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Speculations on Islamic financial alternatives

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1. IBF specialists use the phrase 'conventional finance' to refer to non-Islamic financial practices and forms. Many participants question whether such disciplinary specialization in the field is desirable – is there or is there not a separate body of knowledge called 'Islamic economics', for instance – concerned about the implications for professionalization and credentialization that the disciplinary boundary seems to suggest.

An Islamic banking conference in Kuala Lumpur, Malaysia, 2000.

Islamic banking was born as recently as the 1970s, principally to service Muslims not allowed to pay or receive interest. Also known as 'interest-free banking', it has enjoyed a significant rise in stature over the last three decades. For example, from its humble beginnings, the Muslim Pilgrims Savings Corporation, set up in Malaysia in 1963 to help people save for performing *hajj* (pilgrimage to Mecca and Medina), eventually evolved in 1983 into Malaysia's first Islamic bank, the Bank Islam Malaysia Berhad. Today it is estimated that there are more than 150 Islamic financial institutions operating in over 70 countries, managing 102 Islamic equity funds, and with well over US\$10 billion under management.

But Islamic banking is not limited to Islamic institutions alone. Even Western European banks such as ABN-AMRO and Deutsche Bank have recently established dedicated Islamic banking units. Although in the United States no licence to operate has yet been granted to an Islamic bank, the new Islamic Dow Jones Index has been established within the last year. In London the Institute of Islamic Banking and Insurance publishes a regular journal and also the *Directory of Islamic banking*. Islamic funds are gaining a broader appeal as part of the emerging interest in what are broadly called ethical funds that do not invest in unethical practices and industries.

Contingent futures

The Western business press, critical political economists, and Prime Minister Mahatir Mohammad of Malaysia may seem to have little in common. Yet, in commentaries about the instability and risk inherent in global capitalism, all three pin the blame for recent economic crises and business scandals on the same villain: derivatives. A derivative is a financial contract that can be bought and sold, and thus constitutes an asset in its own right. However, its value is based on the value of other assets which do not exist in the same moment of time as the derivative itself. The most familiar forms of derivatives are options and futures. A simple option contract might state that the bearer is entitled to purchase grain at a specified date in the future at a specified price. The bearer can sell the option contract to another party before that date, and so each party is betting against the direction of grain prices in order to make a profit from the sale of the con-

tract. Derivatives are considered dangerous and risky because the temporal 'future' that is being hedged against in a futures contract is always contingent upon unknown future events. How can a value be ascribed to such a contingency? The financial engineers who develop and price derivatives are sometimes called 'rocket scientists', because they use complex mathematical procedures derived from the particle physics of space-time – the science of contingency – to do their job.

This risky rocket science is received differently in different financial cultures. How do people in these different financial cultures understand, transform and use derivatives when they are working with their own financial practices which may not have been derived from Western economic principles?

This essay reports on the heated debate among Islamic banking professionals about financial derivatives. Because Islam contains injunctions about usury, risk, and speculation (injunctions which are themselves subject to considerable disagreement among Islamic banking professionals), derivatives are a focal point for discussions about the whole field of Islamic finance and have become a major point of difference with other financial cultures. Are derivatives a form of gambling? Do they necessarily entail speculation and therefore religiously unacceptable risk trading? Or are they prudent mechanisms for managing the risk that is a necessary component of business or any other human enterprise, irrespective of local cultural or religious sensibilities? Although I will touch on the first two questions, I am most interested in the last, since if the answer is 'yes', it raises questions about the difference between Islamic banking and what Islamic banking specialists call 'conventional' banking.

'Islamic derivatives' are an important key to understanding salient differences between 'Islamic' and 'conventional' banking from the point of view of Islamic banking professionals.¹ Since banking is at the heart of commerce and industry, such understanding will contribute to understanding many other aspects of the economies of Islamic countries, both in the past and in the future.

I base my arguments in this essay on ongoing research conducted since 1998. This research has involved both online and face-to-face conversations with Islamic banking and finance (IBF) practitioners in the US, Europe, South Asia and Southeast Asia. My interest is not the structure and performance of Islamic banking *per se* (e.g. whether Islamic banking results in a higher rate of savings than conventional banking, or whether Islamic futures contracts are a prudent investment), which would require a close study of particular institutions. My focus is rather on the loose community of academics and professionals seeking to create and sustain Islamic banking and finance as an academic discipline and as a global market force. What are the points of debate and dissent among members of this community? What are the shared background assumptions? How was this network of expertise and knowledge constituted and what are the salient factors underlying its transformation?

I come to Islamic banking from a perhaps unexpected place: the offshore financial services sector in the Caribbean (Maurer 1997; see Hampton 1996, Roberts 1994, 1995). Until recently, Islamic banks could not incorporate very well in Europe and the United States.

An international Islamic banking conference held in Bahrain in 1999.

2. I rely on Vogel and Hayes (1998) for parts of the following discussion, because it has become the standard text to which non-IBF practitioners turn for handy summaries of IBF positions and practices, and because it is a readily available source, unlike various IBF working papers and journal articles. It is also a widely read and accepted authority in Islamic banking circles, although some people I talked to expressed concern that it over-emphasizes the distinction between acceptable forms of risk and unacceptable speculation.

3. There are exceptions. Bahrain is the site of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), an international standards-setting institution for Islamic finance. One of the largest Islamic investment firms, Al Baraka, is based in Saudi Arabia.

4. On different logics of securitization and recent challenges to property law posed by securities formation, see Maurer 1999.

A montage image from the website of Bank Sharia Mandiri, one of the two Islamic banks operating in Indonesia.

necessarily on the merits of their arguments, 'but on the basis of politics' (Ritter 1997:73). For Ritter, looking at lost economic alternatives throws the contingency of the present and of possible future trajectories more clearly into relief. It is in this light that I examine a contemporary, rather than a 'lost', economic alternative.

Futures and options in Islamic banking and finance

There is no one 'Islam' in Islamic banking and finance. Practitioners draw from various schools of Islamic jurisprudence as well as concepts from a wide cross-section of economic theory, from neoclassical to Marxist to Keynesian. There is, however, an emerging toolkit common to Islamic banking and finance professionals based in the USA, Europe, the Gulf States, and South and Southeast Asia, and a vocabulary of concepts and technical terms used widely at conferences, in publications and during training courses. The Western business press has even started to gain a grasp of these terms, as most of their articles on Islamic banking contain handy lists of commonly encountered financial contracts.² Most of the discussion, innovation and actual practice of IBF occurs not in Saudi Arabia or the Gulf, but in the USA, the UK and Malaysia.³ This is due, in part, to legacies of colonialism, patterns of wealth and privilege in the Middle East, and widely publicized banking scandals like the Bank of Credit and Commerce International affair, which linked Middle Eastern Islamic banking, Caribbean tax havens and criminal money-laundering activities in a neat and ill-fated bundle. At a conference held in southern California, in the spring of 2000, for instance, one IBF practitioner based in London stated that the Middle Eastern states wanted to see 'models developed in the West, before they would import them back to the Muslim countries', for fear of encouraging money laundering or other illicit activities.

Riba and usury

Just as there is no one 'Islam' in Islamic banking, so too there is no one understanding of the basis of Islamic banking or the reasons (religious or mundane) for its existence. Most insiders and outsiders would be quick to remark that the Qur'anic prohibition against interest, or *riba*, underpins Islamic banking. But *riba* is a hotly debated topic in Islamic banking, and is never simply equated with interest or usury. A consensus seems to be emerging around a specific reading of *riba*, according to which not all interest is *riba*, and not all *riba* is interest. Several professionals have cited to me a *hadith*, or story from the life of Mohammed, in which the Prophet chastises a man for having exchanged a certain quantity of lower-quality dates for a smaller quantity of higher-quality dates. Mohammed proclaims that this transaction constitutes *riba*, since the lower-quality dates were not first priced to market, that is, sold for money. The implication is that a transaction constitutes *riba* when it avoids the use of money and the market to allocate and moderate risk (see Vogel and Hayes 1998:85).

Riba cannot be equated with early Christian injunctions against usury, for the Christian ban on usury concerned the relationship between time and money, not specifically the market. A key fifth-century document, central to Christian canon law, begins, 'Of all merchants, the most cursed is the usurer, for he sells a good given by God, not acquired as a merchant acquires his goods from men' (quoted in Noonan 1957:38). The God-given good here, and a good given presumably in common to all people, is time itself. Where Christian injunctions against usury turn on the question of the sale of time, Islamic injunctions against usury do not deny the time value of

An image of the 'Islamic Gold Dinar', a coin minted by a Scotland-based Sufi organization, Murabitun, that seeks to re-institute the Caliphate. Completely at odds with the Islamic financial community discussed in my essay and visible at conferences and websites, the Murabitun seek to introduce a new gold standard and to forbid all forms of financial activity save good, old-fashioned trade (they also want to recreate guilds and caravans).

The logo of the Dow Jones Company's Islamic Market Index, an index of stocks of businesses deemed to be operating in a manner consistent with Islamic law.

5. I am not disputing that IBF is a 'twentieth-century phenomenon' – it clearly is. I am disputing, however, the method of interpretation of this fact that assumes that any 'twentieth-century' phenomenon is therefore a 'Westernized' phenomenon. Nor am I denying the overwhelming hegemony of 'the West' over 'the Rest'. But I am claiming that that hegemony is always shot through with contradiction and indeterminacy. Dominant assessments of 'globalization' generally miss these contradictions and contingencies, instead recounting tales of the triumph of 'universal reason' with foregone conclusions and predictable outcomes. I hope my brief foray into Islamic economics has demonstrated, however, how chronologically and geographically specific these stories of global inevitability are. They are, I maintain, specifically Christian. Contemporary

money or the money value of time, but rather contain a different set of assumptions about the relationship between time and money. Time, when joined to an object of property, legitimately has value in Islam – as a quality of the object, another dimension of it, as it were. Here, Islam approaches elements of quantum physics, perhaps. For many contemporary IBF specialists, time is bundled up within objects, and can partially determine their value.

Bai salam

This conception of time and property comes out clearly in the common financial contract called *bai salam*. *Bai salam* is a forward contract (payment now for delivery later), and provides a means of selling credit to a producer. In *bai salam* the parties to the contract agree to compensation for the temporality of an object of property. Taking again the example of grain, the purchaser can offer to pay the producer in advance of receiving the grain, paying less than he would if he were purchasing it at the time when the grain is ready for delivery. From one perspective, the parties to a *bai salam* contract essentially 'agree on price differentials compensating for the delay in contract fulfilment' (Vogel and Hayes 1998:77). From another perspective, the buyer putting forward credit 'holds' the temporality of the object to be delivered and subtracts the value of that temporality from the purchase price. This is a far cry from the Christian ban on selling 'God's commonly-given good'.

Khiyar al-shart

In Islamic banking, the closest to an option is the *khiyar al-shart*, or stipulated option contract. This also concerns itself with the temporality of an object, being a sale agreement in which one or both parties has 'the right to rescind an otherwise binding contract' (Vogel and Hayes 1998:155) within a specified period of time from its commencement. The *khiyar al-shart* contract provides an analogical basis for other sorts of options contracts, and is a point of great debate within IBF circles. There is general agreement, however, that *khiyar al-shart* contracts are valid if and only if they remain linked to the object that is at issue in the proposed sale. In other words, the contract itself cannot be bought or sold. Given the conception of property as always containing within it a temporal quality, this view of the *khiyar al-shart* option makes sense.

Some debates and 'U-turns'

Using *khiyar al-shart* options to create Islamic derivatives on the same basis as conventional finance futures and option contracts, however, presents problems. First, a conventional derivative is a 'derivative' precisely because it is a contract derived from one or a series of other contracts: an option on an option, for instance. Conventional derivatives depend on the securitization backing up options contracts like *khiyar al-shart*. When securitized, or rendered into partible and salable shares,⁴ such options become dissociated from the good or goods at issue in the contract. If they are far enough removed from the good itself, they become free-floating rights to rights to rights. To some IBF experts, they are invalid precisely because they attempt to detach time from property and deny the temporal properties of the good itself. And this, of course, is the point of conventional derivatives – they are intended as a hedge against risks, and, in particular, the temporal risks associated with market fluctuations over time.

Islamic banking professionals are far from unanimous on the issue of whether derivative contracts are invalid, however. Several prominent scholars in the field advo-

cate the creation of derivative securities based on the *khiyar al-shart* model and conventional derivative contracts (e.g. Kamali 1996, 1997, 1999). They generally avoid the question of the temporality of property, and instead emphasize the role of derivatives in managing risk. To the charge that derivatives necessarily entail speculation that verges on gambling, which is prohibited under Islamic law, these scholars respond with two arguments. First, there is nothing inherently non-speculative about Islamic finance: business always involves risks, and entrepreneurs always take chances against an uncertain future. Second, speculation and gambling are not equivalent – the latter involves creating or seeking out 'risks that would not be present otherwise' (Kamali 1996:217), while the former involves dealing with the risks 'that would be present whether [derivative contracts] existed or not' (ibid., p.218).

The idea that economic activity in the world carries risk whether or not derivatives are involved implies both a conception of the universe in which risk is a generalized condition, and a conception of business activity as always and everywhere about hedging risk. Both these notions are implicit in discussions about the purpose of Islamic financial alternatives. One contributor to an Islamic finance internet discussion group, reporting on a conference he had attended in Malaysia, wrote of several 'U-turns' he thought Islamic finance needed to make in order to fulfil its mission. Among those U-turns he included 'our understanding about the forms and the positive role of options in the present financial markets', which he 'expected to improve fast in the near future'. He concluded that the 'exaggeration of the differences between Islamic and conventional economics may fade further. [...] One would then wonder about the difference between Islamic and conventional finance.'

His comment generated a heated and uncharacteristically direct exchange. One participant responded:

If Islamic economics must make U-turns to remain in business, I suggest that we cut the whole crap and join mainstream *riba* economics under the *fiqh* category of *dharurah* [necessity] and the modern criteria of efficiency. Perhaps [the previous commentator] should join the World Bank instead of remaining at [the Islamic Development Bank]. We should all then adopt the Turkish Islam and read the English Qur'an and convert the Islamic banks into the global conventional finance players. All Islamic business should be profit maximizing, speculation should be made *halal* in the name of survival, and Zakat and Waqf can be turned over to the mullahs to administer as they are no longer the cornerstones of the Islamic economy. May Allah help us if this is the trajectory (the ultimate surrender) Islamic economists and obsolete *faqihs* are taking us.

Others are similarly unequivocal in their opposition to derivatives. 'They are *HARAM!*' one commentator wrote to an Islamic banking internet discussion group. Another, protesting against what he sees as the tendency of Islamic 'financial engineers' to offer juristic opinions where they have no business or religious authority to do so, wrote that the main purpose of financial engineering 'is to make money by imitating instruments of western finance, for example options and futures, which have been explicitly forbidden by jurists. [...] Yet, the field continues to grow in the number of papers and people working in this area. Is it not time to drop those efforts and do something which is of benefit to Muslims?' At times, the tension between those IBF professionals interested in, say, microlending to the poor, and those interested in capturing a global market segment, is palpable. 'You should write a message to the Net,' one interlocutor

practices of financial interconnection such as conventional derivatives may seem, for many observers in the West at least, to escape Christian metaphysics, yet I hope to show in future reports on this research how intimately the two are bound.

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Translations of Qur'anic verses on usury:

3. Al-Imran (The Family of Imran)

128 Not for thee, (but for Allah), is the decision: whether He turn in mercy to them, or punish them; for they are indeed wrong-doers.

129 To Allah belongeth all that is in the heavens and on earth. He forgiveth whom He pleaseth and punisheth whom He pleaseth; but Allah is Oft-Forgiving, Most Merciful.

130 O ye who believe! Devour not usury, doubled and multiplied; but fear Allah, that ye may (really) prosper.

131 Fear the Fire, which is repaired for those who reject Faith.

132 And obey Allah and the Messenger, that ye may obtain mercy.

told me, 'asking them why they want to talk about stocks and futures, instead of helping people.' I never did; others on the listserv took up the charge, instead. But the tension continually resurfaces in conferences and other discussion forums. At one such conference, after presentations by finance specialists devising new Islamic mutual funds, one speaker, worried that the conference had been taken over by 'materialism', took the microphone, leaned forward toward the audience, and intoned, 'We must always remember: credit is a human right. We are here to help people gain access to credit, which is their God-given right.'

Toward alternative finance

Timur Kuran argues that Islamic economics 'emerged in late-colonial India as an instrument of identity creation and protection,' and that the 'concept of Islamic economics is a product of the twentieth century' (1997:301). Economic exchange, in Islam, is inseparable from Islamic values. Kuran maintains that the very act of distinguishing economics as a separate domain within Islamic culture was both a reaction to Westernization and itself a form of Westernization. On the basis of the assumption that 'religion' and 'economics' are separate domains in the West, Kuran suggests here that Islamic economics, by first adopting the distinction between the two terms, and then trying to bring them together, is evidence of Westernization. While the idea that religion and economics are separate domains is without doubt part of the West's self-narration, can that idea sustain close scrutiny? Talal Asad (1993), among others, has argued that it cannot. If this is the case, the argument that Islamic economics is a product of Westernization falls apart.⁵

While Kuran's work does help flesh out the historical context of the emergence of Islamic economics in the late colonial era, his argument about Westernization is beside the point. The debate on Islamic derivatives with which I am concerned here reveals not Westernization, but a field of interpretative practice that is both specific to Islam and, just possibly, an alternative to the purported universality of conventional economics in their current neoliberal

Translations of Qur'anic verses on usury:

2. Al-Baqara (The Cow)

275 Those who devour usury will not stand except as stand one whom the Evil one by his touch hath driven to madness. That is because they say: 'Trade is like usury,' but Allah hath permitted trade and forbidden usury. Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge); but those who repeat (the offence) are companions of the Fire: they will abide therein (for ever).

276 Allah will deprive usury of all blessing, but will give increase for deeds of charity: for He loveth not creatures ungrateful and wicked.

277 Those who believe, and do deeds of righteousness, and establish regular prayers and regular charity, will have their reward with their Lord: on them shall be no fear, nor shall they grieve.

278 O ye who believe! Fear Allah, and give up what remains of your demand for usury, if ye are indeed believers.

eral formation. In Islamic banking, the Qur'anic term 'riba', like the Qur'an itself, is untranslatable. It depends on the interpretative practices of a global community of believers, or *ijtihad*, to gloss its meaning. And it is precisely the practices of *ijtihad* and the creation of community that become apparent in debates about Islamic derivatives.

Islamic banking specialists around the world post hundreds of email messages to the Islamic finance listserv, the primary forum for continuous, real-time discussion of Islamic banking matters in the world today. The sole language of discussion is English – just as English is the official language of the two main institutions granting credentials in Islamic finance. Participants in the virtual dialogues seem to agree, however, that rather than trying to translate *riba* and other such terms into English, perhaps the English language, and the supposedly universal language of economics itself, need to be expanded and supplemented by terms and concepts from Islamic banking and finance. Doing so would expand the field of *ijtihad*, making it accessible for economics generally.

In a world where neoliberalism and market logic appear to be the only games in town, the interpretative practices that form the real basis of Islamic banking provide a possible alternative. Even when the debate gets hot, the idea that only God knows truth and that humans can only debate and discuss and approximate implicitly binds people, not to the *market* as an abstract force or universal principle, but to the *practice of interpretation*, indeed, the politics of interpretation. In its emphasis on *ijtihad* and the community of believers, Islamic finance could thus be taken, not as an index of Westernization, but as an exhortation to interpret and exceed the boundaries of (economic, neoliberal) belief. Islamic financial understandings, therefore, provide a means to consider the alternatives of the present as potential elements for the shaping of any future economic formation, market-based or otherwise. More than serving as a vehicle for managing financial risk or a new kind of salable commodity, then, Islamic futures open a space for engaging in a new, and necessary, *ijtihad* ●