Introduction

Can Islamic capitalism, which has served Muslims so well for centuries in different periods in history, provide a viable alternative economic system to humanity? In this age of recession, the worst since 1929, this is surely a provocative question. But if this alternative is to emerge and serve mankind as a gift of the Islamic world, it must, first of all, be well understood. To start with, was there, indeed, an Islamic capitalism? Are we justified to call this system that emerged a thousand years before Adam Smith, capitalistic? What are the principles upon which this system has been built? What were the institutions which developed from these principles? How have they functioned and evolved, and most important of all, can they be modernized to address today’s needs? This book aims to address these problems.

It would be appropriate to provide now a brief explanation of the term Islamic capitalism. Indeed, capitalism, for many not exactly a respectable term, is strongly associated with the West. It may therefore seem strange that the economic system practised by the Islamic world from the seventh century to roughly the middle of the thirteenth century, also known as the classical age of Islam, should be referred to with this term. But, subject to certain caveats, the characteristics of this economic system to which I will refer shortly can be best described with the term capitalism. What these caveats are will become clear below. Meanwhile let us note that the two capitalisms share important characteristics. Indeed, the three most important rules crucial to economic development identified by the Western new institutional economics – property rights protection, enforcement of contracts and good governance – constitute the essential principles of Islamic capitalism as well.

Islamic capitalism of the classical age was an economic system derived basically from the Qur’an and Prophetic traditions. Sincere Muslims, who have great respect for these sources, may therefore, with some justification, find the term irksome. But there is strong evidence that Islam had developed its own capitalism. Consider for instance that the bulk of the Islamic jurisprudence was written down by men most of whom were merchants. More importantly, even Prophet Muhammad, himself, was a merchant, who firmly believed in free markets and refused to interfere in prices. Moreover, of the four righteous Caliphs, Abu Bakr was a cloth merchant and Uthman was an importer of cereals.1

Great Islamic philosophers also had firm opinions about markets. This is not surprising, because most of them had been appointed as muhtesibs, officials
in charge of markets, and earned their living as such. Consequently, being in charge of the smooth functioning of markets, they had a profound understanding of the way markets actually functioned. Continuous and close observation of markets instilled in their minds respect for private property. For instance, Al-Shatibi and Al-Ghazali consider the protection of property, *hifz al-mal*, as one of the five purposes of Islamic jurisprudence, *Maqasid al-Shari’ah*. The great fourteenth-century historian and philosopher Ibn Khaldun had highly sophisticated ideas about economics and, reflecting the Prophet, favoured minimum state interference in the economy.

The immense importance of trade for Muslims is also demonstrated by the transfer of mercantile concepts to the religious sphere: the good and bad deeds of each person are registered in a *personal account book*. The Muslim will be judged according to these deeds recorded and will be rewarded with paradise if his good deeds exceed his sins. Having faith is like a *profitable transaction*; participating in the struggle of the Prophet is like *giving a loan* to God; each Muslim has a *covenant* (contract) with God. It is believed that *Allah* buys Muslims’ lives and properties and sells them, in return, the paradise. This means that if a Muslim spends his/her life and property in the cause of *Allah*, he/she would be rewarded with entry to the paradise. But to be able to spend one’s property in this way, property needs to be earned first. Therefore, it is believed that an honest merchant struggling to earn and enlarge his assets legitimately will be exalted and shall join the ranks of the martyrs.

Therefore, there is nothing surprising about the fact that Islam, a religion born in the Arabian Desert, where trade constituted the most important, perhaps even the sole economic activity, favours merchants, property rights, free trade and market economy. The Prophet himself has informed us that trade constituted nine-tenths of the livelihood of early Muslims.

Because an economic system which favours merchants, and respects property rights and free trade, applies the principles of market economy and market wage rate and treats interference in the markets as transgression and sinful would be considered capitalist, I have no qualms about calling this Islamic economic system as such, even though this term is so closely associated with Western experience. Moreover, another condition of capitalism, the ownership of the factors of production by private persons, can also be observed in the Arabian Peninsula during the age of the Prophet. Not only is the market wage rate mentioned in the Qur’an, there is also definitive evidence about its widespread application across centuries. Still another condition of capitalism is the existence of buyers who purchase goods not only for their own immediate consumption but also for further sale to third persons. The fact that classical Islamic jurists had felt the need to approve certain popular partnerships such as *wujuh* (sharikat al-mafalis), which specifically focused on the resale of merchandise to third parties, indicates that this condition also found wide-
spread application. Furthermore, the West should not have a monopoly over this term, particularly because many important principles, institutions, even laws, of the medieval Western European economy, which formed the nucleus of the modern Western capitalism later, have been borrowed from the Islamic world.13

Thus, the fact that the medieval Islamic economy was not industrialized, does not disqualify it from being capitalistic.14 That capitalism is not necessarily associated exclusively with industrialization, has been confirmed long ago by Fernand Braudel.15 Indeed, some eminent historians from Mommsen to Pirenne have considered many ancient civilizations such as Babylonia, ancient Greece, Rome and China as capitalist. This has led to a fierce and ideological Marxist counterattack. Karl Polanyi, for instance, ridiculed historians for arguing that capitalist merchants existed in ancient Mesopotamia. This is despite the fact that thousands of cuneiform tablets have survived, proving the existence of commercial correspondence between Assyrian and Anatolian capitalists. Van Leur and Steensgaard, fearing the Marxist witch hunt, have put all the powerful capitalist merchants of the oriental spice trade under the category of ‘pedlars’.16 In short, orthodox Marxism refuses to accept capitalism before the industrial revolution and in doing so it contradicts Marx himself, who did recognize its existence in medieval Italian city states.17 It goes without saying that I do not feel bound in this book by the confines of this orthodoxy.

The capitalism that I am referring to here is pre-industrial, commercial capitalism. It naturally differs from the industrial capitalism referred to by Adam Smith and Karl Marx.18 Why this Islamic commercial capitalism differs from the industrial capitalism and why the latter did not emerge in the Islamic world will be discussed below.

There are essentially two traditional approaches to characterizing a society capitalistic: statistical or institutional. The former assumes that more than 50 per cent of the total output was produced by capitalistic methods, while the latter focuses on the government and customs of the country, its written and unwritten laws and whether capitalistic forms of production and exchange were preferred over other forms.19 I have already mentioned above that the capitalistic commercial sector of the classical Islamic economy probably constituted some 90 per cent of the total economy. Since it is very difficult to confirm this quantitatively for an economy that emerged fifteen centuries ago, I will prefer the second method and focus in this book not so much on the theory and statistics of capitalism, but rather, on its institutions and their evolution.

In addition to these two traditional approaches, there has emerged in the 1970s a third, ‘new’, approach to determine whether a society was capitalistic. This is the entrepreneurial history. As the name suggests, this approach focuses on explaining economic change by focusing on business management. All the traditional three factors of production – land, labour and capital – are given
equal weight while the fourth element – entrepreneurship – is given prime importance. Even profit maximization, the most traditional guide of economists, becomes modified by the personal preferences of the entrepreneur in this scheme. This third approach will also be adopted in this book. This is not only because of the wealth of information we have on Islamic entrepreneurship but also because of the modified character of profit maximization practised by the homo-Islamicus.

Finally, Immanuel Wallerstein pursues a different approach and first identifies the conditions necessary for the emergence of a capitalist system and then explains how and why these conditions could not develop before the late fifteenth century in Europe. Nearly all of these conditions, which Wallerstein approaches negatively, actually, existed in classical Islam. First, he makes the point that in history, societies had many considerations and these usually intruded upon the process of capital accumulation. Then he says:

Whenever, over time, it was the accumulation of capital that regularly took priority over alternative objectives… we are observing a capitalist system in operation.

As we will see below, classical Islam considers capital accumulation as the conditio sine qua non for the performance of the pilgrimage as well as the payment of zakat, two of the five pillars of Islam. Thus, capital accumulation is given a sacred status, which enables a Muslim to perform his prayers.

Another condition Wallerstein identifies is the ability to make profit – endless profit. This condition was also fulfilled. In classical Islam it was not any public authority but competition which controlled profits. Classical Islam does not impose any maximum limit upon the profits a Muslim can generate. The only condition that is imposed is that profits should be earned through legitimate, halal, means. A Muslim merchant would certainly wish to make endless profits because this would not only enable him to finance his and close relatives’ pilgrimage expenses and zakat payments, but it would also enable him, by establishing a waqf, to finance the needs of other Muslims. As we will see below, establishment of a waqf would save a Muslim’s soul in the Hereafter.

Wallerstein then refers to the non-availability of one or more elements of the process – the accumulated stock in money form, the labour power, the network of distributors, the consumers, etc. – to explain why capitalism rarely emerged in history. Of these, only the availability of money appears to have been a serious impediment, but as will be explained below, this problem was solved within a very short time after the revelation. The solution was so definitive and money became so widely available that even Europe was re-monetized thanks to Islamic coins.

In view of all the arguments presented above, we are justified to claim that there is an economic system called Islamic capitalism, in which objectives
Islamic capitalism and finance

of capital accumulation and religion are intimately fused and inseparable. Remarkably, this Islamic capitalism was born more than a thousand years before Adam Smith.

Finance and financial entrepreneurship may be the most important components of any capitalist system. Islamic finance, however, has a rather remarkable feature: a segmented time frame. While, on the one hand, it is based upon the classical sources of Islam dating from the seventh century, it is generally believed that this is a new field of finance and that all its major institutions have been invented during the last 40 years or so. This way of thinking is reflected in the organizational structure of every Islamic bank. Indeed, each Islamic bank has a Shari’ah board, which supervises the directors of the bank. Thus seventh-century Islamic jurisprudence and modern finance try to coexist.

Focusing exclusively on classical Islamic jurisprudence, fiqh, the bulk of the literature on Islamic finance implicitly assumes that from the end of the eighth century, when the most important works of Islamic jurisprudence were completed, until the 1960s, when Ahmed al-Naggar started his Mit Ghamr experiment,23 that is, for more than a millennium, nothing of any significance happened in Islamic finance. Thus the entire field of applied fiqh is simply ignored and consequently there is near total ignorance about how the fiqh had been actually applied across centuries. The by-product of this ignorance is that, with a few exceptions,24 the evolution of Islamic financial institutions remains largely unknown.

A basic point of this book is that Islamic finance is actually fifteen centuries old. Therefore, like its Western counterpart, it is actually the end product of a long-lasting evolution. The continuity of Islamic finance is even more remarkable than that of Western finance. This is because its basic principles, particularly the stringent interest prohibition enshrined in the Qur’an, have remained unchanged ever since the seventh century. This cannot be said for Western finance, which not only went through a very gradual dilution of the interest prohibition, but also the cataclysmic ‘Enlightenment’ of the eighteenth century. With its basic principles remaining intact, Islamic finance exhibits a much greater degree of continuity than Western finance. One of the main purposes of this book is to demonstrate this continuity as well as the evolution of Islamic financial institutions.

Indeed, the origins of Islamic finance can be traced back to the very birth of Islam, and even earlier, to the pre-Islamic era. This is attested by the fact that Prophet Muhammad had been involved in mudaraba ventures, a pre-Islamic partnership form, before the revelation.25 Thus, there is no doubt that the wisdom of pre-Islamic civilizations was incorporated into Islam. This was done through a process of Islamization, that is to say, by a process of selection and elimination whereby pre-Islamic institutions were closely examined and those that did not conflict with the basic teachings of Islam were accepted.
Many pre-Islamic institutions were incorporated into the Islamic jurisprudence this way. It is generally agreed that this process was completed by the end of the eighth century.

At this point, the term Islamic finance must be explained. By this term, a whole spectrum of financial activities is meant. But banking in the Western sense is not. This is because, whereas Western banking is based upon deposit and its commercial exploitation, i.e., relending it with a premium, Islamic law recognizes deposit in the form of wadia only. That is to say, safe-keeping plain and simple without any further benefit either to the depositor or the depositary. These radically different financial concepts had far-reaching consequences, which will be explained later. But one consequence must be mentioned here. In the Islamic world, although banking activities and a host of financial transactions existed, they were practised by merchants, who needed to finance their commercial transactions. But specialized institutions, as we know them today, focusing entirely on financial transactions cannot be observed in medieval Islam.

What then were these financial transactions and how were they carried out in the absence of banks? They can be categorized into two main groups: financing the entrepreneur and transferring capital across time and space. The former was done primarily by utilizing various forms of business partnerships, such as the mudaraba, mufawada, inan, wujuh etc., while the latter was done by instruments called hawala or suftaja. Sales based upon deferred payments were also very important. These institutions and instruments will be explained later. But it should suffice here to note that in the period from the seventh to the thirteenth centuries, they were the most advanced financial institutions. Indeed at least one of them, actually the most important one, the mudaraba, was borrowed, in all probability, by Europeans from Muslims. Actually, there is a substantial body of evidence that other important Islamic institutions such as waqfs were also borrowed by the Europeans.

At this point one may wonder why Europe, in the medieval era, should have borrowed some of its most important institutions from the Islamic world. Since detailed studies of this phenomenon have been made elsewhere, it will be briefly stated here that Europe went through a dramatic period of discontinuity after the collapse of the Western Roman Empire. This discontinuity was exacerbated by the Catholic Church trying to establish its complete monopoly over the pre-Christian heritage. Muslims, by contrast, openly embraced the combined wisdom of ancient Greece, Rome, Iran and India and expanded it considerably further. Consequently, the Islamic world enjoyed a higher level of civilization in the medieval era.

It has been argued that between the eighth and the eleventh centuries Europe came to be increasingly dominated by the Church. The Church imposed a very strict prohibition of interest and discouraged trade and capitalist accumulation.
In this period Western Europe was deprived of its bankers, great merchants and contractors. Europe increasingly succumbed to barter, the only method of commerce according to the church that was free of any suspicion of usury.\footnote{33}

Meanwhile, the Church came to own one-third of all land in continental Europe. It was this huge wealth that provided seed finance for the crusaders. Ironically, it was the crusaders, who, by establishing close contact with the Islamic Middle East, lifted up Europe from the dark ages described above.

How could the Islamic world have such a positive effect on Western Europe? What the crusaders found in the Islamic world was fabulous wealth, created and maintained by the classical Islamic capitalism. We will return to these principles in detail.

Thus, we have two capitalist systems: Islamic and, its follower, the Western European capitalism. The latter followed the former with a lag of some 200 to 450 years.\footnote{34} Despite this lag, these two capitalisms had much in common. Most significantly, they both applied a stringent prohibition of interest.

Once interest prohibition is taken as a starting point, financial institutions that developed from this maxim in the two capitalist systems had to be quite similar. Moreover, the West did not have to re-invent these institutions developed by Muslims centuries ago. Institutional borrowing rather than invention would generally characterize the follower and the follower increasingly becomes similar to the leader. Indeed, this was the case.\footnote{35}

Despite the initial institutional similarity, however, the two systems eventually began to follow different evolutionary paths. To start with, in Europe, the Church itself began to evolve into the very first corporation. This concept, originally developed by the Church, was then borrowed by independent cities, guilds, universities and finally merchants. When merchants began to apply the idea of corporation to business, they quickly combined it with the partnerships they had borrowed from the Islamic world. The resulting synthesis paved the way to the powerful incorporated joint-stock companies of the sixteenth century.\footnote{36}

The sixteenth century was also the period when a belated but powerful reaction against the Catholic Church and its corrupt and ruthless Inquisition emerged. The Inquisition represents the most horrifying example of what an alliance of a powerful state and a corrupt Church could do to a society. In a nutshell, it can be asserted that the Inquisition violated two basic human rights: the right to live and to own property. It is well known that whenever the King of Spain needed extra funds, the Inquisition descended upon the rich individuals with the false pretence that they were disguised Muslims or Jews and subjected them to torture beyond human imagination. Nearly always, the torture, which lasted many months, ended with the hapless victims being sent to the stake to be burnt alive. Needless to say, all the properties of the victims were confiscated.\footnote{37}
Obviously, this lethal combination of corrupt state and Church had to be stopped. The initial reaction came from the Church itself. Led by a fearless monk and a great leader, Martin Luther, Protestantism started. Helped by the Ottomans, who were quick to appreciate the enormous potential of the movement in splitting the power of their adversary, the Catholic Holy Roman Empire, Protestantism spread rapidly in Central and Northern Europe.38

One of the most important disagreements Luther had with the Catholic Church was the established belief and practice that one could save his soul by purchasing indulgences from the Church. This meant that only the rich could go to heaven. Luther vehemently opposed this and argued that heaven could only be reached through faith and hard and honest work. This concept is known as ‘justification through faith and work’. Thus, an important by-product of Protestantism was a new attitude towards work, profit and business in general. Hard work, honesty and well-deserved profit were now regarded as pious deeds.39

But Protestantism, initiated by Martin Luther and expanded further by Calvin and others, was just the beginning. Two centuries later a group of French philosophers started a new movement, the ‘Enlightenment’, which also proved to be lasting and powerful. This time not only the Catholic Church, but religion itself was attacked.40 Pushed to the extreme during the French Revolution, nearly all the values preached by the Church for more than a millennium were now discarded. Gone were not only the confiscated properties of the Church but also many of the moral controls with which businessmen had been conducting their businesses for centuries. Uncontrolled profit, exploitation of labour, in short, all the tenets of a new and ruthless form of capitalism, the modern Western capitalism, came out of Pandora’s box.

If we return to the Islamic world, we observe a considerably different evolution. To start with, not burdened by a centralized universal Church and its corrupt Inquisition, the Islamic world experienced neither a universal Protestant movement nor Enlightenment. Islam neither went through cataclysmic transformations, as Protestantism and Enlightenment, nor experienced a dilution of its influence.41

What affected the evolution of Islamic capitalism was not a transformation of the religion itself, but rather the political economy of the various Islamic empires. What we observe in this context is a gradual divergence from the sunnah of the Prophet, which represents the origin of Islamic capitalism.

Concerning the system of land ownership, for instance, whereas the Prophet had distributed conquered land to the warriors and thus confirmed private ownership of land, beginning with Omar the Second Caliph, the Roman system of landownership was introduced in the newly conquered territories of the Sawad (Iraq and parts of Syria). Thus, the pure private ownership of land as practised and confirmed by the Prophet was replaced by this complex
Roman system. Omar was able to push his scheme through by referring to the Qur’an, and the result was that private ownership of land was subordinated to state ownership. It should be noted here that these two different land distribution systems applied by the Prophet and Omar the second caliph were both based upon the Qur’an, the former on 8: 41 and the latter, 59: 7. Omar was able to alter the Prophet’s system by both referring to the Qur’an and by consultation.

The next divergence from pure Islamic capitalism of the Prophet was introduced by the famous jurist Ibn Taymiyya during the late thirteenth to early fourteenth century. This was the concept of ‘fair prices’. Ibn Taymiyyah asked what price would be the fairest price, and concluded that it is the price practised by the majority of the merchants in the market. Ibn Taymiyya even advised how in practice this price could be found. He suggested two procedures.

Once again, these procedures represent a deviation from the sunnah of the Prophet, who refused to interfere with prices. This is because both of these alternatives actually involve, however ‘fair’, a process of price fixing by an authority. Moreover, the second procedure also introduces inadvertently the concept of ‘fair profit’. ‘Fair profit’ suggests that any rate of profit that exceeds it is actually unfair, unjust – something to be avoided or ashamed of. Yet, a combination of ‘fair prices’ and ‘fair profits’ powerfully impedes entrepreneurship. With ‘fair prices’ prevalent in the market, the entrepreneur no longer tries to minimize his prices and with ‘fair profits’, he loses interest in cost minimization and revenue maximization.

Another deviation from pure classical Islamic capitalism concerns taxation. It is well known that when the Prophet established the Madinah bazaar he had declared that no taxes were going to be imposed on transactions conducted in that market. Thus the sunnah of the Prophet suggests clearly that an Islamic state should abolish taxes in order to encourage trade or that the tax burden should be relatively light. In this context, particularly the abolition of the internal customs by the Prophet can be mentioned. These taxes used to be imposed in pre-Islamic Arabia on all imports as well as commercial transactions at the rate of one-tenth. Obviously, with the abolition the Prophet must have aimed at enhancing trade within the realm of Islam. Taxes on foreign trade, however, were not abolished. This was because of reciprocity – Muslim merchants were taxed when they went to trade to non-Muslim countries. So, when non-Muslim merchants from Europe visited the lands of Islam, they had to pay the same rates. Muslim as well as local non-Muslim merchants, zimmis, involved in external trade, appear to have been exempted from export taxation. These merchants, initially, were only liable to pay their zakat and jizya respectively. During the reign of Omar the second Caliph, a more concrete system was established: Europeans were to pay customs duty at the rate at which they charge Muslims in Europe, i.e., full reciprocity, usually 10 per cent; local
non-Muslims, *zimmis* were to pay 5 per cent and Muslims only 2.5 per cent, which was of course, the *zakat*.

It is well known that in the following centuries nearly all Islamic states violated these early traditions and began to impose heavier taxation on trade. With the Mamluk rule in Egypt, further deviations from classical Islamic capitalism took place. When the Mamluk Sultan Baybars introduced trade monopolies in 1432, the state monopolized the pepper and spice trade along the Red Sea. This was the end of the famous Karimi merchants, who had dominated this trade ever since the thirteenth century. The rebirth of the Egyptian mercantile class had to wait until the Ottoman conquest, which peripheralized Egypt. Becoming periphery of a huge empire meant that state control came to be diluted, which gave Egyptian merchants and craftsmen a breathing space to flourish.50 The same, however, cannot be said for the merchants of the Ottoman heartlands. In those regions, the mercantile class was subjected to the ‘Ottoman proto-quasi-socialism’ and could not flourish. Consequently, Arab merchants from Syria, which was too near to the Ottoman heartlands for comfort, appear to have consistently emigrated to Egypt. From the sixteenth to the nineteenth centuries, there was a substantial Syrian merchant community in Egypt.51

Recent research by Gad Gilbar, who showed that major Muslim merchant families were observed primarily in the Eastern and the Southern parts of the Middle East, i.e., the periphery of the Ottoman empire, rather than in its Western and Northern parts, has provided powerful support to this argument.52 Gilbar has observed such powerful merchants in Iran as well. This is not surprising in view of the fact that the Iranian state did not actively interfere in mercantile activities and pursued a decentralized economic policy. Unlike the Ottoman economy, the Iranian economy was left to the private sector; governments were happy to collect taxes and leave the bazaars alone. Even when a national central government was formed, the economy was left alone other than major public works undertaken by the government. Indeed, the full notion of a centrally designed and implemented national economic policy framework came into being in Iran only in the 1950s.53

Thus the Ottoman economic doctrine constitutes probably the most radical divergence from the classical Islamic capitalism. This doctrine has been called ‘proto-quasi-Ottoman socialism’.54 ‘Proto’ because it antedates Marxism by several centuries and ‘quasi’ because, it was not based upon the Marxian class conflict but on the preservation of social harmony. In any case, albeit possible theoretical differences, the Ottoman system functioned in reality by and large akin to the modern socialism as we know it.55 This is attested by the fact that the Ottoman state firmly controlled all the basic factors of production and physical capital, possessed nearly all mines and metallurgical establishments, and exerted a firm control over factor prices and mercantile profits – in short, it effectively controlled and dominated the economy.56 This is clearly a major
divergence from the classical Islamic capitalism of the first two centuries of Islam.

As the political economy of the Islamic empires evolved from the classical Islamic capitalism towards greater state control and gradually culminated in the proto-quasi-Ottoman socialism, financial institutions also evolved to respond to the changing needs.

Notwithstanding its divergence from the classical doctrine, the Ottoman experience is still important because it is the most important source with rich archival evidence informing us how a major Islamic state functioned in reality. Moreover, Ottomans succeeded in establishing a powerful state, which could protect a large part of the Islamic world for centuries. It was also able, by and large, to eliminate poverty.

On the negative side, it insisted on embracing its time-tested doctrine and failed to respond to the rise of modern Western capitalism. Thus, it has the dubious honour of succumbing to Western capitalism first, even before Soviet socialism. The demise of the Ottoman Empire was followed by colonization of the bulk of the Islamic world. This was followed by the abolition of the Caliphate, replacement of the Shari‘ah by the French or British civil or common laws and the dismantlement of waqfs by the modernists. In short, all the Islamic countries, even those who could maintain their independence, were exposed to powerful Western influence. Things began to change only after the Second World War, when the Islamic world regained its independence. Attempts to recover the lost heritage began in earnest soon after. Emergence of modern Islamic finance, as the heart of modern Islamic capitalism, should be viewed within this historical framework.

Exposed for far too long to the debilitating effects of proto-quasi-socialism, it is high time that the Islamic world rediscovers its original capitalism established by the Prophet himself. One of the purposes of this book is to do precisely that.

Thus, modern Islamic finance is built upon three sets of institutions: classical Islamic capitalism and the institutions it has created; Western capitalism (pre- and post-Enlightenment) and the institutions that emerged out of them; and finally the Ottoman proto-quasi-socialism and its institutions. We will focus primarily on the two Islamic systems and their institutions and refer to the Western institutions only selectively and by way of comparison.

Currently, modern Western (conventional) finance is having a huge impact on Islamic finance. So much so that conventionalization appears to have emerged as the greatest danger to modern Islamic finance. If it is conventionalized, Islamic finance will become a mere imitation of Western finance and will fail to contribute to the birth of modern Islamic capitalism as an alternative economic system. To the extent that an observation made by Prof. Zubair Hasan can be generalized, jurists sitting on the Shari‘ah boards of Islamic
banks share much of the blame. One such jurist who sits on the boards of two banks admitted that they inevitably avoid initiating new products. Instead, they prefer to ask bank managers the details of the conventional product for which they need an Islamic counterpart: for ‘it is much easier’, this jurist said, ‘to put on it the Islamic face than to structure an entirely new one’.59

Danger of conventionalization, with even more serious implications, is not limited to finance alone but is relevant for Islamic economics as well. With the expulsion of moral Church-imposed controls, Western capitalism ended up relying on state-imposed external controls.60 The expulsion of moral controls was followed by the entire Western economic thought being focused upon the imaginary and supposedly rational, profit-maximizing homo-economicus. Conventional economics then attempted to discover how this fictitious being would behave.

Recently, with Kahneman receiving the 2002 Nobel Prize in economics, economic theory began to borrow from psychology and behavioural economics and started to move the latter to the mainstream. Kahneman challenged the standard economic theory that everybody acts like the homo-economicus and is a rational, calculating profit maximizer. He showed that psychological motives determine people’s behaviour and that these motives are important for economic phenomena. The main paradigm here is the discovery of the laws, which govern actual human economic behaviour. It is believed that failure to understand these laws has caused the present crisis.

With respect to the above, Islamic economics has a huge advantage: Islam not being burdened by a powerful, centralized and an incorporated Church and its oppressive institutions, particularly the Inquisition, did not need an Enlightenment. Thus, moral controls imposed by the original sources of Islam were never discarded. The world of homo-Islamicus, which comprise about one-fourth of humanity, is still governed by an inbuilt auto control system spelled out in the classical sources of Islam. There is therefore no need to discover the laws that govern this Islamic capitalism. These have been laid down about 1400 years ago and are well known.

More specifically, rules that govern market participants, producers, traders and consumers alike are determined outside the market. They are internalized by participants before entering the market. These laws are clearly stated in the Qur’an, ahadith and sunnah. Rules such as no waste, no overconsumption, no harm or injury, faithfulness to contracts as well as trustworthiness, no fraud, no cheating, no short-changing of weights and measures, no interfering with the flow of supplies, no hoarding of commodities or money are general rules of behaviour that are internalized by Muslim consumers, producers and traders. These rules permit free and unrestricted interplay of demand and supply.61

Thus, the field of behavioural economics, for Muslims, boils down to the study of the relationship between the ancient code of life provided by the
Shari’ah and the actual economic behaviour of Muslims. Conventionalization, to the extent that Islamic economists borrow laws and concepts from Western economics, has the implicit danger that the laws developed for the *homo-economicus* are being super-imposed on the *homo-Islamicus*.

The code of life as embodied in the Qur’an and the Prophetic traditions was actually translated into daily economic life through institutions. What economic and financial institutions emerged out of this code of life and how they evolved over the centuries is the main subject of this book. By focusing on institutions – past and present – this book tries to shed light on the economic behaviour of Muslims determined not only by the ancient code but also by modern institutions.

We will start our inquiry with the basic principles of classical Islamic economy or capitalism and the financial institutions that developed from these principles. Throughout the book, I will try, whenever possible, to explain each major economic or financial institution by first providing its historical origins, then its evolution and then, finally, its present. Since I consider history, present and future as inseparable parts of the same continuum, in Part V some thoughts on the future of Islamic capitalism and finance will also be provided.

NOTES

2. For a major modern study of the *Maqasid* see Ibn Ashur, *Treatise on Maqasid al-Shari’ah*.
7. For evidence that there was no textile production, tailors nor even mills in Mecca at the time of the Prophet, see Kallek, *Devlet ve Piyasa*, pp. 85–6. Thus trade, indeed, appears to have been the sole economic activity.
9. That there were many types of capitalism classified according to chronology and function is now generally recognized. The salient characteristics of all capitalist economies were the use of market for allocation and distribution of goods and factors of production. Hartwell and Engerman, ‘Capitalism’, in J. Mokyr, *Economic History*, p. 319. For an excellent account of a non-Western, Chinese capitalism, see Faure, *China and Capitalism*, p. 48. On the Islamic disapproval of market interference see Mirakhor and Iqbal, *An Introduction to Islamic Finance*, p. 48.
10. For a very detailed and rigorous discussion on whether the Islamic economic system can be called capitalistic, see Rodinson, *Islam and Capitalism*, 1974. Rodinson first approaches the problem from the Marxist perspective and declines to call the Islamic economic system capitalistic but then admits that it possessed a highly sophisticated ‘capitalist sector’. This sector was, naturally, the trade sector and with the near total absence of agriculture and industry in the Arabia of the Prophet’s time, it must have constituted some 75 to 90 per cent of the economy. Thus, Rodinson’s admission should actually be considered as a confirmation that the early Islamic economy was capitalistic. He also admits that ‘the merchants of the Muslim Empire conformed perfectly well to Max Weber’s criteria for capitalistic activity’,


13. Çizakça, ‘Cross-cultural Borrowing’. There will be a further discussion of this borrowing process below.

14. Although the term ‘medieval’ normally refers to the period from the fifth to the fifteenth century in Europe, it can and has been borrowed for the Islamic world. In this case, ‘medieval Islam’ refers to the period from the seventh century, when Islam was revealed, to the mid-fifteenth century, when Constantinople was conquered and walls ceased to protect cities.


18. For a brief account of these differences, see Lane and Commentators, ‘Meanings of Capitalism’, pp. 8–9.

19. Ibid., p. 10.

20. Ibid., p. 12 (comment by Arthur Cole).


23. Establishment of the first Islamic bank. To avoid any possible misunderstanding, it might be appropriate to reiterate the three very important terms referred to in this page: *Shari'ah* is the revelation that the Prophet received, *fiqh* is the collection of Islamic juridical opinions regarding *Shari'ah*’s application, applied *fiqh* is the actual application through institutions and institutional evolution of the jurists’ rulings.


25. It has been argued that Hashim, the grandfather of the Prophet, had perfected the mudaraba. See Şencan, *Homo-Islamicus*, p. 4.

26. For example, for the incorporation of the Roman land system into the Islamic Caliphate, see İnalcık and Quataert, *An Economic and Social History*, pp. 103–8.


29. The Islamic origins of the medieval European partnership *commenda* has been hotly debated ever since Udovitch published his groundbreaking article; ‘At the Origins of the Western Commenda’, 1969. For a summary of this debate see Çizakça, *Comparative Evolution*, pp. 10–12.


31. For a theoretical explanation of this topic supported with substantial evidence, see Çizakça, ‘Cross-cultural Borrowing’.

32. Borrowing the wisdom of other cultures was encouraged by Prophet Mohammad himself. Consider the following statement attributed to him: ‘A word of Wisdom is the lost property of a believer. He can take it wherever he finds it, because he is more entitled to it’, Al-Tirmidhi, *Kitab al-'ılın, hadith* 2687. On striking examples of how Muslims borrowed the scientific achievements of Greeks, Persians and Indians and expanded them further, see Sezgin, *Einführung in die Geschichte*, vol. I.


34. The exact length of the gap depends on the beginning of Islamic and Western capitalism. The latter can be assumed to have begun roughly with the first Crusade in 1095 AD. If we consider the year 622 AD, when the Prophet migrated from Mecca to Medinah, an event known as the *Hejrah*, as the beginning of Islamic capitalism, the gap would be about 450
years. If, on the other hand, we consider the year 900 as an approximate date, when Islamic jurisprudence with respect to commerce and finance was more or less completed, then the gap would be about 200 years. If we accept the thirteenth century as the beginning of Western capitalism, the gap increases even further.

35. Çizakça, *Comparative Evolution*, pp. 10–12; Çizakça, ‘Cross-cultural Borrowing’, passim; Çizakça, *Philanthropic Foundations*, pp. 8–13; Heck, *Arab Roots of Capitalism*, chs. 5 and 6. In the area of public finance, however, autonomous European city-states invented institutions, which differed substantially from those invented by the centralized Islamic empires. Thus, eventually different political systems, quite naturally, led to different institutions of public finance.

36. Çizakça, *Comparative Evolution*, ch. 2. A joint-stock company is a company having a certain amount of capital, divided into a number of transferable shares, managed for the common advantage of the shareholders by a body of directors chosen by and responsible to them.


40. This happened particularly in France and, under its influence, in continental Europe. English and American Enlightenments did not lead to such a hatred of religion. For the subtle but important differences between the various forms of Enlightenments, see Himmelfarb, *The Roads to Modernity*, pp. 152–3.

41. During the nineteenth and twentieth centuries, under the influence of the French Revolution and colonialism, a dilution of religion did take place in the Islamic world. After the Second World War, however, most newly independent Muslim countries began to restore their Islamic heritage. Today, Islamic values are making a strong comeback everywhere.

42. Actually, although the system of land ownership as introduced by Omar, indeed appears to have been nearly identical to the Roman system (for details of this similarity the reader is referred to Inalcı and Quataert, *Economic and Social History*, p. 106), it is possible to deduce from the Qur’an a system of land ownership based on a full right of possession for the individual without the state (representing the Creator or the collectivity) losing its initial right of possession. For this deduction, see Mirakhor and Hamid, *Islam and Development*, forthcoming. Thus, it is also possible that Omar may have reached the same system by deduction from the Qur’an. Some authors, usually those unaware of the Roman system, argue that Omar simply imposed the *kharaj* on the previous owners and allowed them to keep their lands. What he granted, of course, were the *usus* and *fructus* rights, with the *dominium eminens*, *ragaba*, remaining firmly with the state. Thus, while deduction from the Qur’an was certainly possible, simple continuation of the previous Roman practice must have been far easier. In any case, Omar’s practice of learning the ancient customs of conquered territory before drawing up any system of administration for it has been acknowledged. Moreover, it is known that Parsis, Greeks and Copts employed in the land revenue departments of the conquered states were allowed to maintain their posts as before. It is only natural that, providing they were permitted to do so, they would simply continue the systems they knew. See on this, Shibli, *Al-Farooq*, pp. 233, 235, 238.

43. 59:7.

44. For details, see Erkal, *İslam’ın Erken Döneminde*, pp. 200–4.


47. Indeed, there is evidence that the *jizya* imposed by Muslims when they conquered an area was usually lower than the taxes that prevailed before the conquest. Erkal, *İslam’ın Erken Döneminde*, p. 86.


51. Ibid. and Gilbar, ‘Muslim Tujjar’, Session 121.
52. Gilbar, ‘Muslim Tujjar’, p. 5.
53. I am grateful to Abbas Mirakhor for this point. Personal correspondence, 21 March 2009.
55. I have been criticized by Hans-Georg Majer for using a term invented by Karl Marx for
the sixteenth-century Ottoman economy. But my depiction of the Ottoman economic
system as ‘proto-quasi-socialism’ simply argues that just as there were capitalist or quasi-
capitalist systems before Adam Smith, so was there an Ottoman proto-quasi-socialism
before Marx. Actually, it was Ömer L. Barkan who, more than half a century ago, probably
for the first time, applied the term socialism to describe the Ottoman system. The precise
term he used was: ‘a type of war socialism’ (Bir nevi harp sosyalizmi). See Barkan, ‘Bazı
Büyük Şehirlerde Eşya’, p. 327.
56. Genç, ‘Osmanlı İmparatorluğu’nda Devlet ve Ekonomi’, p. 67; Genç, ‘Osmanlılar: Ticari ve
İktisadi Yapı’.
57. None of the other great Islamic empires, not even the relatively recent Safavid and Mughal
empires, have left any archives comparable in quantity and quality to the Ottomans. The
Prime Ministry Archives of Turkey alone is estimated to contain some 400 million docu-
ments. For an exceptionally important pre-Ottoman source primarily based upon Arabic
papyrus documents on early Islamic Egypt, see Morimoto, The Fiscal Administration.
58. Latest research has yielded that in 1736 there were 322 beggars in Istanbul. Out of these,
only 70 persons were considered by the authorities as genuinely poor and permitted to beg.
This figure was less than 0.1 per cent of the population of Istanbul. By contrast, Paris, which
had a smaller population than Istanbul, had more than a hundred times more beggars. See
60. Lecture given by Mervyn Lewis on ‘An Islamic Economic Perspective on the Global