Engineering an Islamic future

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.

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 contract. 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. 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.
Islamic banks operating in
website of Bank Sharia
A montage image from the
see Maurer 1999.
challenges to property law
securitization and recent
Saudi Arabia.
firms, Al Baraka, is based in
largest Islamic investment
standards-setting institution for
Organisation for Islamic
Accounting and Auditing
Bahrain is the site of the

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

3. There are exceptions.

4. On different logics of
power, government, economics and society – a struggle
USA, the debate between the antimonopolists and the lib-
tives, like those proposed by the greenbackers and
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Relying on profit and loss sharing contracts rather than
conventional deposit accounts, Islamic banks could not
reconcile their practices with onshore regulations which
mandated rates of return on deposits; in other words, with
regulations requiring 'interest'. However, they could
operate in the international tax havens in the Caribbean
where Islamic banks were permitted to incorporate. They
found that Caribbean offshore centres provided, as one
Islamic finance professional put it, a 'safe haven' for
Islamically acceptable banking practices. I think of my
research in the Caribbean as of a piece with my research
among Islamic finance professionals, since in each case
my focus is on the often unexpected transformations of
dominant financial forms into alternatives that may be
transient or may, in unanticipated ways, endure.

Economic orders have to cope with contingency, that
is, the uncertainty of changes in the elasticity of produc-
tion and consumption. The future price of grain in a
derivative contract is based on certain assumptions about
the nature of economic realities in a particular economic
order. So also, any economic system will by its very
nature come to express that element of contingency. In
her study of monetary transformations in the late nine-
teenth-century United States, for example, Gretchen
Ritter questions assumptions about the 'inevitable his-
toric supremacy of mass production' over other alterna-
tives, like those proposed by the greenbackers and
antimonopolists, who were engaged in a debate with
orthodox liberals over whether currency should be
backed by precious metals or by the national debt. Both
in terms of the contemporary debate and when viewed as
a formative moment in the cultural political life of the
USA, the debate between the antimonopolists and the lib-
erals represents a struggle over how to define money,
power, government, economics and society – a struggle
in which the victors triumphed, Ritter demonstrates, not
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 contempo-
ry, 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 juridiscence 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 tech-
nical 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. 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. This is due, in part, to legacies of colo-
nialism, 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 laun-
dering 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 chas-
tises 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 impli-
cation 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 injunc-
tions against usury, for the Christian ban on usury con-
cerned 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
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 or 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 an original 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.

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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 IBF 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 the former ‘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 general-ized 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 uncharacteristi-cally 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 faqihis are taking us. Others are similarly unequivocal in their opposition to derivatives. They are *HARRAM*! 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, microcrediting 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.


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.

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 universalization of conventional economics in their current neoliberal 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.