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Islamic Economics and Economic Development

Kjetil Bjorvatn

1. Introduction: Islamic Economics and Economic Fundamentalism

Islamic economics is part of the Islamic fundamentalist movement gaining ground in large parts of the Muslim world. Various shades of fundamentalism have always existed in Islam. But the attention around Islamic fundamentalism, as well as the number of supporters, received a great boost after the Arab nations' defeat against Israel in the Six-Day War of 1967. Many Muslims felt that this humiliating defeat was caused by the Arabs turning away from God and embracing foreign ideologies such as communism or capitalism – ideologies which are viewed as inherently opposed to Islam and therefore unable to solve the problems of the Muslim world. The fundamentalists call for a return to Islamic law, the *Shari'a*, which is believed to offer solutions to economic and social problems of all times and all places. This message naturally has great appeal in many Muslim countries, due to widespread poverty, inequality and unemployment. Islamic scholars point to the military and economic success of early Islamic society to prove that adherence to Islam may bring about great material achievements. It is claimed that this success was caused by religious inspiration and high moral standards among people in those early days of Islam.[1]

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Due to its emphasis on political action, the fundamentalist movement is sometimes referred to as 'Political Islam', and its supporters as 'Islamists' rather than fundamentalists. I shall not go into the discussion on the proper label of the movement or its members here. For the most part, fundamentalism and fundamentalists will be used since these concepts are well established at least in popular debate.

The demand for Islamisation of society has found many expressions, such as the veiling of women, segregation of the sexes in public life and banning of alcohol. Islamisation of economic life is certainly not the most visible expression of Islamic fundamentalism. Still, the rapid growth of Islamic banking in the Middle East, North Africa and East Asia has attracted some attention and is a matter of great prestige to the Islamic movement. Islamic banking is based on the Koranic prohibition against *riba*, which may be interpreted as usury but which most Islamic scholars understand as interest. I will return to this issue later in the article.

Islam is not the only religion with a fundamentalist economic agenda. Indeed, there are striking similarities between the economic analysis of fundamentalist movements in Christianity, Bhuddism and Hinduism.[2] Their common denominator is the view that economic and social problems are the product of a moral decay which must be countered by a moral reform on all levels of society. Norms such as solidarity and honesty are viewed as prerequisites for social stability and balanced economic growth. Secular economics is rejected as immoral or at best amoral, since market competition is believed to make people selfish and less concerned with helping those in need. Nevertheless, while the ideological foundation is similar, Islam is without comparison the champion of fundamentalist economics today. Islamisation of society is official policy in several countries with a predominantly Muslim population, and fundamentalism is a powerful source of opposition in Muslim countries with a secular regime.

The first part of the article focuses on the first concept in the title of the article, namely 'Islamic economics'. In practical terms, the implementation of Islamic principles has been limited to eliminating interest from financial transactions. In evaluating the effect of Islamic economics on economic development, I therefore concentrate on the Islamic ban on interest, and consider the performance of the Islamic banks in both religious and economic terms. The main conclusion is that Islamic banks have not eliminated interest from their operations. From a religious point of view, then, the success of Islamic banking has been limited. And precisely because the transformation of the banking system has been rather superficial, the impact on economic development of Islamic banking has most likely been limited.

In the second part of the article, the focus is on the second concept in the title of the article, namely 'economic development'. I point at evidence from development theory demonstrating that interest-free loans and other forms of gift exchange are common institutions in traditional, rural societies in poor parts of the world today. Economic development, however, challenges these informal institutions, for a variety of reasons. Similarly, the viability and success of the Islamic scheme of interest-free banking can be expected to be far greater in a traditional, rural setting, relative to a modern, urbanised environment. Section 4 concludes with the recommendation that Islamic banks be implemented as rural development banks.

2. Islamic Banking

In discussing the impact of Islamic economics on economic development, I take a rather narrow view of Islamic economics, and focus on the Islamic ban on interest.[3] Such a narrow approach may be justified for three reasons. First, the general Islamic norms of altruism and honesty are common to most ethical systems, religious and non-religious. This is not to say that such norms are unimportant for the market economy. My point is simply that these general norms cannot be expected to influence economic development in a Muslim country in other ways than they affect economic development in a non-Muslim country. Second, the ban on interest is the only issue where there is some degree of consensus amongst Islamic economists. Third, and perhaps as a result of the second point, the interest ban is without comparison the Islamic economic issue that has attracted the most attention from both supporters and observers of Islamic economics.

Based on the Koranic ban on interest, Islamic banks have been established in more than 50 countries, particularly after the increase in oil prices in the early 1970s, and mainly in North Africa, the Middle East and South Asia.[4] In a few countries, interest has been eliminated altogether from the banking system, at least on paper. Before presenting Islamic banking in theory and practice, I shall discuss the basis for the interest ban, and compare the Islamic tradition with the Jewish and Christian ones in this respect.

2.1. The prohibition of interest

The source of the Islamic ban on interest is the Koran. What the Koran actually forbids is something called *riba*. There is some controversy regarding the true meaning of *riba*, even among Muslim scholars. Literally *riba* means 'increase' or 'excess'. Some translate it as usury, in other words a rate of interest which in some sense is unreasonably high. But the majority of Islamic scholars understand it as interest, that is, any predetermined return on a loan. In the discussion that follows, I shall deal only with this majority view, and interpret *riba* as interest, and treat interest and usury as synonyms.

The ban on usury, or interest, forms part of the more general Islamic vision of a moral economy. As the following verses in the Koran indicate, the ban on interest is directly linked to almsgiving and to the circumstance of the lender:

> God has laid His curse on usury and blessed almsgiving with increase . . . If your debtor be in straits, grant him a delay until he can discharge his debt; but if you waive the sum as alms it will be better for you.[5]

The terms of credit in the Arabian Peninsula at the time of Muhammad could be very harsh and suggest why usury is made the focus of attention several places in the Koran. Taking advantage of their market power, the commercial élite in Mecca frequently made use of the common practice of doubling the debt if the loan was not repaid when due. Usurious practices were therefore a visible sign of what Montgomery Watt (1968) describes as a 'weakening of social solidarity and growth of individualism' in Mecca at the time of Muhammad. Here I might add that at the time of the Prophet, the commercial élite in southern Arabia included a large number of Jews. Elsewhere in the Koran, God promises a severe punishment for those of the Jews who break their own prohibition against interest.[6]

It is interesting to note the similarity between the Jewish and Muslim tradition in this context. The ban on usury is mentioned several places in the Old Testament. And the intention of the Jewish usury prohibition is very similar to that of the Koran, namely income sharing:

> If you advance money to any poor man amongst my people, you shall not act like a money-lender: you must not exact interest in advance from him.[7]

Elsewhere in the Bible, in Deuteronomy 23, it is stressed that it is pefectly alright to demand interest on loans to strangers, that is, non-

Jews, but charging interest is strictly forbidden within the Jewish community.

Although the interest ban can be interpreted as a reaction against the breaking down of traditional solidarity networks, Islamic and Christian scholars in the Middle Ages developed more elaborate explanations for the prohibition of interest.[8] Islamic scholars explain the prohibition in the following way.[9] Projects of trade and production generate an income. A moneylender may be entitled to a share of this income, but only if he enters into a partnership with the entrepreneur. By entering into a partnership, the lender shares in the risk of the enterprise. And by sharing the risk, the lender is directly involved in the enterprise and may receive a share of the profits. This partnership model should be contrasted with the lender as a creditor, in which case the lender is not directly involved in the project, and therefore has no right to any share of its profits.

Certainly, the creditor is involved in the project to the degree that he runs the risk of the borrower becoming insolvent. Islamic scholars argue that this is not sufficient to justify a return on the money, since the risk of insolvency can be eliminated by demanding sufficent security for the loan. Profit and loss sharing, or risk sharing if you wish, is therefore essential to justify a compensation to the lender. Loans which do not create any verifiable value added, such as consumption loans, should be made without a return to the lender.

The medieval Christian usury doctrine developed along similar lines as the Islamic one. Thomas Aquinas and the Christian scholastics made use of both Aristotelian philosophy and Roman Law in arguing that interest was unnatural and against sound principles of property rights.

Economic development and growing international trade brought with it an increase in market transactions, such as interest-based banking. A first response to this challenge was for the medieval religious scholars, Christian as well as Muslim, to insist on the principle of the interest prohibition, but to allow interest in practice through a number of legal tricks. Yet another option was to let certain groups, such as the Jewish community, take care of banking, a solution employed in both Europe and the Muslim world.

The Christian Reformation attempted to bridge the gap between principle and practice, and brought with it a pragmatic approach to such issues as interest and the right to private property. Even Martin Luther, however, did not in principle approve of interest, but in practice accepted it as a necessary and beneficial institution for society (see Hyde 1979).

Even though Islam has yet to experience its 'Reformation', some leading Islamic scholars take a more pragmatic stance on the usury issue, for instance by accepting interest as long as it is not 'unreasonably' high. But the majority view amongst Islamic scholars appears to be a clear rejection of the right to take interest. One may therefore say that today's Islamic scholars continue the tradition of the Christian scholastics. They have developed schemes of interest-free banking which have been introduced in most parts of the world and, at least nominally, have been implemented comprehensively in Iran, Pakistan, and the Sudan.

2.2. Islamic banking in theory

As discussed above, the Islamic solution to finance without interest is profit- and loss-sharing arrangements, that is, partnerships where people participate in a project by sharing profits and risk.[10] According to this risk-sharing ideal, depositors buy shares in Islamic banks, while the banks buy shares in other companies or initiate joint ventures. The two main risk-sharing techniques are called *mudaraba* and *musharaka*, the main difference between the two being the degree of financial involvement by the entrepreneur. *Mudaraba* is an investment fund in which the entrepreneur contributes to the project with his time and effort only, while *musharaka* is a joint venture agreement in which the entrepreneur also invests some of his own capital in the project. Consumption loans should be interest-free.

In addition to profit and loss sharing, Islamic banks may use mark-up techniques such as service charges, and leasing operations. However, these financial methods are recognised as inferior from a religious point of view since they closely resemble interest. Take the following example: A customer approaches an Islamic bank, specifying a commodity that he wishes to purchase. The Islamic bank then buys this commodity worth, say, 100 riyal. After a certain period of time, for instance a year, the customer pays for the commodity including a mark-up of, say 20 riyal. The commodity's total purchasing price is therefore 120 riyal. The 20-riyal mark-up in this case is clearly equivalent to a 20 per cent interest rate.

But even though these mark-up techniques very much resemble interest, Islamic scholars are willing to accept such contracts since the banks, at least for a limited period of time, own the traded goods. It is argued that in this period of bank ownership the banks run the risk of the commodities being lost or damaged in transport, or the risk of the customer changing his mind and choosing not to buy the good after all. This element of risk is what makes the mark-up contract legal according to Islamic law.

The Pakistani Council of Islamic Ideology, which has been in charge of the design and implementation of Islamic banking in Pakistan, admits that 'there is […] a danger that the mark-up techniques could eventually be misused as a means for opening a back door for interest along with its attendant evils'. The Council therefore strongly recommends that 'their use as general techniques of financing must never be allowed'. [11]

To summarise briefly, the fundamentalist ideal of Islamic banking is to replace interest by profit- and loss-sharing contracts. Clearly, since interest is viewed as contrary to Islam, the fundamentalist goal is not only to offer Islamic banking as an alternative to interest-based banking, but rather to eliminate interest-based banking altogether. In evaluating Islamic banking in practice, I will therefore mainly deal with the situation in the three countries which have attempted to shape their entire financial systems according to Islam, namely Iran, Pakistan and the Sudan.

2.3. Islamic banking in practice

Central Bank statistics from the three above-mentioned countries reveal that profit- and loss-sharing contracts constitute around 30 per cent of total bank assets in Iran, about 15 per cent in Pakistan, and even less in the Sudan. The remainder of the banks' financial transactions, which means the large majority of contracts, are based on the religiously dubious techniques such as mark-up and leasing.

This is according to official statistics. The picture is even more discouraging for the supporters of the fundamentalist agenda if you look behind these data. During the summer of 1995 I conducted several interviews with employees in the Iranian Central Bank and other financial institutions in Iran. These conversations revealed that the Islamic ideal of risk sharing in practice hasn't been implemented at all in the Iranian banking sector. In fact, the contracts classified as profit and loss sharing in the Iranian Central Bank statistics are based on what is called a 'minimum rate of return'. Since any announced profit above this minimum level would amount to a gift from the entrepreneur to the bank, not surprisingly, the bank's minimum rate of return turns out to be exactly what the bank gets. For all practical purposes, this ex ante-determined rate of return is equivalent to interest.

The experience in Pakistan and the Sudan, and indeed in countries where Islamic banks operate side by side with interest-based banks, is entirely similar: Profit and loss sharing is hardly implemented at all.

Instead, Islamic banks base their operations on the religiously dubious mark-up techniques, known as *murabaha*. The back door for interest, which the Pakistani Council of Islamic Ideology warned about, appears to be wide open.[12]

Why then are Islamic banks so reluctant to enter into profit- and loss-sharing contracts? There may be several reasons, but I will focus on one very important explanation, namely asymmetric information between bank and entrepreneur. Consider the moral hazard problem. Imagine entrepreneurs approaching an Islamic banker applying for funds to finance a project on a profit- and loss-sharing basis, for instance on a 50-50 sharing rule. The banker's problem is that it may be very difficult, and at least very costly, to verify the true profitability of the various projects. This problem is particularly serious in developing countries where systematic accounting is rare, or where companies for reasons of tax evasion keep several accounts. There is clearly an incentive on the part of the entrepreneurs to underreport true profits and in this way reduce the transfer to the bank. This incentive to cheat makes banks reluctant to enter into joint ventures with entrepreneurs.

Due to the lack of success in implementing risk-sharing financial techniques, Islamic banking has not been a great success from a religious point of view. But what are the implications for economic development? Many observers, even those sympathetic to the idea of Islamic banking, point out that Islamic banks are reluctant to invest in long-term projects. These observers argue that by concentrating on financing of working capital and short-term trade in commodities, Islamic banks negatively discriminate long-term investment projects and therefore reduce the prospects for economic growth and development (see Iqbal and Mirakhor, 1987:23-4).

Although it is true that Islamic banks mainly deal with relatively safe short-term trade projects, I do not believe Islamisation as such can explain this fact, for two reasons. First, the moral hazard problem has nothing to do with Islam. If the banks, due to lack of information choose to concentrate on relatively safe, short-term projects such as trade finance, they would have done so also if the banking sector was not Islamised. In fact, to the extent that Islamisation of society leads to increased awareness of Islamic values such as honesty, the moral hazard problem should be reduced. Second, we have seen that interest is eliminated only in name. Islamic banks operate almost exclusively on what may be called 'Islamic interest', that is, interest in an Islamic disguise, such as the mark-up techniques and the minimum rate of return. Sometimes there is no disguise at all, which is the case for interbank loans and loans to the Central Bank which are openly based on interest. There is, therefore, no reason to believe that Islamisation of the banking sector in practice has had any great impact on economic performance in general or economic development in particular.

The short-term project concentration in the Islamic countries can be more readily explained by reference to a general economic slow-down and political uncertainty, both of which tend to discourage long-term investment. Islamisation may, of course, contribute to the economic slow-down and political instability, for instance because fundamentalist rule tends to scare away the rich and clever. My point is that Islamic banking, as we observe it in these countries today, has not been an important factor in slowing down economic growth.

3. Is There a Role for Islamic Banking?

Given the apparent difficulties in applying the Islamic principles of banking in practice, one can ask whether at all interest-free banking has a role to play in today's world. My answer to this question is in the affirmative: Islamic banking may indeed play an important positive role in stimulating economic development. But in order to play this positive role, the scope of Islamic banking in the economy should be reduced, relative to the amibitious plan of Islamic fundamentalism. Rather than attempting to eliminate interest from the entire financial system, the principle of profit and loss sharing should be applied to the more traditional, rural areas in the Muslim world. In this way, Islamic banks should play the role of rural development banks.

Experience from the Sudan seems to indicate that Islamic development banking in the rural area has been rather successful. Stiansen (1995) reports that two of the Islamic banks in the country have been involved in *musharaka* partnerships with small-scale farmers, in which the banks supply the necessary financial and physical capital in return for a share of the harvest, in other words, a share-cropping agreement. There are three reasons why I believe banking based on profit and loss sharing is more likely to be successful in rural areas than in modern cities.

First of all, cheating is likely to be less of a problem in small, transparent societies such as rural communities. The value added of an agricultural project is probably relatively easy for the parties to observe, in particular if the bank is located in the area.

Second, rural people may be more concerned with religion than the urban population. These people may therefore be unwilling to place their savings in or borrow money from conventional, interest-based banks. Financial institutions with an Islamic profile may therefore be necessary in order to integrate the rural population into the national financial system.

Third, the need for Islamic banking as a means of improving income distribution may be greater in rural communities. When informal social security networks break down, as they do from time to time due to, for instance, natural disasters, people often depend on local moneylenders who may demand extremely high rates of interest. This is usury in the true sense of the word. Establishing small-scale Islamic banks in the rural areas provides an alternative source of finance to people in need.

The claim that Islamic banking may be more viable in the less developed sectors of the economy, typically the rural sectors, may find support by reference to the literature on rural institutions in the developing countries of today. In fact, institutions which closely resemble the Islamic ideal, including interest-free loans, are widespread in these environments, Muslim as well as non-Muslim. It is also true, however, that the importance of these informal, non-market institutions declines in the wake of economic development. The same forces that challenge the informal institutions of risk sharing in developing countries today, can be expected to challenge the viability of Islamic banking in the Muslim world.

In what now follows, I start out by describing the informal institutions of risk sharing, and then analyse the effect economic development may have on these institutions.

3.1. Solidarity networks

Traditional economies are frequently organised as networks of trust and gift exchange in the context of a family, a tribe, or a village, and involve various expressions of solidarity such as voluntary communal work, gifts, food transfers, and credit without interest. There has been some debate in the literature as to what exactly these solidarity networks imply (see, for instance, Platteau, 1991). Some argue that gift exchange is an expressions of high moral standards among the poor, and call it 'the moral economy of peasants'. Others claim that gift exchange is part of a social security system: 'I help you today because I know you will help me tomorrow.' Gift exchange may, therefore, be a perfectly rational arrangement from a selfish point of view, and may have nothing to do with altruism.

Most likely, solidarity networks are motivated by both moral and selfish concerns. Indeed, these two concerns probably reinforce each other. Continuous interaction between members of village economies permits emotional bonds to develop. Similarly, emotional bonds improve the social security system: 'I know you will help me tomorrow because you care about my well-being. Therefore I will help you today.'

The informal insurance systems in traditional societies may be efficient substitutes for formal credit markets and insurance, which for various reasons are not available to the rural population. The informal arrangements are efficient because they are highly flexible, which is necessary for efficient risk sharing when individual risk of starvation is high. Flexibility implies that specific conditions, such as interest, cannot be tied to the transfers. The recipient of aid is simply expected to help others in return. How much help he shall offer in return and when it should be offered is entirely determined by his future situation relative to the situation of the other members of the group.

The flexibility of the traditional social security systems is important for efficient risk sharing, but as is well known from insurance economics, there is a trade-off between risk sharing and individual incentives. 'If I help you today, how do I know that you will help me tomorrow?' We have already mentioned the emotional bonds that are likely to develop between members of the social security networks. But there is still a risk that people will take advantage of the solidarity arrangements by working less or trying to hide income from the other members of the group. This is, of course, the same problem of moral hazard as the one we encountered under the discussion of profit and loss sharing in Islamic banking. Moral hazard is obviously a threat to the mutual insurance system. 'If I can't trust you to help me tomorrow, why should I help you today?'

Within small village societies the problem of moral hazard is not likely to be very important. Not only do people care for each other. There is also the fact that the degree of privacy is very limited in these societies. This means that monitoring of individual effort and income is possible at low cost. In other words, it is difficult to get away with opportunistic behaviour. In addition, alternative sources of income outside the home village may be limited, so that the risk of being caught breaking the rules of the insurance game and subsequently perhaps being expelled from the village may be very high. In this way, the informal insurance contract can be self-enforcing.

It is precisely because of the importance of monitoring and enforcement that we observe very little inter-village lending in developing countries (see Platteau, 1991). When different villages are involved, the lender will have great difficulties in observing the conditions of the borrower. And even if he could monitor perfectly the borrower, the lender does not have access to the necessary sanctions such as expelling the borrower from the village in case he breaks the agreement and doesn't pay back the money.

Let me briefly recapitulate. From the above discussion, we have seen that individual risk of starvation creates a need for co-operation in order to handle this risk. Co-operation stimulates emotional ties between members of the group which strengthen the informal insurance agreement. Efficient risk sharing requires flexibility, but flexibility may create moral hazard problems, that is, cheating. In small, closely knit societies, the chances of getting away with cheating are small, and the costs of being caught are very high. This lack of privacy and the lack of alternative sources of income are important reasons why solidarity networks can survive in traditional societies.

3.2. The challenge of development

There are at least three reasons why traditional solidarity networks tend to disintegrate as a result of economic development. First, economic development is accompanied by greater affluence and therefore a reduction in the need for comprehensive risk sharing. When people's lives no longer balance on an uncertain subsistence level of income, the demand for solidarity networks in order to smooth out variations in income is reduced. And since the demand for income-sharing agreements is reduced, it is more difficult for such agreements to survive.

Second, economic development stimulates migration and urbanisation and therefore increased privacy. Clearly, effort and income are much harder to observe in a modern city than in a small village, for instance because people do not work in the same place anymore. Increased privacy threatens the mutual insurance agreement by increasing monitoring costs.

Third, economic development brings with it more varied income opportunities, such as jobs in manufacturing. Since this implies that alternative sources of income outside the village can easily be found, the punishment that villagers can inflict on a member who cheats on them, by being lazy or hiding money, is reduced. By making it difficult both to discover cheating and to punish this kind of behaviour, economic development reduces the possibility of upholding the traditional income-sharing and risk-sharing arrangements.

In this way, economic development leads to institutional change: modern, impersonal institutions take over the functions of traditional and highly personalised institutions. Gift exchange is replaced by market-based commodity exchange, work sharing is replaced by labour markets, interest-free loans are replaced by interest-bearing credit. This institutional change may in turn undermine moral values, as emphasised by Platteau, in his extensive study of Third World solidarity networks (Platteau, 1991:158-9): 'Deeper and deeper penetration of market values has the effect of loosening the web of traditional social relations: people become more and more free of group pressure to conform and less and less concerned about the well-being of the extended family or social group.' In other words, market penetration leads to a reduction in group pressure which in turn makes people more egoistic.

4. Concluding Remarks

The forces which challenge informal, small-scale institutions, also threaten the viability of Islamic banking. Market penetration, for instance in the form of increased access to interest-based banking, reduces the need for informal risk-sharing arrangements, and may weaken the social and emotional ties between people. An Islamic economist draws the line from interest to moral decline in the following way: 'Interest inculcates love for money and the desire to accumulate wealth for its own sake. It makes men selfish, miserly, narrow-minded and stone-hearted.'[13]

While one need not share the view that interest as such is responsible for moral decline, it is probably true that economic development, by introducing impersonal, market-based institutions such as modern banking and insurance, reduces the need for social norms, and perhaps also makes people more selfish and narrow-minded. It is, however, unlikely that the overall prohibition of interest which most Islamic economists advocate, can change such attitudes and contribute to greater altruism in society. A more pragmatic and fruitful approach to Islamic banking would be to introduce such institutions in the traditional, rural sector of the economy.

In conclusion, Islamic banking in the form of rural development banks may play an important role in stimulating economic development in Muslim societies. This pragmatic plan of Islamic banking also harmonises well with the intention of the Islamic usury ban, namely to help those in need.

Notes

1. Kuran (1986:141-3) critically evaluates the validity and relevance of this claim.
2. See, for instance, part 2 in Marty and Appleby (1993).
3. For a more comprehensive survey of Islamic economics, see Siddiqi (1981).

4. For a survey of Islamic banking in the Arab world and Turkey, see Moore (1990), for Iran and Pakistan, see Khan and Mirakhor (1990), and for Southeast Asia, see Ariff (1988).
5. *The Koran*, in the translation of Dawood (1990), Chapter 2, verses 275-8.
6. *The Koran*, Chapter 4, verse 161.
7. *The Old Testament*, Exodus, Chapter 22, verse 25.
8. For a description of the development of the Islamic and Christian usury doctrines, see Rodinson (1974) and Tawney (1969), respectively.
9. See, for instance, Iqbal and Mirakhor (1987).
10. For an excellent presentation of the theoretical foundation for Islamic banking as well as an evaluation of the experience with Islamic banking in Iran and Pakistan, see Iqbal and Mirakhor (1987).
11. Quoted from Ahmad *et al*., eds. (1983: 109).
12. Based on interviews conducted in Pakistan, Kuran (1993: 310) reports that Pakistani bankers routinely tell their clients that mark-up financing is equivalent to interest. Kuran also reports that according to Pakistani bankers, profit- and loss-sharing contracts never rose above 2 per cent of the total assets in the banking sector. For the Sudanese case, see Stiansen (1995).
13. Quoted in Kuran (1986: 150).

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Summary

Kjetil Bjorvatn, 'Islamic Economics and Economic Development', *Forum for Development Studies*, 1998:2, pp. 229– 243.
Islamic economics is part of the Islamic fundamentalist movement gaining ground in large parts of the Muslim world. The call is for a return to Islamic law, *Shari'a*, which is believed to offer solutions to economic and social problems of all times and all places. The most visible sign of Islamic economics is the establishment of Islamic banks in a number of countries all over the world. The article evaluates the success of these institutions, in both religious and economic terms. Drawing upon evidence from the economic development literature, it argues that the most viable and fruitful application of Islamic banking is in the form of rural development banks.