

The Islamization of Economies and Knowledge: A New Institutional Economics Perspective

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Abstract

Using ideas from New Institutional Economics (NIE), this paper examines the Islamization of economies and links it to the Islamization of knowledge. NIE uses a multi-disciplinary approach to explain how economic structures evolve and change over time. These structures are studied at four levels: cultural, institutional, organizational, and transactional. While culture embodies a given society's body of knowledge, the nature and growth of that knowledge determine the type and evolution of an economy's institutions, organizations, and transactions.

This paper contends that the Islamization of economies failed mainly due to a lack of the Islamic knowledge needed to produce the appropriate institutions and organizations. After examining the status of knowledge in the Muslim world, examples of legal institutions are presented to illustrate how dormant Islamic scholarship led to economic structures that lack an Islamic ethos. Establishing an Islamic economic structure would require reorienting an Islamic society's culture via the creation of new Islamic knowledge that can build appropriate institutions, organizations, and transactions.

Introduction

After the Muslim world gained its independence from the colonial yoke during the twentieth century, Muslim scholars felt the urge to solve their problems

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according to Islamic injunctions. While a variety of literature appeared, two novel endeavors attempted to address the Muslims' intellectual deficiencies directly. The first one, the "Islamization of knowledge" project initiated in the 1960s, linked the Muslim world's backwardness to the lack of Islamic knowledge produced in different disciplines. The initiators sought to Islamize political, sociological, economic, and other disciplines of knowledge that could meet the needs of the contemporary world.¹ The second one, the "Islamization of economies" initiative, was formally launched in 1976 at the First International Conference on Islamic Economics (held in Makkah). Participating economists pointed out the Islamic economic system's distinct nature and asserted that the Islamic value system would provide a better concept of economic development and a pragmatic approach to achieve it, not only for Muslims but for humanity at large. The manifestation of Islamic economics, however, ended up mainly in the financial sector, which experienced rapid growth and quickly became a global phenomenon.

Despite the great enthusiasm generated during the early years about the potential of Islamic economics, there now appears to be an apprehension that it failed to realize its goals both as a discipline and in real life. The lack of sound theoretical and empirical foundations raised censure from critics and concerns from proponents. Critics challenged its relevancy to modern economies. For example, Kuran asserts that the discipline has no comprehensive framework for a modern economy and, as such, that this experiment established isolated institutions and thereby created an Islamic sub-economy.² Similarly, Khan points out the "disconnection" between theory and practice.³

Among its advocates, Siddiqi blames the decline in interest and contributions on the methodology employed, which focuses more on jurisprudence (*fiqh*) than on the discipline's scientific aspects.⁴ Khan maintains that this particular economic discourse has been mostly conceptual due to the production of very limited supporting empirical work.⁵ As most of the relevant discussion revolves around the ideal Islamic society and lacks any hard empirical validity, the scientific foundations of Islamic economics are weak. Zarqa remarks that the discipline is mainly a discourse that compares the Islamic economic system with the capitalist and socialist systems and then critiques the latter two systems.⁶ Kahf points out that Islamic economics emphasizes historical sources and mentions the dangers of analyzing historical definitions and events without benefiting from the underlying ideas.⁷ This approach has led to discussions of historical issues rather than those of interest to contemporary times. As a result, much of the produced literature has dealt with such specific issues as zakat, *ribā*, and the laws of inheritance.

Given the above, many wonder what went wrong and are still searching for approaches on how best to revive this discipline and its applications.⁸ Siddiqi calls for a new approach to derive Islamic law for contemporary times,⁹ Chapra recommends more multidisciplinary research efforts in Islamic economics,¹⁰ and Kahf suggests seriously reconsidering existing writings and searching for new directions.¹¹

This paper uses the ideas of New Institutional Economics (hereafter “NIE”) to address some of these issues. While NIE is very relevant to Islamic economics and its implementation, it has somehow been neglected in the discipline’s discourse. This paper seeks to introduce and then use its basic ideas to understand the real-life constraints of implementing Islamic economics. NIE takes a comprehensive multidisciplinary view of the economy in order to study a given economy’s structure and evolution. A key feature of its framework is how knowledge helps frame an economy’s institutions, organizations, and products. After discussing NIE’s overall analytical structure, the paper argues that the lack of Islamic knowledge creation has prevented the establishment of those institutions that an Islamic economy must have in order to function.¹²

The complexity of NIE makes it difficult to conduct empirical research using quantitative data related to an economy’s dynamics and evolution. While significant empirical work on transaction costs economics within this particular framework exists, quantitative studies on such institutions as legal and regulatory environments and institutional change are relatively scarce due to the lack of appropriate data. Given this problem, Alston suggests using case studies and historical qualitative information to examine and analyze institutions.¹³ Accordingly, this paper uses a case study approach to investigate institutions and their implications for Islamic economics. To keep the scope manageable, the focus is restricted to the implications of legal institutions on organizations.

The paper is organized as follows: an outline of the NIE’s basic framework by examining its four levels of analysis, a discussion of the role of knowledge in NIE and how economic structures change and evolve over time, a historical account of the status of the stock of knowledge in Muslim societies, an explanation of the implications of this reality on various legal institutions, a presentation of approaches to enhance the body of knowledge that can help Islamize economies, and a conclusion.

Economic Structure and Levels of Social Analysis

NIE criticizes neoclassical economics as being too simplistic to explain a complicated world. The assumptions of the neoclassical theory, namely, perfect

information (no information costs and certainty) and zero transactions cost, results in perfectly operating markets in a frictionless world. This approach does not depict reality and fails to explain the structure of and changes in economies. North defines economic structure as the features of a society manifested in its institutional framework.¹⁴ To understand an economy's structure, the works of North and Williamson are drawn on to identify four levels of analysis.¹⁵ These are described below.

Level 1: Culture/Social Embeddedness

Culture, which constitutes a given society's embedded beliefs and ideology, forms the first level of social analysis. It represents values affecting the behavior of individuals as expressed in their society's customs, traditions, and norms. While ideology is commonly understood to be a body of doctrine of thought that guides an individual, social movement, or group, cultural beliefs are "shared ideas and thoughts that govern interactions among individuals and between them, their gods and other groups."¹⁶ North asserts that ideologies are intellectual rationalizations for the behavior of individuals and groups within societies.¹⁷ Ideology, among other functions, specifies the notion of justice for institutions and exchange relationships in an economy. It has three features: it gives a simplified version of the society's worldview, entails moral and ethical values and judgments regarding different aspects of the society and economy, and can change when an individual's experiences contradict his/her ideology. In such cases, a new ideology that better explains reality evolves.

Ideology and cultural beliefs are closely linked to a society's nature and stock of knowledge, both of which influence and shape the individuals' cultural traits and embedded values and determine their society's behavioral norms and rules. Norms and values arising from culture are sources of informal constraints by which individuals in a society abide. Consensus in ideologies exists when individuals in a society have a similar perception of reality. In such cases, there is a perceived legitimacy of certain informal rules and ideologies substitute some of the formal constraints and compliance procedures. If a society contains divergent ideologies, however, the ensuing lack of consensus can lead individuals to violate the rules. In such cases, some of the rules and procedures may have to be formalized institutionally to ensure compliance.¹⁸

Williamson maintains that for any society, the informal institutions that shape its members' norms and behavior are unplanned and spontaneous.¹⁹ The implication of this is that the possibility of change is slim. A deliberate attempt to change existing values is, therefore, an extremely difficult and long

process. Social theories study the effects of informal institutions (e.g., culture, cognition, and politics) on the customs and behavior of individuals in a society. He envisages culture, which is embedded in the form of customs, norms, behavior, and other elements, as taking centuries to change.

Level 2: Institutions

The second level constitutes the institutional environment, where the formal constraints and enforcement rules are specified. Institutions are used in a broader sense, and the nature of polity, state, constitution, and others constitute the main elements of the institutional environment. By its constitution and laws, the state defines the individual's human and political rights and specifies the fundamental rules of ownership and exchange of property rights. This level's prime focus is on defining and enforcing property rights and contract laws of exchange. To enact and enforce these laws, public institutions like the legislature, executive, judiciary, and bureaucracy are needed. At this level property rights economics, as well as the theory of state and/or positive political theory, are used to explain the nature and role of institutions in relation to economic performance.

Williamson calls an institutional environment that can get "the rules of the games right" as "first-order economizing."²⁰ A conducive environment might involve the separation of powers in a constitutional state. Specifically, the nature and relationship among such institutions as the executive, judiciary, and legislative will determine first-order economizing. Societies can choose to set up different institutional environments within the framework of embedded cultural values discussed in the first level (analyzed above). Williamson anticipates that the time needed to change an institutional environment can range from a decade to a century.

Level 3: Organizations

Organizations are groups of individuals with a common purpose: to achieve certain goal(s).²¹ This level deals with governing contractual relations within organizations. Among the important types of organizations are enterprises that produce goods and services. While their objectives may vary, all of them incur various operating costs. Other than the direct transformation costs incurred during production, transaction costs arise when enforcing contractual obligations and measuring what is being exchanged.²² Although such costs have many dimensions, some specific costs arise while contracting between a principal and an agent in the framework of an organization.²³ In addition to the

ex ante costs of contracting, the costs related to enforcing a contract can be in the nature of compliance costs, enforcement costs, and/or measurement costs. One of the main features of governance at the organizational level is reducing the costs of transactions in the economy.

The effects of formal and informal constraints on behavior depend on the rules' enforcement structure. One aspect that determines this particular structure and, as such, transaction cost is the people's perceptions regarding the enforcement of laws (and the reward/punishment thereof). People behave differently under the same rules depending on their perceptions of how the rules and laws are enforced. Thus, the enforcement structure of contracts is an important determinant of transaction costs in an economy.

At the organizational level, second-order economizing would constitute getting the governance structure right so that transaction costs are minimized within organizations. Note that the compliance costs can be greatly reduced if the society has reached an ideological consensus on widely accepted compliance features. In such a case, people would comply with contracts as a matter of a code of conduct or habit. Specifically, the presence of correct moral and ethical values (e.g., honesty and sincerity) would make parties comply with a given contract's terms and conditions and thereby reduce the compliance, enforcement, and measurement costs.

In the absence of such compliance, however, costly retaliatory measures are required either by the aggrieved party or state (institutions) to enforce contracts. To complement the ideological element, reducing compliance costs would require, among other things, an efficient political and legal structure. Thus, contracts used by organizations and the enforcement regimes together determine different costs and economic performance. Williamson asserts that changing the governance structure in terms of devising new contracts and enforcement mechanisms in an economy may take from one year to a decade.

Level 4: Markets and Transactions

The last level of analysis is that of transaction in which economic agents make optimal choices under different constraints. At this level, resources are allocated in the economy as economic agents make optimal choices in markets under formal and informal constraints. This level can be analyzed in two perspectives. The first one studies how individuals choose, given scarce resources, to meet certain goals. In these cases, the economic agent's (consumer or producer) optimizing behavior and interactions in the market are analyzed. The second perspective, looking at transactions as a "nexus of contracts," examines the interactions in the economy and focuses on the

transaction costs to explain, among other things, the nature of the contracts used in exchanges.

Most of the agents' self-centered choices and strategies can be studied via neoclassical analysis. In these discussions, third-order economizing would constitute getting the marginal conditions right in order to obtain efficiency in the economy. Altruistic choices can be explained by the individual's ideological beliefs and convictions. Thus, actions are determined and constrained by the country's laws and rules on the one hand, and by the society's norms, customs, and values on the other. Note that even with the same resource endowments, different values and convictions in societies will produce different choices and actions by individuals. As for the timeframe, transactions occur continuously over time.

Knowledge and Economies

The NIE framework provides insight into how different levels of social analysis interact and how economies transform and change over time. Although many factors affect the structure and growth in economies, this paper focuses on the role of knowledge in an economy. De Long and Fahey distinguish between data, information, and knowledge. While data is "raw and unabridged descriptions or observations about past, present and future worlds" and information is "patterns that individuals find and imbue in data," knowledge is "a product of human reflection and experience."²⁴ The United Nations Development Program (UNDP) defines knowledge as "the sum total of symbolic structures possessed by individual human beings or by society at large."²⁵ At the level of society, it distinguishes between knowledge wealth ("the sum total of knowledge assets, or symbolic structure in society"), knowledge capital ("part of knowledge wealth used in producing new knowledge"), and effective knowledge ("knowledge that is widely disseminated, absorbed and used").²⁶

Under the NIE approach, knowledge is embedded in institutions, organizations, and products and, as such, plays a key role in defining and explaining changes in economic structures. Roland asserts that like technology and the embodiment of a society's stock of knowledge, cultures also entail knowledge that produce, among other things, political and social innovations.²⁷ Diner, who provides an amplified view of knowledge and culture, argues that "a civilization's future hangs on whether it is able to fulfill the requirements to create and sustain a mature culture of knowledge."²⁸

Knowledge plays an important role in defining institutions. Melody maintains that institutions are "described according to their information characteristics" and can "die when the incentive or the ability to maintain the

information flows and communication links ceases.”²⁹ Similarly, the NIE approach to organizations takes the “resource-based view” and includes knowledge as an important resource.³⁰ Accordingly, a knowledge-based firm is viewed as one that creates, organizes, and uses knowledge and then embeds it in its “routines, systems, and tools.”³¹

While change can be initiated at any of the four levels discussed above, two processes that result in the different paths of economic structures and change are discussed below.

The Evolution of Economic Structures

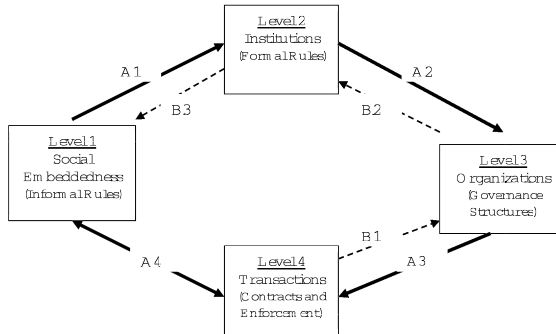
Although there is a discussion on the extent to which embeddedness affects economic activities, NIE contends that culture plays a key role in determining a given economy’s structure and growth.³² Williamson discusses the changes in economic structure as an evolutionary process initiated by changes in culture.³³ This top-down change in economic institutions is brought about by altering the ideology, cultural beliefs, and associated changes in the behavior of individuals as regards the economy. This transformation is brought about by changing the stock and growth of knowledge. North links the people’s ability to process and utilize information to culture, which, in turn, determines the existence of institutions and the people’s ability to understand the evolution of societies.³⁴ Thus, expansion in the body of knowledge at the cultural level is necessary to introduce new institutions and organizational structures.

The rate of learning determines the speed of change; the kind of learning determines its direction.³⁵ Specifically, Roland identifies the linkages of political institutions with the evolution of knowledge and culture.³⁶ The resulting nature of the institutions (e.g., constitution and laws) determines the formal rules that define, among other things, the concept of property rights and the boundaries and nature of organizations. Once new institutions are in place, they affect the rules governing the games in the society and the nature of organizations. Note that a necessary condition for organizational change under the evolutionary approach is that its initiation should be rewarding. The expected rewards and their valuation will also depend on cultural beliefs.³⁷ Given these formal and informal rules, individuals will make optimal choices based on their resource constraints.

If cultures fail to generate knowledge and adapt their informal and formal rules to these newer realities, then these societies will become trapped in a stagnant institutional milieu. North asserts that “societies that get ‘stuck’ embody belief systems and institutions that fail to confront and solve new problems of societal complexity.”³⁸ The evolutionary process emanating from

culture (level 1) and going down to the transactions level (level 4) is shown by arrows A1, A2, and A3 in figure 1.

Figure 1: Economic Change in an Institutional Framework



Marginal Changes under an Existing Institutional Structure

Change under an existing institutional structure is a bottom-up process that originates at the transactions and organizational levels (levels 4 and 3, respectively). It can arise either because there is a change in some exogenous factors (e.g., tastes and preferences) or due to the acquisition of new technologies, learning, and skills. Introducing new products and services may also require crafting/altering new contracts at the transaction level. The entrepreneur either changes existing organizations or establishes new ones to extract profit opportunities in niche markets.³⁹ The effect of transactions (level 4) on the organizational structure (level 3) is shown by arrow B1 in figure 1.

Although in some cases new contracts and organizational formats will comply with the existing institutional regime (given at level 2), there may be circumstances in which new contracts/organizations cannot be devised under the current formal laws and regulations. In such cases, there may be a need to alter some elements of the institutional setup and formal rules to accommodate these new transactions/organizations. This will be possible if the institutional environment is responsive and able to accommodate the entrepreneurs' new initiatives and demands.⁴⁰ Greif identifies a self-enforcing system as one possessing flexible behavior and organizations that can perpetuate institutions when the environment changes over time.⁴¹ The organizational structure's (level 3) influence on the institutional environment (level 2) is shown by arrow B2 in figure 1. Note, however, that this type of change has only a marginal impact on the economy's overall structure, as most of the original institutional environment remains intact.

The Knowledge Base in Muslim Societies: A Historical Overview

The evolutionary approach to economic structures outlined above asserts that culture determines a given society's stock and growth of knowledge, thereby reflecting its values and ideology, which, in turn, determines the corresponding institutions and organizations. Changes in institutions and organizations originating at the cultural level will reflect the society's values and ethos. As the fundamental changes in economies depend on creating knowledge at the level of culture, there is a need to examine this aspect in Muslim societies. A brief historical account of the evolution of the nature and growth of knowledge in Muslim societies is outlined next.

The Stock and Creation of Knowledge in Muslim Societies

Islam, a comprehensive religion that encompasses all aspects of life, provides rules and principles for mundane matters, including economic affairs. While the basic principles or doctrines of Islamic knowledge are given in the Qur'an and Sunnah, which together constitute the Shari'ah, these principles are interpreted to suit circumstances in various times and places through the process of *ijtihad*. Creating knowledge based on the Qur'an and Sunnah (called *fiqh*) has been the focus of Muslim society since its inception. Watt points out that an autonomous Islamic culture and body of knowledge evolved by assimilating Qur'anic studies with alien wisdom from the new lands that came under Muslim control.⁴² Muslims developed a great corpus of Islamic knowledge, one that included applying the Shari'ah to their problems. During this period, Islamic civilization made pioneering contributions to science, medicine, agriculture, industry, and philosophy. The result was a prosperous and developed empire that became "the bearer of the highest culture and civilization in the whole vast region from the Atlantic to Afghanistan."⁴³ With the supremacy of Islamic thought, organizations and institutions based on the Islamic creed (*'aqidah*) were established.⁴⁴ After reaching its zenith in the middle of tenth century, this civilization remained at a high level until the seventeenth century.⁴⁵

Ever since then, however, Muslim scholarship has been in decline. AbuSulayman claims that this is the result of the historical separation of Islamic intellectual leadership from political leadership, which caused the intellectuals to withdraw from public life.⁴⁶ As their isolation increased, they became very resistant to change in order to protect the Shari'ah from corruption. In doing so, they deliberated exclusively on events that had occurred during Islam's early years, thereby causing the progress of knowledge generation

to stagnate. The subsequent focus on problems from narrow perspectives and giving purely lexical interpretations of the Qur'an and Sunnah resulted in closing the door of *ijtihad* and engendering the stagnation of Islamic scholarship. Islamic thought became "distinctly retrospective, lost in faint recollections of times past and the adoration of sacred relics."⁴⁷ By ignoring the realities of material development, the failure of Muslim scholars to address the needs of people and society led to the Muslim world's social and political decline. The Muslim mind lost its "ability to give birth to new ideas, to update its institutions, and to produce the planning, means, and policies essential to further progress at the civilizational level."⁴⁸

This decadence was hastened by Europe's colonization of most Muslim lands. Abul-Fadl points out two interrelated and simultaneous phenomena that acted as a catalyst for the decay⁴⁹: The imperial powers introduced their foreign institutions and values, and at the same time denied the Muslims' indigenous counterparts the opportunity to evolve. Thus the public and collective perceptions were transfigured and began to diverge from the existing individual or personal psyche. Individuals had to adjust their personal values to the new public loyalties and perceptions. Another result of the value displacement at the public level was the Shari'ah's shrinking application in this space.

And so the values that had earlier been in the public or collective domain were relegated to the private or personal domain. Islam became marginalized as a private relationship between an individual and his/her God, a religion that had no place in the economic and public life of the state and legislation. Given this backdrop, the next section discusses the status of the Shari'ah in modern times and presents examples of the non-development of effective laws related to organizations.

Stagnant Knowledge and Inappropriate Legal Institutions

While Islamic knowledge languished for about three centuries, Europe experienced dramatic changes whereby political systems evolved from empires to nation-states and economies were transformed from feudalistic to capitalist ones. These alterations brought about profound changes in its societies' institutions and organizations. North identifies three features of what he calls a "revolution" from an institutional perspective⁵⁰: an increase in the production of scientific knowledge, an enlarged knowledge base that facilitated an industrial revolution consisting of remarkable transformations in the modes of production and organizational formats, and the establishment of a legal framework in which various laws related to new economic realities (e.g., property rights, or-

ganizations, patents, and anti-monopoly laws) were enacted. These laws provided a legal environment in which innovation and economic activities could occur and flourish.

As the Muslim world could not generate the Islamic knowledge required for a changing world, it could neither establish new institutions and organizations nor prevent the stagnation of its existing ones. As a result, Muslims had to adopt and then adapt western institutional models and organizational formats to meet their needs.

To show the impact of dormant knowledge on contemporary institutions in Muslim societies, cases related to legal institutions that have implications for economics are discussed below. The first example recounts how the Muslim world's lawmaking process was severed from Islamic knowledge via the transfer of legal authority from scholars of the Shari'ah to the state. The second case shows the inability of torpid scholarship to produce Islamic organizational law. The third and final example discusses how outdated and inert *waqf* law is impeding this important sector's growth in Muslim economies.

The Lawmaking Process: The Shari'ah's Diminished Role

As Islamic law is derived from the Qur'an and Sunnah using certain legal rules and methodologies, it requires the possession of both knowledge and scholarship. Therefore, making laws has traditionally been in the hands of Shari'ah jurists and scholars, meaning that the caliph/ruler had no legislative authority and that the state did not determine the law.⁵¹ Although judges (*quḍā'*) were knowledgeable about the Shari'ah and *fiqh*, their task was not to formulate the law, but to apply it. This trend continued for about twelve centuries, during which Islamic law was mainly independent of state control.

Closing the door of *ijtihād*, however, led to the ossification of Muslim ideas and knowledge. As a result, laws could not be updated based on the Shari'ah and the legal authority gradually moved from the scholars to the state. This transformation started in the Ottoman Empire during the nineteenth century, when legal councils comprised of both religious scholars and scholars trained in modern European laws were established. These councils were responsible for preparing the laws that were then promulgated by the sultan.⁵² Also during this period, the process of codifying *fiqh* was also undertaken under the influence of civil codes belonging to the European legal system. In 1877, the Ottoman caliphate adopted the *Majallah*⁵³ as a collection of legal rules dealing mainly with commercial transactions.

This event represented a turning point in the history of Islamic law and had far-reaching implications. Not only was a codified law based on classical

fiqh literature made the law of the land, but it was also the first time a sultanic legislation was considered part of Shari‘ah law. An important epistemological implication of this phenomenon was that the law’s makers and users cut their links with the traditional and historical sources of knowledge (the Shari‘ah and *fiqh*), which implied that the judges no longer needed to be Shari‘ah scholars and diminished the comprehensiveness of *fiqh*. This codification initiated the establishment of law schools (*mekteb-i hukuk*) to train judges⁵⁴ and culminated in establishing secular courts. This process became the pattern in the rest of the Muslim world in the following decades.

After many Muslim colonies became independent nation-states during the middle of the twentieth century, many of their leaders and elites adopted the laws and legal systems of their former colonizers. While in most Muslim countries the sphere of personal and family law remains Islamic, the bulk of commercial law is western. Given the secular nature of laws and the lawmaking processes, the legal systems in most Muslim countries are now disconnected from the Islamic sources of knowledge. Moreover, secular commercial law regimes create an environment that is not conducive to developing economies based on Islam’s principles and ethos.

Organizational Law: The Absence of an Islamic Alternative

During the institutional revolution, one of the developments in the legal institutions was the enactment of organizational laws in general and of corporate law in particular.⁵⁵ Corporate law grants a company the status of a legal entity with limited liability, thereby giving it the authority to initiate contractual arrangements with various agents to achieve its goals. Organizational law, however, does not appear in the traditional corpus of Islamic law.⁵⁶ Although the concepts of enterprises and partnerships do exist in Islamic law, they fall under the category of the law of contracts. For example, various types of partnerships (*sharikah*) can be forged between participation agents under profit/loss sharing (*musharakah*) contracts. Cizakca reports that during the later part of the Ottoman period, joint-stock companies did not exist in the empire because most of the businesses were small and used traditional partnership contracts in their original forms.⁵⁷

This absence of a comprehensive Islamic organizational/corporate law has led most Muslim countries to adopt either the civil or the common law variations of the law. Specifically, ex-British colonies inherited the British joint-stock company laws, and many other (particularly the formerly French colonies) Muslim countries adopted French-based civil laws. For example, even though one of the fundamental principles enshrined in the United Arab

Emirates' constitution is that Islamic law is the main source of legislation, the country adopted a French-based classification of companies similar to the Egyptian civil code.⁵⁸ Iraq, Lebanon, and other Muslim countries have also incorporated elements of both the French legal code and English corporate law.⁵⁹

This failure to create organizational law can, in fact, be traced to the non-development of jurisprudence on various aspects of these new enterprises. This is apparent when one observes that the *Majallah*'s classification of businesses (e.g., *shirkat-i-'aqd*, *shirkat mufāwāḍah*, and *shirkat 'imān*) is similar to those of the classical era.⁶⁰ Only in recent times have some scholars sought to discover the concept of legal entity in classical *fiqh* to support the entity known as a corporation.⁶¹

Contemporary resolutions by Shari'ah boards/academies have determined that a modern corporation is a legitimate form of organization. The Islamic Fiqh Academy (IFA) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) have agreed that a company has a legal personality through its incorporation by law.⁶² These rulings establish a corporation as an independent legal entity, thereby separating its liabilities from its shareholders. A corporation's capital can be partitioned into equal units of tradable shares. The company's liability is limited to the paid-up capital, and each shareholder's liability is limited to his/her share in the capital. The company cannot be unilaterally terminated by one party or a minority of its shareholders. A shareholder, however, can sell his/her shares to others. New shares can be issued at the fair value of old shares, at a premium or discount of their nominal value, or at the current market value. The company is also subject to the jurisdiction of its place of incorporation.

Contemporary Shari'ah scholars have accepted the corporation as a legal entity, and yet there is still no detailed Islamic organizational/corporate law. For example, no IFA or AAOIFI resolutions contain an explicit mention of the shareholders' rights as found in the contemporary corporate law framework. In fact, the AAOIFI has only fifteen Shari'ah rulings related to a stock company, four of which are related to prohibitions.⁶³ Although capital providers can make the manager (*muḍārib*) liable for losses in cases of dishonesty and misconduct, as well as negligence or breach of contract,⁶⁴ details as to how shareholders can control the firm in order to minimize expropriation are not discussed.

Waqf Laws: *Inefficient and Rigid*

Historically, *waqf* (pl. *awqāf*) played a vital role in extending social services and improving the overall welfare in Muslim societies in such spheres as

public utilities, education and research, and health care. In addition, these funds could be in kind (e.g., grains to be used as seeds), to make loans to people in need, and to provide services and supplementary income to low-income earners.⁶⁵ Today, however, there is a general feeling that many such institutions have stagnated and are no longer performing their designated function of enhancing social welfare and alleviating poverty. Not only are these assets unproductive and a drag on the economy, very few (if any) new ones are being established to benefit the society.

One institutional cause of this dismal state of affairs can be traced to existing *waqf*-related laws, specifically to Islamic jurisprudence (*fiqh*) and the laws of countries that govern *waqf*. Traditional rules included perpetuity, irrevocability, and inalienability.⁶⁶ Any dedication had to be perpetual and irrevocable. As the donor's ownership of the asset ceased after its dedication, it became inalienable and thus could not be inherited, sold, mortgaged, or gifted. Earlier rulings also contended that any such donation had to be tangible. There is a contention that this sector stagnated because the relevant jurisprudence was too rigid and unresponsive to changing socioeconomic conditions.⁶⁷

While the related *fiqhī* rules were restricted in the past, contemporary resolutions appear to be more flexible. For example, a landmark 2009 IFA ruling stated that many moveable and intangible items (e.g., money, bonds [*sukūk*], shares, benefits, and services) could now be considered *waqf*.⁶⁸ Furthermore, any such dedication could be either permanent or temporary in nature, according to the founder's decision. But although this jurisprudence appears to have become more flexible in recent times, it has had no impact on the sector's growth as the laws of different countries continues to define the nature of *waqf* that can be established within its borders.

Some Muslim-majority countries (e.g., the Gambia) have no *waqf* law, which means that such entities cannot be legally established there. Other countries do have such a law, but it might be outdated or irrelevant to contemporary reality. If laws related to different types of nonprofit organizations (NPOs) exist in a single country, differences in their efficiencies and flexibilities can create legal asymmetries. If legal asymmetries exist, they can give rise to incentives for legal arbitrage, whereby the organizational format with the least cost and burdens is chosen.⁶⁹ Thus, if a *waqf* is difficult to establish due to more stringent law relative to other organizational laws, people will opt for other legal organizational formats. Among others, issues such as the extent of government interference in various matters of operations, the relative operational benefits, and the flexibility in the laws in terms of enabling and promoting growth of different NPO types will determine the choice of organizational format.

An examination of the legal regime of NPOs in Bangladesh sheds light on the legal environment under which a *waqf* operates relative to other NPO types. While these NPOs can be registered as a society, a social welfare organization, and a nonprofit corporation, conceptually a trust is closest to this specific charitable institution. When the laws of *waqf* and trust are compared, the legal asymmetry between them becomes apparent.⁷⁰ For example, a trust remains in the private domain and its trustee is accountable to the beneficiary and liable for any losses due to breach of trust. *Waqf* law, however, makes the manager (*mutawalli*) accountable to the Office of the Administrator (a government body), which is tasked with closely monitoring and interfering, when necessary, in the *waqf*'s administration.

In addition to the government's dominance, there is an extra burden of a 5 percent tax on the *waqf*'s income – a tax that trusts do not have to pay. Furthermore, a trustee has more managerial freedom than does a *mutawalli* under the laws of the country. For example, a trustee has the authority to convert an asset in order to either develop it or prevent it from getting lost. This cannot happen in the case of a *waqf* without the Office of the Administrator's prior approval. Legal asymmetry in *waqf* and trust laws creates incentives for legal arbitrage and can explain why most contemporary NPOs in Bangladesh have opted for non-*waqf* organizational formats.

The Islamization of Economies and Knowledge Creation

As asserted by Hayek, one of the key elements of designing an efficient economic system is to identify the best way in which knowledge is dispersed and utilized among people.⁷¹ Thus, Islamizing economies in light of NIE would require the creation and use of knowledge that produces appropriate institutions, organizations, and transactions. As discussed above, however, Muslim countries inherited the institutions of their ex-colonizers along with an incomplete and torpid version of Islam. AbuSulayman detects two dominant trends that appeared in the thought processes of contemporary Muslim countries.⁷² First is the imitative foreign solution that borrows solutions from foreign sources, particularly from their ex-colonizers. These solutions are based on the cultural and historical experience of the contemporary West and are manifested in individualism, the separation of state and religion, capitalism, socialism, and other areas. These approaches are, for most part, secular and devoid of religion.

The second solution adopted by a few religiously conscious scholars is the imitative historical solution, which relies on solutions derived from the Is-

lamic historical experience without scrutinizing its relevance to time and space. In deriving solutions, Muslim scholars insisted on returning to the vision of the “golden age” and, as such, remained prisoners of those concepts and basic approaches that caused the thought process and growth of knowledge to stagnate. Qaradawi identifies the knowledge produced by Muslim scholars as “semi-knowledge,” for it focuses on marginal and trivial issues.⁷³ As insight and vision are absent from this semi-knowledge, it failed to see the overall relationship between the parts and the whole. Lewis maintains that the system of education in the Muslim world taught people a finite set of information, rather than critical thinking and evaluation.⁷⁴

In the absence of creating the Islamic knowledge needed to mold contemporary economic institutions and organizations, Islamizing economies in the Muslim world took the marginal adaptation approach. This is evident when one observes that even the basic elements of an Islamic economy (e.g. *zakat*, *waqf*, and *hisbah*) could not be revived in a robust way in most countries. As mentioned above, the implementation of Islamic economics only occurred in Islamic banking and finance.

Although this sector has been growing at a fast pace, questions have been raised regarding the path it has taken. The practice of Islamic banking has been accused of mimicking the practices of conventional banking too closely and not fulfilling the objectives of the Shari‘ah.⁷⁵ Due to the scarcity of knowledge required to develop appropriate organizational formats that could deliver equity-based Islamic financial products, Islamic banking adopted the format of the dominant debt-based conventional commercial bank.⁷⁶ Adoption of this organizational model is perhaps one of the reasons why Islamic banking practices have been sliding toward those of their conventional counterparts.

The Way Forward: Generating Islamic Knowledge

As the nature of institutions and the given economic structure depends on how society changes by accumulating effective knowledge, it is important to understand how human learning and the generation of knowledge occur. In line with the NIE framework, the UNDP identifies culture as one of the most important determinants of a knowledge-based society.⁷⁷ North maintains that knowledge is acquired through primary and secondary socializations.⁷⁸ The former source of knowledge is passed on from families, and the latter is learned in such institutions as schools, religion, and the overall socioeconomic and political environment. He further asserts that the source of creative thinking that affects belief systems and ideologies arises from “representational redescription.”⁷⁹ This process entails, among other factors, the ability to gen-

eralize from the particular to the general and to use analogy to analyze new realities. The learning process implied here is comprehensive, as it includes not only the current experience but also the cumulative stock of knowledge reflected in the culture.

Ferguson identifies four ways in which change can take place when new and conflicting information comes forward.⁸⁰ The least disruptive is change by exception, in which new information introduces minor variances without disturbing the existing belief system. Incremental changes occur when information gradually induces minor changes of which individuals are unaware. Pendulum change, defined as a state of disorientation in which one moves from one state of information to another, is the result of disappointment with an old structure due to incomprehension and the failure to differentiate the value of the new scheme from its rhetoric. The final change is the paradigm change, in which change in information is holistic and thus affects individuals and the society. This change is possible if the information is logically consistent and integrated to form a new information structure. Ferguson asserts that while the former three kinds induce changes in the information content, only a paradigm change introduces transformation in the information structure. Thus, change in knowledge brought about by paradigm change will be instrumental in changing the institutions so that a new economic structure can emerge.

The above discussion indicates that in order to Islamize economic structures, comprehensive and paradigm changes are required in the sphere of knowledge creation. In the light of NIE, this will require two major strategies. The first would be to reorient cultures of Muslim societies toward this goal by moving the existing cultural traits, values, and norms toward seeking and creating new knowledge based on the Islamic value system and worldview. To accomplish this would require, among other achievements, revising and refining both the primary and secondary levels of the socializations pointed out above. As changing cultural traits is a complex and difficult process that can take a long time, it can be hastened with a strong resolution, concentrated effort, and using plenty of resources. The incentive structures at the institutional and organizational levels should also be supportive of this endeavor.

The second strategy relates to Islamizing the knowledge in those areas relevant to the different levels of analysis of NIE. In order to have the appropriate institutions, organizations, and products of an Islamic economic system, the existing stock or wealth of Islamic knowledge must be increased via enhancing the knowledge capital that can produce the appropriate effective knowledge. Different types of learning and research affect the growth and stock of knowledge on which new institutional entities can be based. The Organization for Economic Cooperation and Development (OECD) identifies types of research

as basic, applied, and experimental development.⁸¹ Kim and Oh have devised a similar classification: basic, applied, and commercial research.⁸² As basic knowledge is a prerequisite for applied knowledge, and the latter is a source of the former, developing an Islamic economic system according to the Shari‘ah’s principles and goals would require input from all three types of research.⁸³

One core reason for the lack of an Islamic economic system that reflects the spirit of Islamic law is the deficient foundational basic and applied knowledge. Basic research in Islamic economics would include theoretical work on such fundamental concepts as the overall goals of Islamic law (*maqāṣid al-shari‘ah*), legal methodology (*uṣūl al-fiqh*), jurisprudence (Shari‘ah and *fiqh*), and their applications to contemporary economies. For instance, while the principles of *maqāṣid* are well-known, their implications at the institutional, organizational, and product levels are not understood and still require extensive research. Similarly, applied research should produce appropriate models of legal and regulatory systems and organizational formats for an efficient and just Islamic economy.

From a NIE perspective, the multidisciplinary and comprehensive nature of economies imply building a stock of Islamic knowledge in numerous areas and at different levels. Other than undertaking research in Islamic economics, Islamic knowledge must be developed in several areas, such as a theory of ideology and social theory (the cultural level); a theory of state and positive political theory, legal theories including constitutional law (the institutional level); theories of organizations and transactions cost theory (the organizational level); and a theory of contracts and incentive structures (the transaction level).

Conclusion

The paper links the problem of Islamizing economies directly to the failure to Islamize knowledge. Using the NIE framework, the paper shows that the economic structure and its evolution depend on how societies produce knowledge that reflects their values and worldview. Specifically, the stock and growth of knowledge determines the nature of institutions, organizations, and transactions in different societies. Knowledge production based on an Islamic ethos has been stagnant in the Muslim world for about three centuries. The resulting vacuum prevented the establishment of Islamic institutions and organizations. As a result, the economies of Muslim countries adapted alien institutional structures that were void of Islamic values. The push for Islamizing economies without the necessary knowledge base and appropriate economic structure led to adopting a marginal adaptation approach. This resulted in the creation of Islamic sub-economies under an overall conventional institutional environment.

The NIE framework indicates that Islamizing economies would require a massive endeavor of Islamizing knowledge as regards various aspects of institutions, organizations, and products related to modern economies. The speed at which economies could be Islamized depends on the rate at which Islamic knowledge can be produced. Specifically, there is clearly a need to invest in knowledge capital that can produce the effective knowledge required to support such a system's institutions, organizations, and products. While this would require further interdisciplinary research in various areas, it cannot be accomplished without undertaking the challenging, complex, and lengthy task of prodding the cultural traits of Muslim societies toward seeking, creating, and using new knowledge based on the Islamic value system and ethos.

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