A Note on Regulation of Markets in Islamic Perspective: An Institutional Approach

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Abstract: Modern capitalist economies have mostly regulated markets. The objective, nature, extent and methods of regulations differ from country to country and from market to market within a country. This paper argues that market, as an institution is not a product of the capitalist system. It predates capitalism. An Islamic economy is also a market-based economy. However, the need for and rationale of market regulation in an Islamic economy may be derived from its own objectives. This paper presents some of the guidance provided by *Sharīʿah* for human behaviour in the market-place, which has important implications for the working of markets. The objectives and principles of market regulation in an Islamic perspective may be derived from these *Sharīʿah* injunctions. However, in order to do this, the economies of Islamic countries will have to develop and maintain special institutions.

> *"The government view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And, if it stops moving, subsidize it".*
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> **Ronald Reagan,** Former President of the USA,
> Address to White House Conference on Small Business
> 15 August 1986

I. Introduction

The market is an institution that modern industrial capitalism inherited from its predecessors. It did not create it, although it

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modified, refined and polished it so much that 'modern industrial capitalism' and 'market economy' have come to be regarded as almost synonymous. In point of fact, the market predates capitalism by several centuries. While the history of capitalism is not more than two centuries old, the institution of the market is as old as organized society itself.

A single act of buying or selling does not constitute a market, though buying and selling is integral and central to any definition of market. A market is an institution in which the acts of sale and purchase take place with some regularity and with some regulation. Regulation is an essential attribute of the market as an organized institution. Regulation itself is generally understood to mean government intervention in the market, though as a definition that is vague, unsatisfactory and incomplete. On a scale from zero to a hundred a laissez-faire market would be one with zero regulation, whereas a market completely controlled by government (if that could be called a market at all) would score one hundred. Both of these situations are strictly hypothetical. In the real world, market regulation is always above zero and below one hundred. However, markets can be described as less regulated or more regulated.

Most modern economies have been so regulated that, in the last two decades, a conscious drive for deregulation has taken over the desire to regulate. The economics of regulation is generally concerned with analysis of the impact of regulation on production, distribution and social welfare. Regulation in modern capitalist market economies is justified either on grounds of market failures or for the consideration of equity. Market failure is said to have occurred if a natural or contrived monopoly exists, or in cases where significant externalities occur, or information asymmetry exist.

In this paper, 'market regulation' is not used in any narrow sense, as indicated in the cases cited above. Rather, we argue that 'regulation' is a wider concept: regulation is a response to market failures but there are kinds and instances of regulation where there has been no such failure. Regulation can refer to the set of rules without which markets cannot function. It can be used to refer also to the range of policy instruments used by the regulatory agency, if any, to influence the behaviour of the market.

The market is an organized institution. Its successful functioning depends upon a number of non-market parameters and pre-requisites such as a set of laws or conventions, which lay down the rules under which the market would function. These rules may be written or unwritten. Such rules may be observed in the operation of even the most simple forms of market, such as rural or tribal markets. For example, take the case of a rural market (of the kind still found in Africa and India) where agricultural output is sold at regular intervals, say every Tuesday. The market is open at a specific location and time and with a specified regularity. Moreover, there is an understanding as to what kind of goods may be brought to that market, how transactions are conducted, what weights and measures are employed, etc. All these rules 'regulate' the market and help it to operate effectively.

II. Characteristics of Markets in Developing Countries

It is widely acknowledged in the literature on economic development that markets, even left uncontrolled, do not function as well as they do in the advanced countries. The markets do not allocate scarce resources in developing countries efficiently. The price mechanism does not function effectively as it often does not reflect social costs. In the absence of any institutionalized mechanism for transmission of information, access to information is generally distributed very asymmetrically. In the absence of any rules regarding product specifications, the quality of output is generally poor. In certain sectors such as food and pharmaceuticals, adulteration is a known problem, which poses a health hazard raising a demand for regulation of these industries and others where poor standards affect public safety (security, transport, environment) or social well-being and prosperity (health, education).

We may then distinguish two concepts of market regulation. In the narrower textbook sense, regulation refers to direct intervention in the market by government. In the wider concept, market regulation refers to the rules necessary for the (effective) functioning of the market. Whatever helps the market to exist and discharge its functions may be said to have regulated the market. It is in this wider sense, that the term is used in this paper.

III. The Need for Regulation

Irrespective of the definition of regulation, the need for it in received economic theory is well established. Economic theory suggests that a perfectly competitive market is Pareto optimal in the sense that all agents are in equilibrium: one cannot be made better off without making the other worse off. Even in such a perfectly competitive market there is a need for regulation of market for well-known reasons of market failures, externalities, natural monopoly, etc.

Markets in the developing countries, which includes most of the Islamic countries, have many defects. The market organization is far from being competitive. Monopolistic elements, if not outright monopolies, abound. Asymmetric distribution of information and other resources allow sellers to take advantage of buyers. Product specifications and standard are rare. Hence adulteration, counterfeit products, fraudulent practices are rampant. All this underscores the need for regulation to specify the rules of game, and level the playing field for all players.

IV. Normative Foundations of Market Regulation in an Islamic Economy

Regulation of market in any society has to function within the overall framework of the underlying general principles, philosophy and the particular objectives of economic policy. The market is one social institution among others, and must be geared to achieve the objectives generally deemed worthwhile by society. The regulation of markets thus cannot be divorced from the value premises on which social and economic policies are based.

In the light of the Qur'ān and *Sunnah* the following values may be considered of prime importance in devising policies for regulation of markets in an Islamic economy.

4.1. Fairness and justice

The basic value that all social transactions, economic and non-economic, must respect is justice and fairness. It is enjoined upon Muslims that they conduct their mutual affairs in a spirit of fairness and justice for all.

> "Call upon your Lord humbly and in secret. He does not love those who transgress [the bounds of what is right]: Do not spread corruption and disorder on earth after it has been well ordered" (Qur'ān, 7: 55 – 56).
>
> "Act with fairness. For Allah loves those who act fairly (and) just" (Qur'ān, 49: 9).

Indeed, one of the purposes for which God sent Revelation human beings is to restore order and peace, and establish fairness and justice amongst them: "We sent Our Messengers with clear signs and sent down with them the Book and the Balance, so that humankind might establish just measure [in all their affairs]" (Qur'ān, 57: 25).

For justice and fairness to obtain in the market place, "Covenants should be honored, conventions followed, rights recognized and aggression shunned. Every one should willingly concede what is his due" (Siddiqui, 1992: 12). Justice requires equality of rights, and giving full measure to others; as the Qur'ān commands: "Give just measure and cause no loss (to others by, for example, fraud). And weigh with scales true and upright. And do not withhold things justly due to men. Nor do evil in the land, causing disorder" (Qur'ān, 26: 181-183).

4.2. Free markets

Islam places a high value on individual freedom to be exercised within the bounds of the *Sharīʿah*. Free markets are a logical concomitant of the freedom enjoyed by the individuals. This value is well enshrined in the basic sources of Islamic law. The Qur'ān enjoins all Muslims to conduct their transaction with full knowledge and mutual consent: "O believers, do not consume your property among yourselves in vanities, but let there be amongst you traffic and trade by mutual good will" (4: 29). The four schools of Islamic jurisprudence are unanimous that free mutual consent is a necessary condition of the validity of any contract (Chapra, 1980: 190, with reference to 'Abd al-Rahman al-Jaziri *K. al-fiqh 'alā l-madhāhib al-'arbah*).

A system of free markets is not only consistent but is a prerequisite of Islamic economic system. In this context, Chapra (1980: 190) has aptly observed: " the only system that would conform to the spirit of freedom in the Islamic way of life is one where the conduct of a large part of the production and distribution of goods and services is left to individuals or voluntarily constituted groups (of individuals), and where each individual is permitted to sell or buy from whom he wants at a price agreeable to both the buyer and the seller".

It may also be observed here that mutual consent between buyer and seller must be real, not nominal: They must be equally well placed in respect of access to information, and bargaining capacity. Obviously, this can be assured only in a competitive environment.

4. 3. *Sharīʿah* rules of economic transactions

In order to ensure justice and fairness amongst the people, the *Sharīʿah* has laid down a number of rules for transacting business. Some of these are directly stated in the sayings of the Prophet (pbuh), others have been deduced by Islamic jurists.

The sale and purchase of all goods except those prohibited by the *Sharīʿah* (such as alcohol and pork), are considered lawful and valid if the contracts are executed with the consent of the contracting parties. However, business contracts should be free from *ribā* (charging or paying interest on a loan or on a contract of differred payment), *qimār* (gambling where an economic gain is obtained by taking a risk which is not inherent in the economic transaction), *ghabn* (fraud, embezzlement), *ikrāh* (coercion), *bayʿ al muḍṭar* (taking advantage of situation of a weak party), *iḥtikār* (hoarding with the intention of raising the price), *najsh* (raising prices by making false bids), g*harar* (ambiguity in contacts), and *jahl* (absence of relevant information or vagueness about the attributes of the commodity, which may lead to dispute) (For further details, see Siddiqui, 1992: 16-17).

V. Objectives of Market Regulation

From those normative foundations, we can identify the objectives of market regulation in an Islamic economy. It is obvious that the overall objective of regulation in an Islamic economy is not to control the market per se, but to create the conditions that would help the markets to perform better. The following objectives of regulation of markets in an Islamic economy may be identified:

(i) To ensure justice and fairness in the market
(ii) To keep markets free and competitive
(iii) To avoid corrupt and fraudulent practices.

In order to attain these objectives, the society will have to create mechanisms and institutions that translate these ideals into practice. Generally speaking two kinds of mechanism are required, legal and institutional.

The society must evolve different types of institutions to discharge obligations in different fields.

VI. Institution for Standardization of Weights and Measures

Islam places a high value on standardization of weights and measures. In order to ensure justice in the market place, it is necessary that all players in the market adhere to certain rules and no agent is allowed to take advantage of the other. The standardization of weights and measures helps to ensure that sellers do not cheat buyers.

Several verses (in addition to what has been cited above) in the Qur'ān explicitly command Muslims to use correct weights and measures:

> "Give full measure and full weight with justice. We do not burden any soul beyond its capacity…" (Qur'ān, 6: 153)

> "Give full measure and full weight with justice. Do not withhold from the people the things that are their due. Do not do evil in the land, provoking disorder" (Qur'ān, 11: 85)

> "Fill the measure (correctly) when you measure, and weigh with an upright balance. That is better and more worthy (virtuous) in the long term (or in the end)" (Qur'ān, 17: 35)

> "Give full measure, and do not be like (among) those who give less (short-change people). Weigh with fair and true scales. And do not wrong people in their merchandise, and do not do evil in the land, provoking disorder" (Qur'ān, 26: 181-183)

> "Woe to the fraudsters who, when they take the measure from people, exact full measure, but when they give the measure or weight to people, give less than the due. Do they not think that they will be raised up on a Tremendous Day (and then give account of all their dealings)? (Qur'ān, 83: 1-5)

In the light of these commands, standardization of weights and measures should constitute the cornerstone of market regulation in an Islamic society. It allows people to obey the *Qur'ānic* commands, and minimize the risks from fraud and malpractice, inevitable if standardized weights and measures are not used.[1] This also minimizes the injustice and ensures fair play in the market.

Standardization of weights and measures also helps economic development as it integrates regional markets and enlarges the size of national markets. That is why most national governments seek to establish National Standards Institutions, which not only standardize common weights and measure, but control also specifications and standards for goods and services. As for the former, many countries in the world have adopted international standards of weights and measures such as the metric system, indeed it is a prerequisite for their participation in any significant degree in international trade. Many Muslim countries in Africa (e.g. Nigeria) still use an indigenous system of weights and measures, which vary greatly from region to region, and sometimes even from village to village.

Another aspect of standardization is specification of quality. The low quality of manufactured goods in developing countries is well known. Lack of quality control, in part a consequence of the absence of quality standards, is responsible for the lower performance of Muslim developing countries in the export sector, and indeed a violation of Islamic moral norms in trade. Muslim traders are required under Islamic norms and laws to supply quality goods commensurate with the price charged, and to disclose any defects in the product. They are required not to mix high quality goods with low quality of goods. Observance of these norms, an Islamic duty, can be built into the system, if National Standards Institution issues quality standards: the Institution must determine technical specifications for a product, require the producer to indicate the quality and dimensions of the product where the potential buyer can see the information and impose penalties on non-compliance.

In the classical Islamic period, the office of *ḥisbah* used to supervise the behaviour of the market and secure observance of Islamic rules. In modern times, a single unified office to discharge all the relevant functions may not be enough. Instead institutions will be needed to specify technically competent standards in the market for different goods and services. Thus different agencies would oversee the market in the consumer goods, transport, and monetary and financial sectors.

We may also point out here that merely issuing of standards and its observance will not suffice. Standards need to be harmonized at regional, national and international levels. Globalization is turning the world into an inter-dependent interconnected system. Many regulatory policies simply will not succeed until other agents adopt similar policies also.

The next section presents regulation of transport sector as a case study.

VII. Regulation of Transport Sector to Control Pollution

Road transport is fast becoming a major source of pollution in many developing countries including Muslim countries. However, efforts to reduce pollution are unlikely to succeed unless its main cause i.e. emissions from motor cars is tackled. The Box on the next page shows the technical nature of this task. The relevant factors of emission control have been classified into three categories: engine characteristics, fleet characteristics, and operating characteristics. In order to control and reduce pollution, all three categories need to be tackled at the same time

In order to regulate the road transport sector with a view to reducing pollution, we need first of all an institution that will not only set the required standards, but apply them consistently and vigorously. In practice this means that different regulatory agencies will be needed to issue and enforce the standards, otherwise markets may not achieve the desired social goals.

Appendix: Case Study

Factors affecting motor vehicles emissions

Vehicle/fuel characteristics

Engine type and technology: two-stroke, diesel, Otto, Wankel, and other engines; fuel injection, turbo charging, and other engine design features; and type of transmission system;

Exhaust, crankcase, and evaporative emission control systems, in-place catalytic converters, exhaust gas re-circulation, air injection, and stage II and other vapor recovery systems;

For engine, mechanical condition and adequacy of maintenance;

Air-conditioning, trailer hitches, and other vehicle appurtenances;

Fuel properties and quality: contamination, deposits, sulphur, distillation characteristics, composition (such as aromatics and olefin content) additives (such as lead), oxygen content, and gasoline and diesel octane levels.

Alternative fuels

Deterioration of emission control equipment;

Deployment and effectiveness of inspection/maintenance and anti-tampering programs.

Fleet characteristics

Vehicle mix (number and types of vehicles in use);

Vehicle utilization (kilometers per vehicle per year) by vehicle type:

Age profile of the vehicle fleet;

Traffic mix and choice of mode for movement of passengers/goods;

Emission standards in effect and incentives/disincentives for the purchase of cleaner vehicles;

Adequacy and coverage of fleet maintenance programs;

Clean fuel programs in effect.

Operating characteristics

Altitude, temperature, humidity (for nitrogen oxide emissions);

Vehicle use patterns and number and length of trips, number of cold starts, speed, loading, and aggressiveness in driving;

Degree of traffic congestion, capacity and quality of road infrastructure, and traffic control systems;

Transport demand management programs in effect.

Source: Faiz, *et al.*, (1996).

VIII. Conclusion

Market is an important institution. Islamic economy is also a market oriented economy. It has a claim on the institution of market as much as capitalistic economies. This paper argues that the term of regulation of market may be defined in a narrow or wider sense. The textbook meaning of 'regulation' refers to government's intervention in the market, which leads to various types of controls. Some time these controls have proved to be counter-productive, requiring a period of de-regulation after an initial period of regulation. It is argued here that regulation should be defined in a wider sense. All markets, even laissez faire markets are regulated markets as they function on the basis of some rules. The paper identified normative foundations for regulation of markets in Islamic perspective and argued that evolution of different types of institutions appears to be indispensable, if Islamic moral norms are to be respected in the market place.

NOTE

1. As well as the economic and legal aspects, there is a technological aspect to standardization. In the United States, the National Institute of Standards and Technology has established facilities dedicated to supporting US industries with measurement services for electronics, optical and radiation technologies. Developing countries have established comparable institutions, but the specification of standards is generally speaking, technically inferior, and standards are not enforced rigorously. The OIC member countries need to pay attention to this deficiency.

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