



Bringing Muslim nations into the global century

IMAGINE THE U.S. ECONOMY WITHOUT home mortgages or car loans. The result would be the economic equivalent of a heart attack. Yet today that unthinkable economic reality is the norm in many Muslim nations. The absence of such simple, powerful mechanisms for fostering prosperity reflects a much deeper inadequacy: the lack of the legal and economic infrastructure that led to and sustains the supremacy of the West.

In the past three centuries three powerful ideas arose in Europe and America whose combination enabled the West to generate enormous pools of investment capital—capital that fired the Industrial Revolution, developed America, created global corporations, and even forged democracy.

First was the notion that reasonable interest on loans isn't usury. That idea, which seeded modern banking and capital markets, today seems self-evident to Westerners. But before John Calvin and the Protestant Reformation, Christianity, like Islam, maintained that any return on a loan was usurious, thus sinful. (The same was true in Judaism, where it was forbidden to charge interest to fellow Jews.) The Koran absolutely forbids usury, which most contemporary Muslim jurists still interpret as collecting any amount of interest. The prohibition exercises a powerful hold on many Muslims' minds.

Second was the legal fiction of the corporation as an independent "person" distinct from its owners. That freed companies to assume debt for risky ventures, lose money, and claim bankruptcy without ruining the shareholders. Putting a firewall between shareholders and company liability enabled individuals to own the upside of success while absolutely limiting the downside risk to, at most, the amount of their investment. Not surprisingly, it unleashed the potential for entrepreneurs to raise previously unheard-of sums.

Third was the development of a uniform system of property rights. By widely adopting deeds, titles, and stock shares, the West ingeniously decoupled the economic features of almost any asset from its physical state. Such legal representations made assets fungible and suited to practically any financial transaction. That essential step helped transform assets into



ARDILES RANTE—EPA/LANDOW

Indonesia's top Muslim council last year denounced interest charges at banks like this one.

Many Muslims worry that mortgages and other financial instruments are sinful.

capital, thereby opening the possibility of generating surplus value. Today in the West financial instruments lead invisible but profoundly important parallel lives alongside the physical assets they represent. Titles to U.S. homes, for instance, provide the foundation for mortgage-backed bonds that are re-discounted and sold in secondary markets. The arrangement injects economic life into assets, making them generate capital, which then allocates itself to its best and most efficient use.

Contrast the vibrant U.S. real estate market with that of Egypt, where my parents were born. A brilliant analysis by economist Hernando de Soto has shown that Egypt has "dead [i.e., uncapitalized] real estate assets 30 times the value of all shares on the Cairo Stock Exchange and 55 times the value of all foreign investment ever recorded in Egypt."

He blames the undercapitalization of Egypt and other underdeveloped nations on the fact that assets are not adequately documented. Financiers and investors cannot "see" houses or land for which titles and deeds aren't adequately recorded, nor are they interested in unincorporated businesses with un-

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defined and unlimited liability. But I note a deeper cause: Many Muslims are troubled that mortgages and other financial instruments are usurious and therefore are reluctant to use them.

No modern society, even strict Muslim ones, can exist without banking, of course. Thus far, Muslim theologians have come up with two approaches to resolve the tension between interest-based banking and devout Muslims' scruples. The solutions derive their authority from the fact that the Koran unambiguously supports trade and that Muslims have traditionally been traders. One approach is "Islamic banking," which is practiced by banks throughout the world: Banks essentially package retail loans in products like leases and equity positions that avoid using the term "interest." Payments that cover the cost of capital are absorbed into what is labeled profit, an Islamically legitimate charge. Islamic legal specialists review the products to ensure that they are sharia-compliant—that they do not violate Islamic law.

That practice has enabled Islamic bankers to deal successfully at the retail level. (In fact, to cater to customers who want to bank in this manner, Citibank and other Western banks have started what they call Islamic windows.) Yet Muslim cultures have yet to "Islamize" ways to securitize assets. Without securitization, capital markets can't flourish, and governments would be unable to issue or trade interest-bearing securities, a primary tool all central banks use to control inflation and calibrate money supply.

The second approach has been to accept modern interest rates as nonusurious. Jurists supporting this position contend that Koranic verses define usury as capital used in a predatory way. In other words, a loan is usurious only if it erodes the borrower's equity in favor of the lender's, or if a lender charges interest to a borrower who is in need of charity, or if debt is not relaxed or forgiven when the debtor is in difficulty. The jurists regard interest-bearing loans as nonusurious when they help increase borrowers' equity in their assets, and when the loans promote the cooperation of capital and labor in stimulating economic expansion

and creating and distributing wealth more broadly. On this basis, all countries in the Muslim world, even Iran and Saudi Arabia, maintain central banks. But while Muslim governments have accepted the reality of interest in the banking system, many Muslims still wrestle with the religious arguments in their minds.

Calls to democratize the Muslim world usually focus on the need to introduce the ballot box. Give people the vote, the argument goes, and flourishing democratic capitalist societies will emerge like water flowing downhill. But the machinery of democratic-capitalist societies is actually much more complex. It hinges crucially on separations of power: between the executive, legislative, and judiciary branches of government, between civilian and military authority, between the media and the state, and between church and state.

Arguably the most valuable separation for Muslim nations' prosperity is between the economy and the state. This entails creating efficient property and legal-rights systems, privatizing and breaking up state-owned monopolies, and guaranteeing the central bank's independence. Arguments desperately need to be made and widely disseminated proving that those separations are as consistent with Islamic law as they are with Western law.

In 1999, President Musharraf of Pakistan invited Citibank executive vice president Shaukat Aziz to "intellectually remit" his expertise by returning to reform the nation's economy. Aziz accepted the challenge; as Finance Minister he helped reduce the national debt and lift Pakistan from recession to GNP growth of more than 6% a year. He is now Prime Minister; al Qaeda's July 29 attempt to assassinate him as he campaigned for office makes it obvious how the improvement of Pakistan's economy threatens al Qaeda's recruiting.

As Islamic nations struggle to modernize, they will need "intellectual remittances" from other courageous Westernized Muslims. They will need something more besides: To counter the threat posed by al Qaeda, public and private sectors of the West need to ask what sociopolitical help they can contribute. ■

For Muslim nations, the most valuable separation may be between the economy and the state.