Mutuality as an Antidote to Rent-Seeking Shari`a-Arbitrage in Islamic Finance

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Abstract

Islamic finance is a prohibitions-driven industry, which aims primarily to circumvent the canonical Islamic prohibitions of riba and gharar. The concepts of riba and gharar may best be understood as unbundled sales of credit and risk, respectively. An obvious solution is to adopt mutual structures for financial intermediaries of credit (e.g. banks) and risk (e.g. insurance companies), as early experiments in Islamic finance had apparently done. However, growth in Islamic finance over the past three decades has been led by rent-seeking Shari`a arbitrageurs, whose efforts continue to be focused on synthesizing contemporary financial products and services from classical nominate contracts, without regard to corporate structure of financial institutions. In this paper, I argue that mutuality should be given back its central role in our discourse on Islamic finance. In particular, I argue that mutuality in intermediation of credit and risk can assist significantly in implementing the substance of Shari`a as well as its forms, including the financial empowerment of Islamic financial customers (be they Muslims or otherwise) to face the challenging domination of Islamic finance by international financial behemoths.

Introduction: Absence of Mutuality in Islamic Banking and Insurance

The theory of Islamic banking is often attributed to Uzair (1955), and later literature that focused on a mutual-fund style double-tiered silent partnership model, c.f. Siddiqi (1983). The contemporary Islamic banking model began with the establishment of Dubai Islamic Bank (1975), followed by Kuwait Finance House, Faisal Islamic Banks in Egypt and Sudan, and Al-Baraka banks, most financed by windfall wealth following the dramatic rise in oil prices in 1973. In due course, the industry utilized synthetic loan structures based on credit sales and leasing, pioneered theoretically by Humoud (1976), to replicate much of the asset-structure of conventional banks. Recent innovations have allowed governments and corporations to issue sale and lease-based debt instruments, known by the Arabic name *sukuk* (=certificates, or bonds), thus allowing Islamic banks to replicate all asset classes held by conventional banks. However, the liabilities structures of Islamic banks have remained committed to the theoretical model of two-tiered silent partnership, developed by Islamic economists and implemented in the 1963 Islamic banking experiment in the village of Mit Ghamr, Egypt. Under that arrangement, the bank was capitalized by external shareholders, and accepted three types of deposits: demand deposits on which no interest was paid, investment deposits on which a profit-share was paid or to which loss-shares were charged, and zakah deposits.

Investment accounts based on profit and loss sharing continue to be the main distinctive feature of Islamic banks, to which much of the work of AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions, in Bahrain) and IFSB (Islamic Financial Services Board) is devoted. As of the writing of this article, IFSB has not yet issued its discussion paper on corporate governance for Islamic banks, which will address the fundamental agency problem facing those investment account holders. Of particular concern in this context is the fact that Islamic bank managers answer to shareholders, whose risk preferences (associated with equity investment) are typically quite different from those of investment account depositors (conventionally associated with debt investments). The problem is exacerbated by investment account holders' lack of control over bank decisions, which exposes them to substantial moral hazard compared to bank shareholders. Investment account holders are also disadvantaged relative to conventional depositors who are deemed creditors of the bank, and thus have first claims to its assets in case of bankruptcy.

A natural solution to this problem is for Islamic banks to adopt a mutual corporate structure. As we shall see in future sections, the mutual corporate form does not eliminate moral hazard entirely, since shareholder/depositors are typically too small individually to control bank operation. Indeed, literature on mutual banks often identifies each shareholder's ability to withdraw his deposit from the bank as the only means of punishing its managers – a prospect called "displaced commercial risk" in the literature on Islamic banking. However, by eliminating the separate group of profit-oriented shareholders from the formula, or putting them on par with investment account holders in the corporate structure, managers' incentive for excessive risk taking is largely eliminated, resulting in lower risk-taking that reflects depositors' preferences.

Interestingly, historical studies of Islamic banking prior and leading to the Mit Ghamr experiment in Egypt points to the strong influence of European mutual banking institutions and cooperatives. This influence applied equally to early 1950s banking experiments in Pakistan, as well as the 1960s Malaysian Tabung Haji, which eventually gave rise to the fast growing Malaysian Islamic banking sector. Dr. Ahmed Al-Najjar's initiative in Mit Ghamr appears itself to have been equally influenced by the social and economic thought of the Muslim Brotherhood, and the mutual banking institutions that Dr. Al-Najjar witnessed in West Germany during his study there, c.f. Warde (2000, p.73 and the references therein). The later GCC-based pioneers of Islamic banking in Dubai, Kuwait and Saudi Arabia capitalized the first group of Islamic banks in the mid 1970s, and later lamented the modes of operation adopted by those banks, which mimicked conventional banking practices. Many today criticize Islamic banks for failing to deliver economic and social development to Muslim populations that remain among the poorest and least educated in the world. Indeed, Dr. Al-Najjar, Sh. Saleh Kamel, and most of the early pioneers of Islamic banking expressed their displeasure with the industry's modes of operation on the assets-side, and predicted that foreign banks would soon be able to capture significant market share in an Islamic banking industry built on synthesizing loans and bonds from sales and leases, c.f. Saeed (1997, pp. 119-128) and the references therein.

In later sections, I shall argue that mutuality in Islamic banking can in-fact bring to the industry large numbers of depositor/investors as well as managers who are committed to Islamic ideals of social and economic development, as opposed to profit and fee oriented Shari`a arbitrageurs. A by-product of identification of Islamic banking with mutualization would be to give indigenous Islamic banks a much-needed comparative advantage vis-à-vis international financial behemoths that have been able to attract the most respected Shari`a advisors and law firms, thus capturing fast-increasing market shares in today's Islamic finance industry that is built on rent-seeking Shari`a arbitrage.

The absence of mutuality is even more surprising in the Islamic insurance industry, known generally by its Arabic name *takaful* (= mutual guaranty). It is interesting that even companies that use the term *takaful ta`awuni* (= cooperative mutual guaranty or insurance) have not adopted mutuality structures. This is particularly astonishing given the classical ruling 9/2 of the Fiqh Academy of the Organization of Islamic Conference (OIC), which distinguished commercial insurance from what it called "cooperative insurance … built on the principles of voluntary contribution (tabarru`) and mutual cooperation".

In fact, the contemporary Islamic insurance industry has adopted a superficial mutuality notion in its name (*takaful*), but not in substance. Thus, most Islamic insurance providers are structured with stockholder rather than policyholder ownership. Insurance claims are paid by shareholders through the *takaful* provider on the basis of tabarru` (voluntary contribution, as opposed to contractual obligation). This model based on voluntary contribution, replacing commutative contractual obligations with legally binding unilateral promises, raises a host of legal and juristic problems that have not yet been resolved fully. While insurance providers are typically characterized as investment agents of the stockholders, Bank Al-Jazira in Saudi Arabia has pioneered a characterization of insurance provider as pure agent (*wakil*, rather than *mudarib*). This can be a step towards eventual mutualization, where the insurance provider can act as a pure agent for shareholders who are themselves the policyholders. This would satisfy the most widely accepted means of eliminating gharar from insurance, by negating the commutative financial nature of the transaction through mutuality. However, there seems to be precious little initiative for mutualization in the Islamic insurance industry.

In the remainder of this paper, I shall briefly review the historical roots of mutualization in banking and insurance. In this regard, the goal of obtaining credit and insurance at fair prices seems to have been the primary driving force behind the mutuality movement in Europe and the U.S. This objective can also be seen as the foundation of prohibition of riba and gharar, which allow financiers to profit from the sale of credit and risk. Contemporary Islamic finance has focused on the elimination of unbundled sales of credit and risk by bundling credit in sales or leases, and re-characterization of the sale of risk in terms of voluntary contributions. In other words, it has focused on contract forms, without changing the substance of the underlying economic transactions, which remain essentially sales of credit and risk. While such contractual re-characterizations of the contract forms are likely to remain fundamental to Islamic finance for the foreseeable future, substantive contractual modifications that minimize the profit motive through mutualization can help the Islamic finance industry in its quest for economic substance and competitiveness vis-à-vis conventional competitors.

Islamic Banking, Shari`a Arbitrage and Mutuality

El-Gamal (2000, 2001) provided lengthy arguments that the forbidden riba and bay`-ul-gharar can be characterized, respectively, as trading in unbundled credit and unbundled risk. An extreme example of the first is an interest-bearing loan, and an extreme example of the latter is paying for a gamble. Of course, finance is mainly about the transfer of credit and risk, through financial markets and institutions. Islamic finance, thus, aims to accomplish the goals of financial markets and institutions by developing contractual forms of financial instruments and dealings with financial institutions that defy characterizations as sales of credit or risk.

Conventional banks were considered by the majority of jurists as un-Islamic due to the borrowing and lending nature of their operations (see El-Gamal, 2003, for a lengthy discussion of the debate regarding conventional bank permissibility). Banks borrow from depositors and markets (e.g. by selling mortgage backed securities, commercial paper and banker's acceptance) at some interest rates, and lend to the public or sell loans to markets (e.g. by buying bonds) at higher interest rates, thus generating returns on assets driven by the differential in interest rates. The Islamic economics literature of the Twentieth Century envisioned a different model of financial intermediation, built primarily on equity investment (silent partnership) contracts on the assets and liabilities sides. However, Islamic banks in fact emerged according to a model that is very similar to conventional banks. On the assets side, loans were replaced primarily by credit sales and leases, with built-in interest rates (characterized as profits or rents, respectively) matching market interest rates on similar loans. More recently, a practice known as tawarruq (= monetization) has become popular in retail Islamic finance, whereby the Islamic bank sells a commodity on credit to the customer, and then arranges for the customer to sell it back for cash, thus obtaining the desired credit.

Other conventional bank assets were also synthesized from sales and leases for Islamic banks. Long-term Islamic bonds (typically known as sukuk al-ijara, or lease certificates) were structured similarly for governments and corporations, by selling some properties to special purpose vehicles and leasing them back. Thus, the bond-seller can collect the funds up-front as a sale price, and pay back principal and interest in the form of rent. Short-term treasury-bill type instruments are commonly known as sukuk al-salam, and structured through a forward sale of some commodity, by means of which the bill issuer collects the discount price. At maturity, the bill issuer (e.g. Bahrain Monetary Agency) acts as the bond-buyer's agent, selling the commodity at an agreed-upon price that guarantees the bond-buyer the appropriate short-term interest rate, which is typically benchmarked to LIBOR (London Inter-bank Offer Rate, betraying domination of the industry by London bankers).

In all of those transactions, financial services and instruments merely replicate conventional ones (loans or bonds) with obvious inefficiency, due to spurious trading, leasing, incorporation of special purpose vehicles, etc. The net result is that Islamic bank customers are likely to pay a higher interest rate than their conventional counterparts. This higher cost of Islamic financial services creates an interesting host of adverse selection and moral hazard problems. While some Muslim customers may be willing to pay the additional cost to reduce their fear of participating in riba, many others will not. To generate sufficient business from the inefficient replication model, Islamic bankers may be tempted to engage in disproportionately high volumes of sub-prime lending, wherein customers are willing to pay higher interest rates due to their general lack of access to affordable credit at competitive rates.

The liabilities structure of Islamic banks further amplifies the Islamic bankers' incentive to engage in riskier, but more profitable, sub-prime lending. Since investment account holders are contractually obligated to share in the bank's losses, risk exposure of Islamic bank shareholders is reduced. Since managers of Islamic banks answer to the shareholders rather than the investment account holders, they will be tempted to maximize profits by engaging in such sub-prime lending. In the meantime, since the Islamic bank can justify its higher interest rates on quasi-religious grounds (legal fees associated with trading and leasing structures), it may have a client base with disproportionately many sub-prime borrowers, to the exclusion of Muslim borrowers who demand competitive rates. In other words, the Shari`a arbitrage incentive to serve a small market segment willing to pay a higher interest rate for credit that is structured in particular ways may undercut a large segment of demand for Islamic financial services.

Interestingly, the roots of mutual banking in the western world were driven by similar considerations: commercial banks were too profit-focused, thus exposing depositors to excessive risk, and failing to provide affordable credit to small borrowers. Mutual financial institutions emerged in many forms, including cooperatives in Europe, and mutual savings banks, savings and loans institutions and credit unions in the United States. The peculiar mutuality structure, where depositors are shareholders, and no shares can be sold outside the financial institutions, has generated significant interest in theoretical and empirical investigations of the efficiency and risk postures of mutual vs. stockholder owned banks.

A number of theoretical studies investigated the advantages and disadvantages of mutuality in banking. Mutual banks suffer a comparative disadvantage to raise additional capital by selling stock. On the other hand, the theoretical literature on mutuality has suggested that this very difficulty to raise capital deters mutual bank managers from undertaking risky investments. Indeed, while the absence of capital market discipline imposed by stockholders may give managers an incentive to undertake excessive risk, this effect is countered by the fact that a mutual bank manager's compensation is not related to profitability. Indeed, a mutual bank manager's compensation is likely to gain only marginally if higher profits are generated, but the downside risk in case of loss generation can be quite substantial. Thus, Fama (1980) and Fama and Jensen (1983) have argued that mutual bank managers may in fact be more accountable (especially for taking excessive risk) to their collective shareholders since the latter can unilaterally punish the bank by withdrawing their funds. O'Hara (1981) further showed that managers of mutual banks are likely to receive higher compensation than stock bank managers, with the bulk of the differential taking non-pecuniary forms (more leisure, nicer offices, etc.). This increases the mutual bank manager's incentive to shun risks, thus providing depositors/investors with the required low-risk, low-return structure they desire.

Rasmusen (1988) highlighted the attractiveness of this form of banking, particularly to uninformed depositors. He showed that mutual banks have in fact been safer historically, and their significance in the west has only declined after information advances made it easier for depositors and shareholders to monitor bank performance. Since most of the Islamic world, where Islamic banking has thrived, remains shackled with poorly developed capital markets, wherein monitoring bank portfolios is very difficult, mutuality would seem to be a natural solution to much of the problems of Islamic banking corporate governance: simultaneously avoiding the contractual riba problems of conventional deposits as well as the problems of monitoring bank behavior. Moreover, despite theoretical suggestions that lack of capital market discipline removes mutual bank managers' incentive to minimize costs, and hence makes such banks relatively inefficient, recent empirical studies (e.g. Altunbas et al. (2001)) have found no evidence of mutual bank inefficiency relative to stockholder owned counterparts.

Needless to say, cooperative Islamic financial intermediaries continue to exist today, from micro-finance oriented community initiatives in Bangladesh to cooperative home financing cooperatives in Canada. However, the bulk of Islamic financial intermediation is driven by the profit opportunities presented by captive market segments. Of course, as we have argued, the inefficiency of Shari`a arbitrage-driven financial structures defeats the purpose of the prohibition of riba – where disadvantaged borrowers are charged an unfair price of credit. In this regard, it is essential to recall the analysis of Ibn Rushd, upon which the analysis of riba in El-Gamal (2000) is based: The essence of the prohibition of riba is to avoid unfairness in transactions. In this regard, the best means of avoiding unfair lending practices, and ensuring prudent use of credit, is through mutual credit organizations, which should reclaim their central position in Islamic financial dialogues. Unfortunately, discussions of Islamic finance today are dominated by large banks that can afford to pay hefty fees to Shari`a scholars and lawyers, who jointly develop new Shari`a arbitrage analogs of bonds, derivative securities, etc. However, small mutual financing initiatives around the world may be able to utilize advances in information technology to reach critical mass, and stake their rightful claim to "Islamic finance" from the multinationals that have diluted its brand-name with ever increasing levels of rent-seeking Shari`a-arbitrage "innovation".

Islamic Insurance, Shari`a Arbitrage and Mutuality

The absence of mutuality in Islamic insurance schemes is even more surprising than its absence in Islamic banking. Jurists distinguished three types of insurance, which they called mutual insurance, social insurance and commercial insurance. The first form was envisioned along the lines of western mutual insurance companies (where policyholders are themselves the stockholders), the second form encompasses state-sponsored pension and health insurance plans, and the third is the familiar type conducted by profit-oriented joint stock companies. One of the earliest analyses by Dr. Mustafa Al-Zarqa (in 1961 and 1976) led him to believe that insurance in all of its forms is permissible (c.f. Al-Zarqa', 1994, p.8-9), and some jurists of the following generation agreed with that conclusion (c.f. Al-Misri, 2001, p.6). In September 2004, the Grand Mufti of Egypt, Dr. Ali Jum`ah, issued a fatwa also accepting all three forms of insurance as permissible, while recognizing that the third type has been the subject of significant controversy.

For the first two types of insurance, the text of the fatwa said, there is near consensus on permissibility, since insurance in those cases is built on voluntary contribution (tabarru`) and mutual cooperation (ta`awun). In this regard, gharar only invalidates commutative financial contracts (c.f. Al-Darir, 1997), and hence poses no problem for mutual and government sponsored forms of insurance. The Islamic insurance industry, known by the Arabic name takaful (= mutual guaranty), relies heavily on the opinions of jurists who deemed commercial insurance forbidden based on riba (interest earned on investment vehicles used by insurance companies) as well as gharar in commutative contracts between policyholders and the insurance companies. Interestingly, while the name "takaful" implies mutuality (the generic Arabic form "tafa`ul" generally does), takaful companies have chosen the commercial insurance model of joint stock companies. Such companies avoid charges of engaging in riba by investing excess premiums in vehicles wherein interest is characterized as rent or profit (e.g. various sukuk, or Islamic bonds), and avoid charges of gharar by characterizing payment of insurance claims as a unilateral voluntary contribution, based on a binding promise on the insurer. Of course, hair-splitting distinctions between this type of binding promises on the one hand, and commutative contracts on the other, are the substance of Shari`a arbitrage, on which most of Islamic finance is built today. The purpose of this paper is not to offer a juristic critique of those methods, but rather to consider the economic advantages of natural non-Shari`a-arbitrage solutions (esp. mutuality) which have not been utilized effectively to-date.

In the next section, we shall discuss similarities between the rent-seeking incentives that continue to govern Islamic finance today, and those that led to a strong demutualization drive in the 1990s, both in banking and insurance. Before proceeding to that section, it is worthwhile discussing the economic advantages and disadvantages of mutual vs. stock forms in the insurance industry. Towards that end, it is worthwhile noting that mutual insurance companies have played a major role in many insurance lines in the United States during the 1990s, even gaining market share in some property and casualty insurance lines (c.f. Born, Gentry, Viscusi and Zeckhauser, 1998). Empirical evidence suggests that stock insurance companies bore more risk (c.f. Lamm-Tennant and Starks, 1993), and provided higher returns through higher cost efficiency (c.f. Gardner and Grace, 1993,1994; Cummins, Weiss and Zi, 1999, and Swiss Reinsurance Co., 1999). Those results are consistent with theoretical analyses of agency problems of mutuality in insurance companies (c.f. Mayers and Smith, 1977; Smith and Stutzer, 1995). Naturally, those results for mutuality in insurance mirrored those discussed in the previous section for mutuality in banking: mutual insurance companies provide better insurance value (higher loss ratios) for policy holders, since managers answer to them, rather than to separate stockholders. In the meantime, by choosing portfolios of lower risk, mutual insurance companies generate lower profits than their stock counterparts.

Demutualization, Greed and Shari`a Arbitrage

We have argued that mutuality in banking and insurance would provide natural solutions to the problems of riba and gharar associated with intermediation of credit and risk, respectively. Indeed, we have shown that the early theory and practice of Islamic alternatives to banking and insurance were inspired by western models of mutuality and cooperation, as opposed to provision of financial services by profit-seeking joint stock financial companies. However, we have seen that the Shari`a arbitrage mode characterizing Islamic finance in the areas of credit and risk intermediation has prevented Islamic finance from realizing that simple solution of mutuality in banking and insurance. In order to understand this lack of mutuality, it would be instructive to examine this trend through the lens of demutualization in western banking and insurance since the 1990s.

We have argued based on theoretical results and empirical evidence that mutual financial institutions tend to provide their owners lower risk and return profile, and to offer their customers (who are often shareholders as well) better service, compared to joint stock banking and insurance companies. In other words, mutual financial institutions provide the same financial (credit and risk) intermediation services and products, which are necessary for economic well-being, but do so in a manner that does not increase risks unnecessarily. This lower risk profile also makes mutual financial institutions more resilient, especially during periods of financial panic, such as during the great depression of the early Twentieth Century. It is interesting to note that the prohibition of riba and gharar are precisely restrictions on means of trading in risk (the extension of credit exposes the creditor to potential borrower default or bankruptcy). In this regard, the spirit of Islamic jurisprudence allows transfer of credit and risk only if bundled within a financial transaction such as sales, leases and partnerships. Such bundling regulates the riskiness of financial transactions, thus allowing for necessary risk taking to encourage investment and economic growth, while minimizing individual and systemic risks of bankruptcy and wild fluctuations in economic values.

In other words, the prohibitions of riba and gharar, and associated conditions imposed by classical jurists on contracts that allow transfer of credit and risk without violating those prohibitions, are in essence forms of prudential regulation and risk management. While secular regulators have now provided elaborate regulatory requirements that limit systemic risks posed by joint stock financial companies, mutuality appears to fill a needed regulatory gap for protecting individuals from their own tendencies to undertake excessive risk that may prove personally ruinous. Interestingly, the rise of mutual savings banks and mutual insurance companies appears to have occurred in the west precisely to meet the demands of farmers and other risk-averse groups, who built such institutions to gain access to credit and risk-mitigation without necessarily having their financial interests governed by profit motives. It is this similarity of motives and substance that made mutuality a natural idea in the early days of Islamic banking, and in the early literature on Islamic insurance.

The lack of mutuality in Islamic banking and insurance is not surprising when we consider the motivation behind their growth in the past two decades: abnormal profit- or rent-seeking. The bulk of growth in Islamic finance has come from multinational financial conglomerates and conventional banks that were attracted to Islamic finance by lucrative profit opportunities. As we have argued in earlier sections, the very nature of Shari`a arbitrage also justified charging higher fees or interest rates for Islamic financial services and products, hence allowing new entry to the industry by rent-seeking financial providers. In this regard, de-mutualization in banking and insurance were driven by the same profit/rent-seeking incentive. As Gron and Lucas (1997) have argued, de-mutualization was driven by the stock market boom of the 1980s and 1990s, which strengthened the incentive to seek additional capital from equity markets, as it promised mutual owners fast riches.

Of course, higher returns – including through de-mutualization or avoidance of mutuality in the first place – can only be achieved through increased risk exposure. To the extent that shareholders in mutual banks and mutual insurance companies selected that ownership structure in order to avoid excessive risk, yielding to the temptation to pursue higher risk-return investments appears to contradict the initial incentive to shun risk, at least for the part of their portfolio held with mutuals. In the area of Islamic finance, one could argue that the unique power of religious injunctions (e.g. against riba and gharar) is that they protect individuals from temporary greed-driven heightening of their appetites for risk. Alas, by shunning mutuality and adopting some of the most transparent forms of Shari`a arbitrage, the regulatory substance of the Shari`a has been squandered, while adhering to its forms in the shallowest way.

Conclusion: Return to Mutuality can Fight Rent-Seeking Shari`a-Arbitrage

Perhaps the most striking example of Shari`a arbitrage making a mockery of Islamic jurisprudence is provided by the recent growth of tawarruq (= monetization, of a commodity) in Islamic finance, as practiced primarily in GCC countries. One could argue – as the Office of the Comptroller of the Currency had concluded in its two interpretive letters on the contracts – that murabaha (credit-sale based) and ijara (operating-lease based) financing are forms of secured lending. Thus, the risk of excessive borrowing to the point of bankruptcy is minimized by ensuring that total debt does not exceed the value of financed assets (with sufficiently high probability). Moreover, since the objective of secured lending (e.g. to finance an auto or home purchase) is to extract usufruct from the financed asset, interest rates paid on secured loans may be compared to the market rents for similar properties, to determine whether the financing rate is fair, and whether one should engage in the transaction.

Of course, large Islamic banks had, from their inception in the 1970s, used murabaha financing in effect to provide unsecured lending to large corporate customers. In such transactions, the bank would sell – say – $10 million-worth of aluminum to a customer, for a credit price of $11 million payable at a later date. The customer would then turn around and sell the aluminum for its cash value on the spot market, thus gaining liquidity and simulating an unsecured loan. In recent years, this practice has been taken downstream into retail finance, whereby customers in Saudi Arabia, UAE, etc. can get a loan of any value through simple trading of some commodity between a dealer in that commodity and the financing bank. In many instances, the bank can act as agent for the dealer and the customer, thus concluding the back-office loan processing in terms of three trades (cash sale to bank, credit sale to customer, and cash sale back to dealer) in a matter of minutes.

While standardization and agency in those trades have cut transactions costs considerably, the transaction remains nothing more than an inefficient unsecured loan – exposing the customer to the precise risks from which the Shari`a aimed to protect him. It is in this context that ibn Qayyim Al-Jawziyyah (1996, vol.3, p.138) reported the following opinion of his teacher ibn Taymiyyah:

> *And our teacher (God bless his soul) forbade Tawarruq. He was challenged on that opinion repeatedly in my presence, but never licensed it (lam yurakhkhis fiha) [not even as an exception under special circumstances]. He said: "The precise economic sybstance for which riba was forbidden is present in this contract, and transactions costs are increased through purchase and sale at a loss of some commodity. Shari`a would never forbid a smaller harm and allow a greater one!".*

Interestingly, most juristic councils – including the Fiqh Academy of OIC – have deemed tawarruq impermissible. One notable exception was the Fiqh Academy of the Muslim World League (MWL), which approved the practice in its 15th session in October 1998, thus paving the way for its adoption in retail financing around the GCC. After reviewing the contract's utilization by Islamic banks, the same Fiqh Academy of the MWL ruled in its 17^{th} session of December 2003 that: "the reality of this transaction is extension of monetary financing to the party characterized as tawarruq customer, and the buying and selling operations of the bank are most often just meant for appearance, but in reality aim to provide the bank an increase in compensation for the financing it provided…". The continued use of tawarruq despite rejection by all reputable Fiqh councils illustrates the disdain with which current drivers of Islamic finance hold religious injunctions, not to mention their economic substance. Whether or not a product is used depends primarily in the rent-seeking world of Shari`a-arbitrage on market size and possibility of extraction of super-normal profits or rents.

Of course, this characterization applies to all forms of Shari`a-arbitrage, which have to-date dominated the Islamic finance industry. This is the very nature of Shari`a arbitrage: profit or rent-seeking financiers employ jurists and lawyers to synthesize ostensibly forbidden conventional financial practices that transfer credit and risk. A main substantive goal of the Shari`a (minimization of risks to which individuals are exposed when dealing with financial markets and institutions) is ignored by the industry thus configured. If customers are willing to pay extra $y for product A, and it takes $x (legal and jurist fees) to synthesize A from product B, then rent-seeking or Shari`a arbitrage based Islamic finance will provide the synthesized product as long as y is greater than x. Those rents are only possible to collect if the providers of financial services and products are rent-seeking profit maximizers. One way to stop the ruinous spiral in which Islamic finance has been caught is, therefore, to sever that profit-motive in Islamic finance. One way to accomplish the latter goal is to return Islamic finance to its roots in mutuality. An interesting by-product would be re-definition of the "Islamic" brand-name, which is currently generated by Shari`a-board approval. Since multi-national conventional banks have a decided size advantage that allows them to pay higher jurist and legal fees, they have a decided absolute advantage over indigenous (and potentially genuine) Islamic finance competitors. Re-establishing the "Islamic" brand-name as community- and ethics-based would give those genuine Islamic finance providers a decided advantage, and prevent further erosion of their market share by foreign competitors who may dilute the brand-name to the point of destroying the potential of developing a genuine Islamic financial industry in the future.

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