria, which have cracked down on Islamist insurgencies, have ventured into Islamic finance.

Islamic finance as shariah-compliance apparatus

The present emphasis on formal technical solutions and elision of substantive economic concerns makes the most sense if we understand Islamic finance today as a shariah-compliance apparatus: a market-driven regime of technical ethical certification. The shariah-compliance apparatus is a "rationalization engine" in that it streamlines consumer choice into binary ethical categories (shariah-compliant versus non-shariah-compliant) and systematizes the ethical standards that banks must meet and regulators must enforce. It also constructs shariah scholars as technical experts with clear formal justifications for their rulings, not Solomonic qāḍīs who rule arbitrarily and unpredictably (Weber 1978). Elite, relatively conservative shariah scholars (see Chapter Four) are the ethical arbiters of this system, but they are surrounded by an ever-denser forest of rules, organizational forms, monitoring technologies, dedicated experts in classical Islamic jurisprudence, and modes of technical expertise. The shariah-compliance apparatus makes the ethical technical.

The crystallization of Islamic finance into the shariah-compliance apparatus has strong parallels in other arenas, as I discuss in Chapter Three. Just like Islamic finance, movements for fair trade and socially responsible investing were rooted in social movements of the 1960s and 1970s and then faced a trade-off between market-driven scaling-up and adherence to the socially grounded mission of movement pioneers and activists. And in all three cases, the

movements evolved in the 1980s and 1990s into ethical-compliance certification apparatuses: highly technical systems for formally classifying and certifying market-produced goods and services according to standards of ethical consumption. These apparatuses use technical means to construct and certify ethical categories. They use morals to build and capture markets. So while Islamic finance is distinctly Islamic, it also reflects trends in late-twentieth and early-twenty-first-century world-society: the decline of socialism and the rise of new social movements, financialization and the rise of shareholder-value capitalism, the globalization of markets and supply chains, and the spread of electronic information technology.

WHY IS ISLAMIC FINANCE POSSIBLE? IT OFFERS RULES… THAT EVOLVE

Above, I have reviewed *how* Islamic economic ethics rationalized without secularizing. But are there underlying features of Islam or Islamic law that account for this possibility? Why is *Islamic* finance possible under conditions of twenty-first-century capitalism, at a time when no other major form of religious finance exists?

Islamic finance provides rules…

What we have seen in this book points to the conclusion that *Islamic finance succeeds because it provides rules governing economic behavior — but rules that are not overly rigid.*

Markets need rules because they need structure. Macro-level structure provides stability and predictability for firms. Micro-level rules also provide a grammar for innovation, letting capitalists know what kind of products they can and cannot design. Clear rules also help central banks and other state institutions regulate firms.

Collectively, jurists, capitalists, and governments together satisfied the need for rules. When development-oriented economists launched Egypt's Mit Ghamr Savings Bank and Malaysia's Tabung Haji in the early 1960s, and when Saeed bin Ahmad al-Lootah launched Dubai Islamic Bank in 1975, rules about what counted as valid Islamic financial praxis were absent. But when religious jurists and bankers came together starting in the late 1970s to set such rules and administer them via the shariah board, the industry began to grow. Today, the shariah-compliance apparatus provides a dense forest of rules as to what kind of financial behavior is and is not Islamic.

A counterexample illustrates the stabilizing power of the rules that emerged from the banker-scholar alliance. In the 1980s, the banker-scholar alliance and its shariah boards had not yet attained the worldwide near-monopoly they now enjoy over what counts as genuinely Islamic finance. In Egypt, another emerging industry claimed Islamic financial

legitimacy: the Islamic capital-investment companies (*sharikāt tawẓīf al-amwāl al-islāmīyah*). These were high-profile firms that collected savings from ordinary Egyptians and paid out high returns. They did not have shariah boards and did not use jurists to vet their products, but they did rely heavily on religious imagery in their marketing, advertising their fat returns as "blessings." Sadly, many of them — including the giants Al-Rayan and Al-Saad — turned out to be pyramid schemes or to be engaging in other unsavory forms of behavior (Oweiss 1990; Warde 2010). The Islamic capital-investment sector collapsed in the late 1980s, taking the savings of millions of Egyptians with it — despite public displays of piety by their managers, including the notorious Ahmed El-Rayan, who eventually served 21 years in prison (Fikrī and Nādī 2013; Kamal 2011). While Islamic banks have certainly not been scandal-free (DeFede 1998, 1999), the shariah board puts a moral backstop — however imperfect — behind them. Famous shariah scholars can be dishonored in the eyes of the public and their peers if Islamic financial institutions step outside the rules of shariah or, worse, engage in reckless and scandalous behavior. In lending their prestige and credibility to the banks, shariah scholars provide some level of structure and restraint.

…but those rules evolve to accommodate capitalists

At the same time, the rules of the shariah-compliance apparatus evolve. They are not rigid. This gives capitalists flexibility to accommodate market demands. Shariah scholars set the rules for Islamic finance, and while they might rarely admit it, they shape their readings of Islamic law (within bounds) to benefit the banks and their shareholders. In the 1960s and 1970s, the pioneers of Islamic finance felt that shariah banned bonds and derivatives; today, Islamic "bonds" and Islamic derivatives are important parts of the industry, and Islamic hedge funds are emerging. So shariah governance evolves with the times. While some shariah scholars provide structure and restraint, others help financial engineers "push the envelope" into uncharted waters.

Again, a counterfactual: if Islamic economists instead of shariah scholars had become the dominant ethical arbiters, Islamic finance would likely have evolved very differently. It would probably be more oriented toward profit-and-loss sharing (PLS). It might not be based almost entirely on mimicking interest. But as a result, its commercial appeal might be radically weaker. Instead of a $1.7 trillion global industry, Islamic finance might be limited to microlending and other small-scale operations. It might never have succeeded in capital markets, large-scale corporate lending, and mass consumer finance.[162] Thus the dominance of the shariah scholars has been vital to the success of an eminently liberal brand of Islamic finance that can do nearly everything conventional finance can.

[162] Whether this would have been better or worse from an ethical perspective is not for me to address.

Why are such evolving rules possible?

Islamic finance supports rules that evolve to accommodate capitalists largely because of the organizational structure of Islamic jurisprudence worldwide. Islamic jurisprudence in the 20th and 21st century has five key characteristics in this regard: it is voluntary, decentralized, respectful of difference, deep-historical, and innovation-friendly.

- Voluntary: Shariah governance in Islamic finance depends on *voluntary participation*. A given Islamic bank freely chooses the scholars who sit on its shariah board, and a customer freely chooses which bank — and thus which scholars — approve the financial products she buys. The shariah scholars are jurists, not judges: their decisions do not carry government enforcement authority backed by the state's monopoly on violence.[163]

  In those instances where states have tried to impose Islamic finance by fiat, a vibrant capitalist market for Islamic finance has failed to develop. In Iran and Pakistan, Islamist governments attempted to Islamize the entire national financial sector in the 1980s — and failed.

- Decentralized: Shariah governance in Islamic finance is decentralized and non-hierarchical. A given shariah board's decisions are binding only on the institution it oversees.[164] This gives shariah governance a flat authority structure. Furthermore, because religious jurists are not clerics, they do not claim any privileged relation to God relative to the lay believer or to one another.[165] They claim only to be interpreting law as fallible human beings, and thus their authority is limited to the extent that they can defend it scholastically.

  If an explicit hierarchy existed among shariah scholars worldwide (as among the clerical hierarchy of the Roman Catholic Church, with its bishops, cardinals, and pope), or if states established a nested hierarchy of shariah boards akin to a courts system, or if each juridical school (the Shāfiʿī, the Ḥanafī, and so on) had a living leader who dictated binding policy, shariah scholarship would be much more rigid and less able to adjust to the needs and desires of capitalists in different times and places. The decentralized structure of Islamic jurisprudence worldwide gives Islamic finance flexibility.

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[163] with a few exceptions, as in the case of some central banks' shariah-board members.

[164] …with the exception of some government shariah boards, such as the Shariah Advisory Committee of Malaysia's central bank and securities commission.

[165] With the proper study and intellectual ability, any Muslim may theoretically become a shariah scholar; membership is not limited to Muslims of a particular sect, lineage, sex, or age. Although in practice, certain groups — such as men rather than women and Arabs rather than non-Arabs — tend to be demographically over-represented, the theoretical accessibility into the corporate group of scholars vitiates the possibility of *formal* hierarchy.

- Respectful of difference: Relatedly, shariah governance *respects juristic difference of opinion*. Even when one shariah scholar prohibits a product that another scholar approves, the international norms of Islamic jurisprudence dictate that neither may accuse the other of being a bad Muslim (at least not publicly). Shariah scholars treat differences among themselves as differences of juridical approach and opinion, much as law professors may differ on points of law and theoretical approaches while still considering one another ethically sound professionals. But even at the intellectual level, it is almost unheard of for one member of "the fraternity"[166] to say publicly and explicitly that another member's ruling was wrong. This mutual respect and deference extends beyond differences among individual jurists to differences among the major juristic schools and the geographies in which they prevail.[167]
- Deep-historical: Shariah governance is *rooted in classical and medieval precedent*. In order to justify their decisions, shariah scholars refer not only to the Quran — which contains little in the way of detailed commercial law — but also to the great classical ḥadīth compendia (such as *Ṣaḥīḥ al-Bukhārī* and *Ṣaḥīḥ Muslim*, both of the ninth century CE) and the commentaries of classical and medieval jurists. Today's shariah scholars must therefore draw analogies from pre-modern commerce (such as how the Prophet Muhammad or his companions said camels, dates, and slaves could appropriately be bought and sold) to twenty-first-century finance. This distinguishes the shariah scholars' work from that of secular financial regulators, bioethicists (Evans 2002, 2006), fair-trade certifiers, and virtually every other type of contemporary technical governance authority, who are of course informed by history but not bound to justify their ethics with reference to particular historical traditions. Classical jurisprudence gives Islamic finance a grammar and a lexicon: a set of nominate contracts attested in Islamic history (such as murabaha) and rules governing their acceptable use. This grammar and lexicon have changed radically since medieval times: classical murabaha and classical tawarruq were very different instruments from those used today. But the fact that a classical Islamic-financial grammar and lexicon of some sort exist lend legitimacy to contemporary shariah scholars' work.

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[166] Industry practitioners often refer to the community of shariah scholars in Islamic finance, and especially the fraction of elite scholars, as "the fraternity" (Farook 2013; Hanif and Tredgett 2013).

[167] As discussed in Chapter Five, for example, a Malaysian jurist of the Shāfiʿī school and a Saudi jurist of the Ḥanbalī school may approve very different Islamic financial products, but in the vast majority of cases the Malaysian simply acknowledges that things are done differently in Saudi Arabia, and vice versa. And ironically, difference of opinion across juristic schools can lubricate product innovation: contemporary shariah scholars often patch together rules and precedent from various juristic schools in order to find justification for approving a product or solving a juristic problem. They refer to the doctrine of talfīq (literally "piecing together) to justify this syncretism.

- Innovation-friendly: Finally, today's shariah scholars enjoy leeway to approve products so long as they do not violate Islamic law — that is, so long as they are shariah-compliant. Their primary task is not to endorse what is good, but to prohibit what is bad. Scholars often refer to the general juristic principle, crystallized in the work of Imam al-Shāfiʿī, that what is not prohibited is permitted (Zahid 2013:132–133). Thus, when Islamic banks introduce a new product, the scholars' default stance is to assume that it is Islamically acceptable unless proven otherwise. Even if a product seems ethically questionable, scholars often also refer to the doctrines of *ḍarūrah* (necessity) and *maṣlaḥah* (societal benefit) in justifying its use, often by arguing that the Islamic-finance industry might suffer harm without it or that while it may be imperfect, it is ethically superior to the conventional alternative (see Chapter Five). Drawing on these various doctrines, shariah scholars facilitate a liberal approach to Islamic financial innovation.[168]

[168] The decentralized character of shariah governance in Islamic finance makes it more innovation-friendly. Shariah scholars and the financial firms they oversee are more easily able to innovate because one firm's shariah board cannot overturn a fatwa issued by another bank's shariah board. A parallel exists in the history of conventional financial innovation under federal systems of government. In the United States, for example, the fact that banks can operate with state charters (instead of national charters issued by the Office of the Comptroller of the Currency) and the existence of separate rules and regulatory authorities for banks chartered in each U.S. state have turned each state into a separate laboratory for innovation.

The history of the NOW account (Kaplan 1974; Riordan 1974) is an example, and one with an uncanny similarity to the history of Islamic financial innovations such as 4-MS: it is a story of the spread of a financial instrument designed to circumvent a ban on paying interest. Section 11 of the Banking Act of 1933 (the "Glass-Steagall Act") made it illegal for American banks to pay interest on checking (demand) deposits. Regulation Q remained in place until 2011. However, Consumers Savings Bank, a savings-and-loan institution in Massachusetts, introduced instruments in the early 1970s called negotiable orders of withdrawal (NOWs) that could be drawn on interest-bearing savings accounts. NOWs were not technically checks, but they acted just like checks. Somewhat surprisingly, Massachusetts regulators approved NOW accounts. The innovation quickly proved popular, spreading across Massachusetts and New Hampshire starting in 1973 with approval from the U.S. Congress. This put pressure on other state regulators to allow NOW accounts, which thereafter spread across New England and then the entire United States. (Edward J. Kane (1977) describes this *pas de deux* between financial regulators and their regulatees as the "regulatory dialectic".)

It is noteworthy that in American banking, as in Islamic finance, governance institutions (such as shariah boards and issuers of state and national banking charters) depend for their income, occupations, and prestige on the number and size of the private financial institutions they oversee. In the case of American banking, this leads to competition among regulatory authorities and charter-issuers that can promote and spread financial innovation (Wilcox 2005). (But as discussed in Chapter Four, some critics of Islamic finance assert that the industry is riven by "shariah arbitrage": the movement of banks toward whichever shariah scholars will offer the most lenient shariah governance.)

I thank Jim Wilcox for the insights on NOW accounts and innovation in U.S. banking and regulation.

THE CONSUMER STORY

Islamic finance, like any industry, has producers and consumers. The field of producers, which has been the focus of this manuscript, includes Islamic financial institutions that compete in the marketplace, the state institutions that regulate them, and the shariah scholars who supervise them. As discussed above, rules that evolve to accommodate capitalists have been crucial on the producer side to the success of Islamic finance.

This manuscript has focused less on the consumer perspective, which I plan to investigate in future research. Do consumers accept that today's Islamic banks and shariah scholars offer a legitimately Islamic product? The evidence I have presented so far is mixed. I have shown anecdotally that many consumers are uninformed about what lies inside the "black boxes" of Islamic financial products, tending to trust that Islamic banks and the shariah scholars who oversee them are applying Islamic law correctly. But we have also seen that some consumers are starting to question the "Islamicity" of products, such as 2-MS in Malaysia (see Chapter Five).

Another question on the consumer side concerns what kind of people are attracted to contemporary Islamic finance. Islamic finance appears to have broad appeal across the Islamic world: Islamic financial institutions now exist in every OIC country, and demand is growing steadily in locations as diverse as Indonesia, Turkey, Saudi Arabia, and Nigeria. However, we know little about the demographic profile of consumers. Relative to conventional consumers, are they young or old? Rich or poor? More or less educated? More or less likely to have attended Islamic schools? What is their political orientation? Are they more or less likely to support a role for Islam in state institutions? Are they more or less likely to engage regularly in other practices of piety, such as prayer and observance of dietary laws? Islamic financial institutions have already begun conducting surveys into some such questions; I hope to push this research agenda further and make the resulting knowledge publicly available.

In-depth interviews with consumers and ethnographic research can go a step further, examining what Islamic finance means to consumers. How do they think about finance, and consumption in general, as arenas for performing and embodying piety? For example, is buying Islamic financial products the same to them as praying, dressing appropriately, and consuming halal meat; or does finance — archetypally removed from religious ethics in classical sociological understandings of modernity — represent a distinct realm for the practice of piety? When did they first learn of the Islamic ban on *ribā* (usury), and do they think of it as a matter of legal form or of economic substance? How do they understand the role of religious jurists in society, and do they look to them for guidance in everyday behavior? Do they understand Islamic finance as simply a flavor of conventional finance, or as part of a holistic and transformative economic project — part of a largely Islamic moral economy?

Taking this kind of *Verstehen*-orientation in research is crucial for understanding liberal Islamic finance as a historically specific phenomenon. The success of Islamic finance confounds views that Islam is monolithic, historically static, and antithetical to liberal capitalism. Indeed, Islamic finance today is emphatically not the province of so-called "jihadists" or other oft-caricatured fractions of the world's Muslim population who allegedly view liberalism and modernity as moral capitulations to the West that must be rejected and violently combatted. Its appeal seems to lie among a much larger and more eclectic group — perhaps a majority — for whom Islamic law offers an idiom for expressing and constructing one's identity within a distinctly modern terrain of consumption in which the suzerainty of supply and demand is taken for granted. Ultimately, the question on the table for researchers is not "Can Islam be modern?", but rather, "What new understandings of modernity does Islamic finance embody, construct, and reproduce in an age of liberal capitalism?"

POSTFACE

Shariah-compliant or shariah-based?
The changing discourse of Islamic finance

Introduction

The Islamic-finance industry is constantly soul-searching. Because it has always presented itself as a more just and virtuous alternative to conventional finance, people within the industry regularly ask how they can bring the actual practice of Islamic finance closer to an ethical ideal. Conferences, seminars, books, articles, and innovation competitions all call for ethical breakthroughs in Islamic finance. These calls are based on the notion that Islamic finance has the potential to be more ethical than it is today.

Advocates of reform use various terms to describe the changes they envision. Some say the industry needs to shift from an emphasis on "form" to an emphasis on "substance"; others from a "risk-shifting" system to a "risk-sharing" system; others from the "copy-pasting" of conventional instruments toward the indigenous creation of "home-grown" Islamic istruments; others from a "debt-based" approach to an "equity-based" approach; and still others from "asset-based" structures to "asset-backed" structures.

Most recently, reformers have been using new language to state their aspiration: they say that Islamic financial institutions should move beyond offering merely "shariah-compliant" instruments toward offering more "shariah-based" (or "shariah-driven"[169]) ones. But what exactly do they mean? All of the terms listed above suffer from some level of ambiguity, but the "shariah-based" concept in particular seems to leave even industry insiders scratching their heads. I have met senior bankers with many years' experience in the industry who are confused about the distinction between "shariah-compliant" finance and "shariah-based" finance. Others feel the distinction is meaningless.

The body of this postface has two sections, each of which poses a question. The first section asks: Where do the terms "shariah-compliant" and "shariah-based" come from? I discuss their early recorded usages and possible origins, concluding that the popularity of the call for shariah-based finance is an artefact of the 2000s and especially the post-2008 period, when systemic stability and product transparency have become pressing concerns in both Islamic finance and conventional finance.

The second section asks: What exactly do people mean by "shariah-based"? While some assert that the distinction between shariah-based finance and shariah-compliant finance is

[169] Industry literature uses "shariah-based" and "shariah-driven" interchangeably. I use "shariah-based" in this chapter because it is more common at the moment.

straightforward, I find that industry figures have in fact used the term in very different ways. Their definitions sometimes generate more ambiguity than clarity. To find a way out of this confusion, I distill the circulating definitions of "shariah-based" into three categories: those that stress *separation* from conventional finance, those that stress *authenticity*, and those that stress *welfare*. I conclude by noting that the multiplicity of definitions is not a problem to be hidden away, but a starting point for debate and a sign of Islamic finance's growing maturity as an ethical project.

The goal of this postface is not to advocate one path or another, or even to argue for shariah-based finance. Instead, it is to bring conceptual clarity to the debate over shariah-compliant and shariah-based Islamic finance, and to invite further conversation about whether shariah-based finance is a meaningful and realistic lodestar in the second decade of the 21st century.

Where do the terms "shariah-compliant" and "shariah-based" come from?

"SHARIAH-COMPLIANT" ISLAMIC FINANCE

Emergence of the term "shariah-compliant"

The English term "shariah-compliant" appears to have come into existence in the early or mid-1990s. This contrasts with the term "Islamic banking," which appeared in major American newspapers (Hartley 1974; New York Times staff 1974) and academic sources (Ahmed 1974) as early as 1974, and in other sources before that; and with the term "Islamic finance," which we find in English usage by 1982 at the latest (Karsten 1982).[170]

The English term "shariah-compliant" became widespread in the mid- to late 1990s. Literature searches for the term[171] turn up a magazine article from 1996 (MEED staff 1996), a newspaper article from March 1999 (Womack 1999), and a scholarly article from the same year (Wilson 1999). By the year 2000, the term was being used at the Fourth Harvard University Forum on Islamic Finance (Gainor 2000). The year 2000 was also the first year that "shariah-compliant" showed up in American legal literature, appearing in various articles (DeLorenzo 2000; McMillen 2000; Sharawy 2000). All of this suggests the term

[170] I mean here "Islamic finance" in the sense of modern Islamic finance, as opposed to medieval Islamic financial activities.

[171] Databases searched include WorldCat (the world's largest library catalog, which itemizes the collections of 72,000 libraries in 170 countries), Lexis-Nexis, JSTOR, Google Scholar, and Google Books. The search encompassed spelling variants ("shariah," "shariah," "sharīʿah," etc.) and both hyphenated ("shariah-compliant") and non-hyphenated ("shariah compliant") variants.

"shariah-compliant" first came into use sometime in the early to mid-1990s. Prior to that, authors typically simply described financial instruments using the label "Islamic," as in "Islamic profit-sharing arrangement" (Iqbal and Mirakhor 1987), or talked about commercial or financial activities that "conform to Shariah" (Islamic Economics Research Bureau (Bangladesh) 1982). They did not use "shariah-compliant" as an adjective the way it is used today.

Why did the term "shariah-compliant" become popular?

Putting a date on the first appearance of the term "shariah-compliant" may seem pedantic, but it is in fact important because it allows us to place the term in the context of the history of Islamic finance. Why, we might ask, was it necessary to start using the term "shariah-compliant"? What was wrong with just calling a financial instrument "Islamic," for example, as had been done in the 1980s, and as is still often done today? There are several possible reasons for this discursive shift.

The first possible reason was to bolster consumer confidence in Islamic finance in the wake of scandal. Consumers needed reassurance that their money was being handled according to strict ethical standards partly because a number of so-called "Islamic" financial operations had recently been publicly discredited. In one of the most tragic such cases, many of Egypt's leading Islamic capital-investment companies (*sharikāt tawẓīf al-amwāl al-islāmīyah*) of the 1980s, including the giants Al-Rayan and Al-Saad, turned out to be pyramid schemes or to be engaging in other unsavory forms of behavior (Oweiss 1990; Warde 2010) — despite public displays of piety by their managers, including figures such as Ahmed El-Rayan, who eventually served 21 years in prison (Fikrī and Nādī 2013; Kamal 2011). Using the term "shariah-compliant" may have been a way for the Islamic financial institutions of the 1990s to stress that they, unlike the failed Egyptian capital-investment companies, operated according to a high ethical standard.

Second, and relatedly, the word "compliant" serves another powerful marketing function: it communicates that a high level of formal rationality, technical expertise, and rigorous assessment lie behind approved Islamic financial products. The word "compliant" means "meeting or in accordance with rules or standards" (McKean 2005) or "manufactured or produced in accordance with a specified body of rules" (Flexner 1993). Compliance standards for electronics products govern levels of heavy metals; compliance standards for food products set maximum levels of testable toxic substances and bacteria; and compliance standards for aircraft require hundreds of stress mechanical and electrical stress tests on the fuselage and cockpit. Compliance is a serious matter. When the word "compliance" is used, we assume that standards are monitored in a rational and regular way by professional experts. We also assume there is punishment for non-compliance.

Because consumers are used to hearing the word "compliant" used thus, the word "shariah-compliant" provides reassurance to customers who might have wondered just what is "Islamic" about an Islamic financial product. At the same time, use of the word "shariah-compliant" constructs a cognitive equivalence between shariah and a system of regulations, standards, or rules. It stresses the formal aspect of Islamic law. It emphasizes that shariah is more formally rational, institutionally rooted, and standardized than "mere" ethics, which may be subjective. One would never say a financial instrument is "ethics-compliant," because ethics vary from person to person and community to community. Calling something "ethics-compliant" would beg the question, "Whose ethics?"[172] In other words, using the word "shariah-compliant" elevates adherence to shariah from a subjective matter that can vary from interpreter to interpreter to an objective matter that is testable against fixed regulations.

The importance of communicating formal and technical rigor

As Islamic finance evolved toward increasingly sophisticated product offerings, it became ever more important to communicate that the "Islamicness" of those product offerings was being measured in a formal and technical way. In the 1970s and 1980s, most Islamic financial products relied on a single Islamic nominate contract, such as murabaha, musharakah, or mudaraba. The product could be described by using the name of that contract. For example, an Islamic auto financing could simply and accurately be described as a murabaha auto financing (*tamwīl murābaḥah al-sayyārah*). However, as Islamic finance entered the capital markets with gusto in the 1990s, naming requirements changed. Stock screens posed a problem, for example. Describing an investment fund of screened companies as "Islamic" was ambiguous, but describing it as "shariah-compliant" more accurately portrayed that the stocks it contained did not violate specific Islamic legal conditions, such as involvement in *haram* sectors such as pork, alcohol, and pornography. Likewise, as Islamic financial institutions increasingly introduced replicas of sophisticated conventional instruments, the need to differentiate their products from the conventional products they replicated grew stronger. A "shariah-compliant cross-currency swap" sounds more unambiguously different from a conventional cross-currency swap than an "Islamic cross-currency swap." It also sounds more technically rigorous.

In sum, the term "shariah-compliant" is an industry neologism that first appeared in the 1990s. It not only explicitly conveys information about the product in question, but also implicitly communicates a specific understanding of shariah: that shariah is a formal system of regulations. Finally, it is worth noting that the term almost certainly originated within the Islamic-finance industry, as it is virtually never used outside the industry. Likewise, its

[172] However, one could certainly say that a physician's behavior is "compliant with" the American Medical Association's Code of Ethics — because this is a settled, formal, institutionally rooted set of rules.

Arabic equivalent, the phrase "*mutawāfiq maʿ al-sharīʿah al-islāmīyah*," rarely appears outside the context of Islamic finance. In this sense, the Islamic-finance industry and its vocabulary are arguably driving how 21st-century Muslims and non-Muslims conceive of Islamic law (Bälz 2008).

"SHARIAH-BASED" ISLAMIC FINANCE

Emergence of the term "shariah-based"

The term "shariah-based" has appeared relatively often in English-language literature about Islamic law. However, most uses of this term outside Islamic finance simply imply being rooted in shariah in some general way (e.g. "shariah-based arbitration" (Khan 2005), "shariah-based rulings" (Solé 2007), "shariah-based protests" (Khan 2008)). The same is true of "shariah-driven," which experiences various usages, including some inflammatory ones by anti-Muslim entities.[173]

In its usage here — that is, presented as an ethically preferable alternative to "shariah-compliant" — the term "shariah-based" and its synonym "shariah-driven" probably first appeared in the early to mid-2000s. One of the earliest recorded usages was by Iqbal Khan in 2006. At a lecture at the Institute for Islamic Banking and Insurance in London, Khan equated a shariah-based future for Islamic finance with a more ethical one:

> It is critical that the industry redress the balance in the letter and spirit of the law to maintain its authenticity - shifting from its accommodative, Shariah-compliant setup to a spirited, Shariah-based industry, which encapsulates a change in mindset as well as product offering, away from indebtedness products, to savings and investment solutions (Khan 2006).

Here, Khan associates being "shariah-compliant" with "indebtedness products" and being "shariah-based" with "savings and investment" products. He also describes the shariah-compliant approach as "accommodative" — accommodating the whim of market forces, presumably — and the shariah-based approach as "spirited," or agentic and visionary. As we shall see later in this postface, however, this has been just one of many meanings attributed to the term "shariah-based." The term came into increasingly common usage in literature of the late 2000s and the first half of the current decade.

[173] such as David Yerushalmi, a neoconservative American lawyer who drafted legislation that banned shariah in Tennessee courts and speaks of a "Shariah-driven jihad-based" form of Islam (Martin 2011).

Why has the term "shariah-based" become popular?

The example above shows that in juxtaposition to the term "shariah-compliant," the term "shariah-based" probably first came into use in the early to mid-2000s. Its first recorded usage was in 2006, and it was widespread by the end of the previous decade. But why then? What was special about that historical moment? I propose that the answer has to do with the decline of one paradigm in Islamic finance and the rise of another.

This postface began with the proposition that the Islamic-finance industry is constantly soul-searching. The industry's claim to be ethically superior to Islamic finance goes to the heart of its commercial identity — that is, to its appeal to customers. It also goes to the heart of industry practitioners' self-identity — that is, to the way practitioners make sense of what they do for a living and why it is worth doing. As a result, Islamic finance must always have a lodestar. The industry's momentum depends on having beacon that shows the way toward improvement, even if in practice it may be unattainable in the foreseeable future. Customers, and especially practitioners, will only remain committed to the industry if it seems committed to improving itself.

With this in mind, I believe one reason for the ascendance of the "shariah-compliant-versus-shariah-based" dichotomy in Islamic-finance discourse is the gradual decline of profit-and-loss sharing (PLS) as the lodestar for Islamic finance. One aspirational narrative is replacing another in Islamic finance. The old aspirational narrative was that the industry needed to move from debt-based finance to equity-based (i.e. PLS) finance. (This is synonymous with a move from risk-sharing finance to risk-shifting finance.) The new aspirational narrative is that the industry needs to move from shariah-compliant finance to shariah-based finance.

Unfortunately, PLS has always been more of a dream than reality in for-profit Islamic finance. In the 1960s, the earliest utopian ventures in Islamic banking — such as Egypt's Mit Ghamr Social Bank and Malaysia's Tabung Haji — were launched based largely on PLS. From that time onward, it became the paradigmatic ideal template for Islamic finance. However, PLS proved difficult to implement in a commercial setting. In the late 1970s and early 1980s, the early for-profit Islamic banks tried to implement a PLS-based operating model known as two-tier mudaraba. These banks soon found that two-tier mudaraba, while good in principle, raised serious commercial, regulatory, and liquidity-management-related troubles when implemented in financial markets that were full of conventional competitors and that had conventional regulatory schemes and conventional financial infrastructures. This led to the entrenchment of the "murabaha syndrome" (Yousef 2004) — the dominance of murabaha and other debt-based structures in Islamic finance (see Chapter Two). The murabaha syndrome continues today; no one has found a viable large-scale solution for it (Abdul Rahman 2007; Dusuki and Abozaid 2007; Iqbal and Molyneux 2005; Khan 2010; Kuran 2004; Lewis and Algaoud 2001; Nagaoka 2010). PLS has been in retreat since the early 1980s.

Crucially, PLS-driven finance began declining as a pragmatic *operational* goal for the industry over three decades ago, but remained in place as an *idealistic narrative* until recently. The vast majority of marketplace practitioners of Islamic finance stopped making serious efforts to implement two-tier mudaraba and other holistic PLS-based models in the 1980s. This was not because of ethical failings or personality flaws, but because market conditions and regulatory conditions precluded the implementation of holistic PLS. It is true that PLS structures continued to play a role in Islamic finance, but that role has been minor since the early 1980s. Today, even mudaraba-based constructs and musharaka-based constructs often facilitate the replication of conventional debt instruments. True PLS-based finance lives merely in the interstices of Islamic finance. Yet from a *narrative* perspective, Islamic financial institutions, shariah scholars, and even government regulators continued to claim until recently that the grounding of Islamic finance in PLS is the main difference that makes Islamic finance superior to conventional finance. With apologies to Langston Hughes, PLS between the 1980s and the 2000s was always a dream deferred — but one that was consistently useful as a marketing tool.

A reality check and the birth of a new paradigm

The past five to ten years have been a turning point in this regard: narrative has begun to adjust to reality. Since the mid- to late 2000s, the dissonance between PLS as a seemingly impossible operational goal and PLS as an idealistic marketing narrative has become too stark to sustain.

Industry players have started to acknowledge that true PLS is almost nowhere to be found. This is largely because the frequency of serious dialogue has increased: with the Islamic-finance industry growing at 15 to 20 percent per annum since 2000, forums for discussing and debating the industry have multiplied. Conferences, workshops, seminars, and training sessions on Islamic finance have mushroomed. Magazines, academic journals, and information clearinghouses specific to Islamic finance have appeared. Existing industry bodies such as AAOIFI have gotten stronger, while new ones such as the IFSB, the IILM, and others have emerged. Government regulators too have become more knowledgable about Islamic finance. All of these changes have widened the circle of people who understand how Islamic financial institutions operate. In the process, it has become impossible to sustain the myth that Islamic finance is fundamentally PLS-based, or even that a PLS-based Islamic financial system is a realistic goal in anything but the very long term. Increased dialogue in the industry has shattered the PLS myth.

At the same time, earthquakes in the conventional financial industry have underscored the need for a new and more realistic aspiration. A succession of disasters has exposed the dark and lurid underbelly of conventional finance. The Asian financial crisis of 1997–1998 revealed the human cost of footloose investment capital and currency speculation. Accounting scandals at Enron, Tyco, and WorldCom in 2001–2002 unveiled incompetence

at leading accountancies and gross venality among corporate executives. And the U.S. subprime crisis and subsequent global financial contagion of 2007–2008, which claimed Northern Rock, Bear Stearns, and Lehman Brothers as well as tens of millions of jobs worldwide, illustrated the hazard of financial structures so complex that neither ratings agencies nor regulators understood them.

Shariah-based finance as response to global financial crisis

At its core, the call for system-wide PLS was a call to make banking itself obsolete. The early theorists and pioneers of Islamic finance in the 1950s and 1960s aimed to replace banks — defined in a simple sense as financial intermediaries that take deposits at one interest rate and make loans at a higher rate — with trading houses and investment firms. If implemented completely and taken to its logical conclusion, the dream of systemic PLS-based Islamic finance would lead to the elimination of all debt financing paying a fixed non-zero return. This meant the disappearance of banks as traditionally understood (with the minor exception of institutions providing charitable *qarḍ ḥasan*). The early pioneers and theorists had good reasons for wanting this: not only was the entire global banking system worm-eaten with ribā, but it was also an oppressive instrument of Western economic and political hegemony (Al-Najjār 1972; Al-Ṣadr 1977; Tripp 2006).

In contrast, the call for shariah-based finance is a call to make banking *better*. While it is true that most advocates of shariah-based finance continue to support increased use of PLS financing, few expect PLS financing ever to replace banking outright. Instead, they hope to *reform* the banking system. This is a less ambitious, more pragmatic goal.

The new "shariah-based" narrative concedes that debt-based finance, whether conventional or Islamic, is probably be here to stay — but that Islamic finance can curb its worst excesses. In the words of Ibrahim Warde, Islamic finance can show the world how to "put the brakes" on finance, which tends toward dangerous innovations and reckless activity in the absence of moral oversight (Warde 2008). By extension, it is not just Muslims who can benefit from Islamic finance and learn from it, but the whole world. In this sense, the call for shariah-based finance is a response to the current round of financialization (the increasing importance, since the 1970s, of the financial sector — as opposed to trade and commodity production — in the GDP, labor markets, and dominant cognitive frames of national economies, and especially the advanced industrialized economies) (Epstein and Jayadev 2005; Epstein 2005; Fligstein 2002; Froud et al. 2000; Krippner 2005, 2011) and financial globalization (the expansion and increasing transnational interconnectedness of capital flows and financial markets) (Cerny 1994; Heathcote and Perri 2004; Prasad et al. 2003).

What do people mean by "shariah-based"? Separation, authenticity, welfare

There is confusion about just what the term "shariah-based" means. People mean different things by it. One economic research house alleged that in shifting its approach "from sharia-compliant to sharia-based," Malaysia's Securities Commission is implementing "essentially a liberalisation that will allow more innovation and international marketability" (Oxford Business Group 2011). But is this accurate? If anything, the shift toward shariah-based finance is probably the opposite of a liberalization. Similarly, Malaysian Prime Minister Najib Razak stated that

> the Securities Commission [of Malaysia] will also work to encourage the wider shift from a Shariah-compliant approach to a Shariah-based approach, promoting higher levels of innovation and international marketability. (Abdul Razak 2011)

While international marketability might result from a shariah-based approach, it might not. In any case, marketability is hardly the essence of a shariah-based approach. Statements like this, while well-meaning and intended to promote shariah-based finance, add to the confusion about the term "shariah-based."

Sometimes, the terms "shariah-based" or "shariah-driven" even seem to be shorthand for any and all desirable reforms in Islamic finance. In 2007, the regional head of a major multinational Islamic bank argued that a more proactive regulatory framework, greater innovation, appropriate technology solutions, better human resources and training, and wider academic input were all vital components of a "change in mindset from Shariah compliant to Shariah driven products and services" (IFN staff 2007). He clearly did not mean that all of these elements define what it means to be "shariah-driven," but rather that they are components of the broader Islamic financial infrastructure or ecology necessary to bring systemic shariah-based finance to fruition. He was implying, to paraphrase Hillary Clinton, that "it takes a village" to build shariah-driven finance. Nevertheless, such sweeping statements do leave open the question: What exactly does "shariah-based" (or "shariah-driven") mean? And what does it *not* mean? Is "shariah-based" simply a basket term for all the changes that people would like to see in the Islamic-finance industry? Or does it have a more specific meaning?

My interviews suggest that definitions of "shariah-based" finance refer to at least one of three separate principles: *separation*, *authenticity*, or *welfare*.

SEPARATION

Some figures in the Islamic-finance industry define shariah-based finance as being more *separate* from conventional finance than financial activity that is merely shariah-compliant. They argue that shariah-based finance involves separate product development, separate pricing, or the segregation of funds.

Separate product development

One common argument is that shariah-based instruments must be developed "from the ground up" based on Islamic principles. According to this view, instruments that are replicated or "copy-pasted" from conventional finance in order to fit within the legal rules of shariah might be shariah-compliant, but they cannot be shariah-based. In the words of Ashar Nazim, being shariah-based means doing more than "just having synthetic instruments" built to mimic conventional ones (Jamil 2013).

Ahcene Lahsasna and M. Kabir Hassan, for example, lay out separate product-development processes for shariah-based products and shariah-compliant ones. They feel that development of shariah-based products must begin by identifying a pre-existing Islamic commercial contract and working upward from it, whereas development of products that are only shariah-compliant begins by "selecting an appropriate product for a niche market," often leveraging product knowledge from the bank's conventional division if the Islamic bank is part of a conventional mother bank (Lahsasna and Hassan 2011). Making a similar point, Rodney Wilson seems to suggest that the direct involvement of shariah scholars in developing products — and not just approving them — is crucial to shariah-based status:

> Despite the success of sukuk there remain fundamental questions about their legitimacy from a shariah perspective, as the current structures have been devised by lawyers and investment bankers and are not shariah-based, as the contracts in traditional Islamic jurisprudence, fiqh, are significantly different. The sukuk are shariah-compliant in the sense that they have been approved by the shariah boards of the institutions undertaking their arrangement, but the shariah scholars serving on the boards have not been involved in the structuring of the financial instruments.(Wilson 2009a)

Separate pricing

A similar argument, though a less common one, is that shariah-based products must be priced in a way distinct from conventional ones or those that are merely shariah-compliant. According to Securities Commission Malaysia, for example, one characteristic of shariah-

based products is that they would offer "significantly different pricing and returns characteristics" from conventional or shariah-compliant ones.(Securities Commission Malaysia 2011)

A more specific version of this argument is that shariah-based instruments must not use conventional interest rates as price benchmarks. This echoes the longstanding objection to the use in Islamic finance of LIBOR and other conventional interest-rate benchmarks. A leading shariah consultant at one GCC-based Islamic bank argues, for example, that a requirement for a murabaha product to be shariah-based is that it not be priced using any IBOR-type rates[174] (A. L. (anonymous) 2013). To address this issue, Norhanim Mat Sari and Abbas Mirakhor advocate the eventual development of a "shariah-based benchmark" as an instrument of monetary policy: they assert that a central bank could issue a instruments of different maturities whose rates are tied to GDP growth, and which would then trade on the secondary market, setting a yield curve reflecting real economic activity and "the government's risk-premium adjusted 'benchmark' rate" (Mat Sari and Mirakhor 2012).

Separation of funds

Natalie Schoon suggests that the segregation of funds used for Islamic financial transactions from funds used for conventional ones is another requirement for being shariah-based. She notes that while conventional banks offer individual products that are shariah-compliant and use separate distribution channels for their Islamic products, they may well commingle "funds raised in an Islamic manner with conventionally raised funds" (Schoon 2009), which could presumably undermine claims they make to practicing shariah-based finance. (This raises an interesting question: Is it possible for Islamic divisions and Islamic windows of conventional banks to practice shariah-based finance?)

Sectoral separation

To Rushdi Siddiqui, the term "shariah-based" — when used specifically in the context of equities — should be applied only to investments in companies that are in a distinctively Islamic sector. Such sectors include halal foods, Islamic finance, and Islamic education. This contrasts with "shariah-compliant" equities, which are those that merely pass sectoral screens (filtering out *ḥarām* sectors such as alcohol, pork, and pornography) and financial screens (filtering out companies with high debt, high accounts receivable, and high non-operating interest income). "There is nothing 'Islamic' about shariah-compliant indexes, as most of the underlying companies are not from Muslim countries," writes Siddiqui (Siddiqui 2012). "The dominating [shariah-]compliant companies are western based, like Apple, Pfizer,

[174] This includes LIBOR, Euribor, SIBOR, KLIBOR, and so on.

ExxonMobil," unlike shariah-based companies such as "Al Rajhi, KFH, Bank Asya, Bank Islam, Dubai Islamic Bank, Meezan Bank," and so on (Siddiqui 2011).

AUTHENTICITY

A second position defines shariah-based transactions and instruments as more *authentic* than merely shariah-compliant ones. Here, "authentic" can mean three different things: historically authentic, authentically connected to the real economy, or what I call "ontologically transparent."

Historical authenticity

A financial instrument is historically authentic if its current usage is the same as, or at least similar to, its usage at earlier times in Islamic history.

Typically, the historical times in question are pre-modern, such as the age of the Prophet Muhammad himself or medieval periods when a range of Islamic commercial instruments were commonly used in long-distance trade. It is easier to think of historically authentic products as shariah-based because they have passed the test of time: jurists over many generations have scrutinized them and found them to be valid. Products such as mudarabah, musharakah, salam, ijarah, and hawalah are arguably more likely to be shariah-based because they have been discussed "by Muslims jurist[s] through the ages," with "their concepts, meanings, rules and conditions… clearly spelt out in the books of Islamic law" (Lahsasna and Hassan 2011:37). This contrasts with novel structures that have only been synthesized in modern times to suit modern needs. Likewise, some contemporary practitioners of Islamic finance consider many of the present-day usages of murabaha — particularly in tawarruq and commodity murabaha — to be perversions of murabaha's medieval usage, which was as a justified mark-up on real operational risks (such as injury to the trader or the risk of spoilage) incurred during long-distance trade (R. H. (anonymous) 2013).

In some cases, the historical period for comparison is the 1960s and 1970s, when early pioneers and theorists were formulating the original vision of Islamic finance. Some practitioners, for example, stress that the first Islamic banks used mudarabah and musharakah only as investment instruments, and that more recent innovations — such as the use of repayment guarantees with mudarabah and musharakah — are not shariah-based partly because they are not aligned with the visions of the founders of Islamic finance.

Authentic connection to the real economy

Another common argument is that an instrument must be authentically linked to the real economy in order to be shariah-based. This principle was a *sine qua non* for the first Islamic banks of the 1960s and 1970s, which "were suspicious of all financial products whose links to the real economy were deemed tenuous" and "preferred to invest in physical assets such as real estate or commodities" (Warde 2010).

However, with the rise of debt-based financing instruments, Islamic finance became increasingly detached from productive economic activity — even when it employed asset sales or leases to mimic conventional interest-based lending. Although many Islamic financial institutions today pay lip service to the idea of a necessary connection to the real economy, the proliferation of Islamic derivatives, Islamic products with repayment guarantees, and other highly structured shariah-compliant instruments has largely severed this connection. As a result, some industry figures are now calling for a shariah-based finance that re-establishes this link. One such figure is Nik Ramlah Mahmood, who predicts a shift "towards the Shariah-based, as opposed to Shariah-compliant, approach" — a move toward investment products grounded in "productive, real economic activities" (Mahmood 2011).

Ontological transparency

In Islamic finance, two kinds of transparency matter. One kind, which I call "communicative transparency," is easy to describe. A financial product is communicatively transparent if the institution selling it states its terms in a well-written contract, explains the product to the customer without lying or embellishing, and then adheres to the terms it has laid out. Communicative transparency is a basic condition of all shariah-compliant instruments, and indeed of all financial instruments under most bodies of secular law. Lying to or misleading a customer, whether via written contracts or during the product-distribution process, is a breach of communicative transparency.

There is also another important kind of transparency, which I call "ontological transparency," that practitioners often refer to without naming. To many people who believe in shariah-based finance, ontological transparency is an essential feature — often *the* essential feature — that separates shariah-based finance from shariah-compliant finance. An Islamic financial instrument or transaction is ontologically transparent if it "does what is in its nature to do" or "does what it is supposed to do" in a straightforward way. Ontological transparency is a function of the structure of the instrument itself, not of the way it is communicated. When an Islamic financial instrument is ontologically transparent, its Islamicity is readily apparent: its grounding in Islamic principles is so clear that extensive explanation is unnecessary. As the managing director of one Islamic venture-capital firm put

it, "to me, shariah-based means alignment with the principles [of Islam] — as understood by the man in the street" (U. S. (anonymous) 2013).

One shariah consultant at a GCC-based bank described the requirement of ontological authenticity as his "golden rule" of Islamic finance: that "products must be what they claim to be." He elaborated:

> In order to be genuinely in line with shariah, products must demonstrably possess the characteristics of the commercial business-transaction templates they claim to be based on… We have these words like murabaha, salam, istisnaʿ, and ijara — words that people in the industry deliberately use [to create an air of mystery]. They say, 'I understand these words, and you don't, so you need to come to me to understand them.' But murabaha, salam, and istisnaʿ are all just forms of *sale*. And ijara is simply a *lease*. Whatever the flowery names, you can just reduce it to what it is. (A. L. (anonymous) 2013)[175]

Total ontological transparency is an ambitious standard. Those who adamantly support it impose conditions for being shariah-based that virtually no Islamic bank operating today fulfills. According to them, an instrument such as commodity murabaha is not shariah-based because it uses murabaha, which is a mark-up sale whose fundamental function is to facilitate trade, as a cash facility that has nothing to do with a real trade transaction. Indeed, this view of shariah-based finance may completely exclude from Islamic finance any cash-in-hand solutions that impute a time value to money, because no ontologically transparent usage of the basic Islamic-finance contracts — such as murabaha (cost-plus sale), ijara (lease), mudaraba (partnership financing), or musharaka (equity financing) — allows for such activity (A. L. (anonymous) 2013).[176] Moreover, when financing asset purchases using murabaha (as in a murabaha auto financing), shariah-based Islamic banks would have to do much more than they currently do. Instead of simply "going through the motions" of trading, they would actually have to act as trading houses. The shariah consultant quoted above, for example, stresses that in order to be shariah-based, a bank providing murabaha financing must take true and meaningful ownership of the goods it is financing — including legal title and physical delivery — by filing the necessary title paperwork and by maintaining a warehouse or a stocking facility to take delivery. In short, banks would have to be traders;

[175] A. L. continued: "For example, if I'm talking about *ijārah muntahiyah bi-l-tamlīk*, is it indeed acting like a lease — specifically, a lease with an embedded option? And if [I'm arranging a murabaha auto financing], am I actually acting as a car trader? Am I trading based on real ownership, risk of inventory, arranging insurance, pricing based on cost of operation (and not IBOR), real possession, real transfer of possession, no advance promises, and so on?"

[176] It is possible that some uses of salam and istisnaʿ might allow for cash-in-hand solutions that impute a time value to money, but only in special cases.

finance and trade would be fully integrated. This contrasts with the current industry-standard practice of murabaha financing, in which Islamic banks merely take beneficial ownership of a good to satisfy a particular interpretation of Islamic law, while taking neither legal title under secular law nor physical delivery.

WELFARE

The third position is that shariah-based finance is concerned with *welfare*, whereas merely shariah-compliant finance is concerned only with formal rule-following. To put it another way, shariah-based finance adopts a consequentialist approach to shariah, while merely shariah-compliant finance brackets shariah within the formal confines of the transaction itself. Supporters of this position sometimes (but not always) equate being shariah-based with being rooted in *maqāṣid al-sharīʿah*: the objectives, purposes, principles, or divine intents underlying Islamic law (Auda 2008; Kamali 1999).

The welfarist definition of shariah-based finance can be stated simply: "any financial activity or banking product that enhances public interest is shariah-based" (Dar 2009a). However, "welfare" and "public interest" are broad terms. In fact, the welfarist definition comes in several types. Some feel the *sine qua non* of being shariah-based is risk-sharing. Others consider shariah-based instruments to be those that address the financial needs of the poor. Still others focus not on the transaction, but on the financial institution's business operations.

Risk-sharing

Those who consider risk-sharing to be essential to shariah-based finance generally believe that risk-sharing is inherently welfare-improving. They feel that risk-shifting instruments, by contrast, may be merely shariah-compliant but cannot be shariah-based. This vision of shariah-based finance has a long history in Islamic economic thought. It is very similar to the call for universal PLS.[177]

However, we find different definitions of risk-sharing in the call for shariah-based finance. Some focus on the use of particular instruments. Rodney Wilson wrote in 2009 that "mudaraba and musharaka are regarded as shariah-based structures for equity investments" (Wilson 2009b:15), and Iqbal Khan in 2006 associated shariah-based finance with "savings and investment" products (Khan 2006). But others note that investment products such as mudaraba and musharaka can be used in sukuk and in other structured products in ways that

[177] Nik Ramlah Mahmood has expressed this position succinctly, linking the "shariah-based approach" to "greater innovation of investment products that are structured based on more equitable risk-sharing arrangements" (Mahmood 2011).

are not shariah-based, or perhaps not even shariah-compliant. This objection was at the heart of the 2007–2008 AAOIFI sukuk furore (Agha 2009; Anderson 2010; Maurer 2010; McMillen 2007; Rethel 2011; Salah 2010; Usmani 2007), triggered when Sheikh Muhammad Taqi Usmani allegedly estimated that around 85 percent of sukuk are structured in an un-Islamic manner. Following the same line of reasoning, many people insist that a truly shariah-based sukuk must be asset-backed as opposed to asset-based: that is, it must not provide a guaranteed pre-determined return and it must provide investors with recourse to the real underlying assets in the event of default (A. L. (anonymous) 2013; U. S. (anonymous) 2013).

Protection of the poor or unfortunate

Another welfarist definition of shariah-based finance is that it should serve the interests of the poor or unfortunate. This sometimes involves explicit calls for banks to serve the neediest social strata, even if they may not be as profitable as the wealthiest. Asyraf Wajdi Dusuki makes such a call, combining a welfarist definition of shariah-based finance as serving the poor with an authenticity-oriented definition that refers back to the mission of early Islamic financial institutions like the Mit Ghamr Savings Bank, which existed in Egypt in the 1960s:

> The institution such as Mit Ghamr in Egypt had focused on economic development, poverty alleviation and fostering a culture of thrift among poor Muslims. However, with the passage of time, the orientation of Islamic banking and finance has somehow dominated by profit-maximisation doctrine… As a result, most of the financial engineered instruments are designed favorably catering the needs of the well-off clients while the poor left unbankable…
>
> Perhaps this phenomenon does not reflect the raison-d'-etre of Islamic banking, which is supposed to be a Shariah-based institution.(Dusuki 2008)

A similar notion is that shariah-based finance must protect the interests of customers who fall onto hard times, even if this conflicts with the Islamic financial institution's profit motive. When asked what shariah-based finance means to him, one internationally prominent practitioner of Islamic finance said this:

> [Say a] tenant [who has an Islamic mortgage] can't make the mortgage payments because of health issues of the breadwinner, or because of some unexpected payments that come up… If Islamic finance is about [being] equitable and [giving] the debtor time when [he's] having difficulties, because God says in the Quran that "the benefit is much greater than what you think," then the Islamic bank should give this debtor some time to recover… without tacking [extra charges]. (U. S. (anonymous) 2013)

Welfarist business operations

Yet another welfarist definition draws the line between shariah-compliant and shariah-based not at the level of transaction structure or policies with regard to customers, but rather at the level of the Islamic financial institution's business operations. This view is not yet common in industry discourse, appearing only occasionally in basic form.(Schoon 2009) If elaborated further, it could define a shariah-based financial institution as one that maintains high labor standards for all of its workers, from the CEO to every member of the contracted service staff; high environmental standards concerning energy use, carbon footprint, and recycling; targets for corporate charitable donations beyond zakat; and so on. This definition could be similar to common definitions of corporate social responsibility.

Conclusion

Studying the evolution of terms like "shariah-based" and "shariah-compliant" is more than an invitation to semantic promenade. It reveals much about the history and trajectory of Islamic finance.

I have argued that the term "shariah-compliant" emerged in the 1990s. It allowed Islamic finance institutions to move beyond scandals of the 1980s, presenting Islamic finance anew as a highly formalized and technically rational project based on shariah expertise. The new vocabulary was designed to instill confidence in both consumers and industry insiders. Moreover, since so many of those consumers and industry insiders were accustomed to the formal rationality and technical sophistication of the booming conventional-finance industry, burnishing Islamic finance's technical credentials by stressing "shariah-compliance" was particularly important. Later, in the first decade of the 2000s, the term "shariah-based" came into use. It signaled a shift in the vision and self-image of Islamic finance: a turn away from the utopian vision of the 1960s and 1970s, rooted in using PLS to build a separate Islamic economy, and instead toward the more pragmatic but still ambitous notion that Islamic finance can "put the brakes" on the worst excesses of finance. The shift from the PLS-based vision to the shariah-based vision is still in process today.

This shift away from the vision of system-wide PLS and toward the shariah-based vision is happening for two reasons. On one hand, the possibility of system-wide PLS is looking increasingly distant in a world where it is virtually impossible to imagine life without debt. Because such a large proportion of the people who work in Islamic finance today have professional and intellectual backgrounds in conventional finance, and because the conventional financial system is so entrenched in business practice and regulatory infrastructures and human minds, it has become very hard to envision a financial revolution

that completely uproots banking based on the time value of money and replaces it whole cloth with trading and investment. The vision of system-wide PLS — a beautiful concept, to be sure — looks more and more like a mirage. On the other hand, the shift toward the shariah-based vision is happening because the imperative of developing pragmatic solutions to conventional finance's ills is pressing. Each year, newspapers bring word of new bank failures, market instabilities, currency crises, accounting scandals, and financial doomsday scenarios. The global financial system is showing signs of chronic illness. Proponents of Islamic finance feel it must seize the moment, presenting concrete and viable solutions, not utopian ones like system-wide PLS.

The three principles behind calls for shariah-based finance will often complement one another, but they will sometimes conflict with one another. In an ideal shariah-based world, all Islamic financial instruments and ventures would meet all three types of conditions: separation from conventional finance, authenticity, and an orientation toward welfare. But in reality, some Islamic financial arrangements will meet some of the conditions but contravene others. Here are some examples:

Socially responsible equity fund. Consider a socially responsible equity fund that invests in emerging Islamic economies. It is offered by a conventional asset manager that has no shariah board and no Islamic branding. The asset manager does not separate its shariah-compliant funds and returns from conventional ones. However, the fund provides equity capital to community-based start-ups that sorely need it. The fund also happens to avoid haram sectors (e.g. pork, alcohol, entertainment, defense, tobacco). In sum, the fund fails some tests of separation, yet it promotes the welfare of Muslims. As for authenticity, it takes a relatively traditional approach to investment in line with the mudaraba model, but it does not explicitly use a mudaraba contract. Is it shariah-based?

Salam-based futures market. Consider a platform for trading commodities futures that relies on salam and parallel salam. Some would argue that this is an authentic use of salam, while others would say it is not. Likewise, commodities-futures trading can sometimes promote welfare — such as when farmers use it as a hedging tool to stabilize the prices of their inputs and outputs. On the other hand, anyone could also use the platform for speculation (*maysīr*). Is the platform shariah-based?

Murabaha financing on luxury cars. Consider an auto financing arranged in a scrupulously "Islamic" way: the Islamic bank acts as a trader, taking physical possession of the car and acquiring legal title before selling it on to the customer. The Islamic bank also takes real responsibility for damage in transit and for the risk that the customer changes her mind and decides not to buy the car during the period that the bank owns it. This is a very "authentic" use of murabaha. Moreover, the product's profit rate is not based on LIBOR, but on a rate associated with average trading profits in the car industry. This satisifies one of the "separation" criteria. However, the car being financed is a high-end luxury car costing $200,000. The bank performs an ordinary credit check, which the

> customer passes, but makes no other effort to understand why the customer needs financing. Is this murabaha shariah-based? Many would say that it is. But Humayon Dar notes that while shariah does not prohibit Muslims from buying expensive luxury items, buying them "on credit is certainly against the spirit of shariah" (Dar 2009b). If he is resorting to credit, such pricey items may well be beyond his means in the first place. According to this reasoning, even an impeccably structured murabaha financing could fail to be shariah-based it is used to finance an item beyond the customer's means.

It is not difficult to think of more examples.

In the final analysis, discussions about shariah-compliant finance and shariah-based finance are debates about what makes Islamic finance Islamic. It is no exaggeration, therefore, to say that they are debates about the meaning of Islam.

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