Macro vs. Micro-Considerations in Islamic Financial Ijtihad

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Shari‘a Arbitrage Revisited

- **Riba**: cash now for cash later – forbidden
- **‘inha**: credit-sale followed by cash resale
  - Al-Shafi‘i test: is second contract stipulated in first?
- **Tawarruq**: cash purchase from A, credit-sale to C, cash resale to D (or A?) → C gets credit
  - Ibn ‘Uthaymín required legitimate third (fourth?) party
- **Murabaha**: In fact, the final cash-sale may be ignored, characterizing only the cash purchase from A followed by credit-sale to B as *Murabaha*-to-order or *Murabaha*-facility
  - Can always add more “layers” (SPVs, IBCs, etc.)
- **Theorem**: Any conventional financial product can be replicated with sufficient number of layers (laundering)
Prelude: Ibn Taymiyya on Tawarruq


... And our teacher (God bless his soul) forbade Tawarruq. He was challenged on that opinion repeatedly in my presence, but never licensed it [even under special circumstances]. He said:

“The precise economic substance 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 not forbid a smaller harm and allow a greater one”.

- Ibn Taymiyyah (Al-fatawa Al-Kubra – Selected Scholarly opinions – Sales – Riba) And Tawarruq is forbidden, as per one narration on the authority of Ahmad


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الفتاوى النافقة بأحد التقدمين، وهو رواية عن أحمد بن موسى، والخبراء أيضاً. وهو رواية عن أحمد، وإن اضطرنا ذكرها في بعضها جاز.

وحكاية ابن عبد البر عن أبي حنيفة ومالك خلافاً ما نص عليه أحمد. وهو مسألة الفروق.

وهو رواية عن أحمد، وهو نصاه نسابة أحمد، وهو نصهان لا نباهة، وهو نصهان ما لم نكن هناك.

وهو موسوعة من أحمد، في حاله والشيخ أبي محمد المقدسي في حلته، والتحقيق في نظام الربا.

إذا لم تصلقي هذا القاضي أن لا عند، وإن كان بعضهم يقول بالممثل، فلم يذكر بطل العقد، ولو لم يتم بطلان ما تم، ولكنهم باطلة حموراء وحرمتها أشد من حرم الرياض، ولا جوز تعيبه الكتب التي تشتمل على معرفة صناعةها وأتأي بعض ولاة الأمور بإلاقائها.

فصل: ووجوز بعض المقاتلين جملة بصرفها سواء بدأ صلاحها أولاً، وهذا القول له ماذا أن أخفدهما أن العروق كأسول الشجر، فبسبب الخصيارات قبل بدء صلاحها كبيع المشجر بشرب قبل بدء صلاة غرو تعدها، والأخير الثاني فهو الصحيح أن لم تدخل في عني التي، بل يصح العقد على النقطة الموجودة في النقطتان (1) المذكورتين إلى أن تسبحان لأن الحاجة داعية إلى ذلك.

ويجوز بعض المقاتلين دون أصول، وعوامل بعض أصحابنا، وإذا بدأ صلاح بعض شجرة نازح ببيع ذلك الجنس وهو رواية عن أحمد، وقول اللثيم بن سعد، وفقيه الأجانيس التي ساء حمله فإن أصاب ذلك أو الزروع الذي بيعه، ولون من جراد أو جيش، لا يمكن تضمينه.

فمن ضياع بائتعه إن لم يفرط المشترى، وثبت الجائحة في المزارع، كيا إذا أدرك الزمن، فالنملاء كانت تساوية بالجائحة سبعية، ونملاء الناس يطلب أن هذا خلاف ما في المغنى من الإجماع وهو غلط، فإن الذي في المغنى أن نفسه إذا أدركه يكون من ضياع المستأجر صاحب الزروع لا يكون كأنه المستأجر، وهذا ما في خلاف، وإذا الخلاف في نفس أجرة الأراضي ونقص قيمتها فيكون كنا إلى النقطع الماء عن الزروع وثبت الجائحة في المزارع.

(1) كذا بالأصل.
(2) واللفظان هكذا بالأصل، واللفظان العلم.

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Transactions costs – secular considerations

• **Static view:**
  – Standardized (nominate) contracts reduce contract formation and negotiation costs
  – Adoption of variants of classical nominate contracts minimizes contemporary divergence of opinions and increases standardization
  – **Conclusion:** encourage harmonization of Shari‘a standards, etc. (current trend in Islamic finance)
  – Then, would we have to tolerate inefficiencies in the name of Islam? Or, shall we introduce more nominate contracts resembling conventional ones?

• **Dynamic view:**
  – Islamic finance started with mutual-fund (*mudaraba*-based) model of financial intermediation, highly inefficient due to information asymmetries
  – Sequential innovations have led to ever increasing convergence with conventional financial structures
  – **Conclusion:** discourage harmonization (premature codification and precedent-setting of Islamic standards) of Shari‘a standards, allow more efficiency considerations to influence the evolution of Islamic jurisprudence
  – Then, would there be Islamic finance in the long-run?
Macro vs. Micro Considerations I

- **Micro-consideration:** Jurists are in agreement that *fatwa* varies by time, place and circumstances
- **Macro-consideration:** Ibn Taymiyyah and Ibn al-Qayyim saw *Tawarruq* as a ready means of legalizing the worst types of *riba* (coerced usurious “sale” in place of usurious loan)
  - Mustafa al-Zarqa’s “*Nazariyyat al-Ta‘assuf*” parallels Anglo-American legal principles in evaluating coerced sales
  - Rafiq al-Misri: It is better to label mark-up as interest, which is subject to usury-law ceilings, rather than as profits, for which there are no ceilings
Macro vs. Micro-Considerations II

• **Micro-consideration:** If bank loan at market interest rates does not exhibit the **substance** of *riba*, but only its **form** → devise *murabaha* or *tawarruq* alternative to give it the **form** of sales

• **Macro-consideration:**
  – With lower transactions costs than *ijara* and *murabaha*, banks would choose to use *tawarruq*, squandering the benefits of secured financing
  – With *fatwa* available, those lacking access to banking may be exploited with this hidden form of *riba*
Strategic Macro-considerations

• Consider dynamic effects:
  – How will bankers and lawyers react to this fatwa? (Why was it solicited in this particular form?)
  – How will this fatwa affect other future fatawa? Does it support or hinder convergence?
  – How will this fatwa affect future secular legislation?
  – Overall consideration: Does this fatwa hinder or foster overall development of Islamic finance?

• Consider welfare effects:
  – Who are the primary beneficiaries from this fatwa?
  – How does the fatwa affect others inadvertently?
  – Overall consideration: Is the average Muslim better off? Is the average market participant better-off?
Myopia of Micro-fatwa approach

- Consider the debt-ratio screening rule:
  - Originally, one-third debts/assets produced an acceptable universe of equities, and thus codified
  - Then, in response to changes in asset prices, it was changed to one-third debts to market capitalization, later to moving averages thereof
  - Note the rigidity of “one-third” and debts/something rules → fatwa adjustments become more difficult with time
  - Of course, if the one-third rule is fixed, and the denominator is fixed, then investors would be forced to “buy-high (as market cap increases, and assets are included) and sell-low (as market cap decreases and assets are excluded)”
  - The arbitrary one-third rule, albeit used elsewhere, becomes a hindrance to developing flexible debt screens (establishing license in proportion to need in invoking the rule of necessity)

- Other harmful precedents:
  - Economic harm: Canonization of “profit sharing” ideas has become an obstacle to deposit insurance ambitions in US and UK, source of animosity to recent Azhar opinion thereof, obstacle to efficient bond issuances, etc.
  - Possible religious harm: Canonization of “asset-backed” ideas have led to inefficient bond structures for “sukuk al-salam” issuances, which often include forbidden ‘inah (same item sold, re-leased to same party, and in most cases re-sold to same party)
Advantages of Micro-\textit{fatwa} approach

- Faster response to needs of those without access to conventional financial sector, for various reasons
- Jurists, lawyers and bankers have managed to produce instruments that are not significantly inefficient relative to conventional ones
  - e.g. M. El-Gamal and H. Inanoglu, \textit{Journal of Applied Econometrics}, (forthcoming, 2004), find Turkish Special Finance Houses to be cost- and labor-efficient
- The fatwa approach is by its very nature micro-oriented – there is no obvious substitute
- We should hope that some macro-considerations will also be discussed and considered by jurists before issuing opinions
- We should also hope that jurists will be open to re-examining previous opinions based on their observed macro-effects, rather than lament their abuse (which has become quite common)