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Mirakhor on uncertainty and Islamic finance: Comment

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Abstract

This note summarizes the formulations of Abbas Mirakhor on purported uncertainty contextual to Islamic finance in a World Bank (2013) publication and shows its inefficacious character.

Key words: Risk, Uncertainty, Profit, Islamic finance
JEL: F20; F29

Introduction

In 2013 the World Bank published a book – Economic development and Islamic finance - with Zamir Iqbal and Abbas Mirakhor as the co-editors. It is a voluminous work containing 12 Chapters written by 13 well-known professionals, mostly in pairs. I have recently downloaded the book from the internet and scanned through its pages with interest. A discussion in Chapter 3 that Nuri Erbas, and Abbas Mirakhor wrote attracted my attention. It dealt in a sub-section with uncertainty contextual to financial markets, a topic of my unending interest. I have some serious reservations on the position Abbas Mirakhor has taken on the issue,¹ Let me begin by stating his position briefly.

1. First, Abbas discusses at length the views of Frank H. Knight expressed in his *Risk, uncertainty and profit* (1921) on the subject contextual to markets; deriving his conclusions via the rational expectations theorem.
2. Second, the author arrives at his Islamic view of uncertainty from the Qur'anic verse 29:2. He elaborates the implications of his derivation and refers to a number of verses to claim that his interpretation is also cost effective and efficient. Down the line, he links his view to Islamic institutions like trust and morality.
3. Third, there are ordained rules for decisions and actions in uncertainty. Compliance with the rules of the Law Giver is the only way to ensure that decisions and actions are beneficent and efficient and that they entail low costs (4:46; 4:59; 4:66; 4:77; 11:84; 17:35; 47:33; 48:16; 49:14). (P. 101)

¹ I keep his coauthor Nuri Erbas out of this discussion because the section (PP. 99-101) palpably looks as based on a number of references Abbas published over the years.

Comments

Relevant for enterprise and the markets is not how Knight used the rational expectations argument to develop his dissertation: *Risk, uncertainty and profit*; relevant is his distinction between risk which part of uncertainty of the future outcomes of productive activities can be statistically measured and met at a cost, the premium for insurance, and the other part the true *uncertainty*, the risk proper that cannot be so measured and met at a cost. Distinction apart, markets these days are governed by politics, not by rationality.

Mirakhor bases his derivation of his uncertainty notion on the following verse of the scripture.

Do men think that they will be left alone on saying, we believe and that they will not be tested (29.2).

Now, this verse, directly or by implication does not entail to me any concept of uncertainty, a domain of future. It aimed at informing the believers of the presence of deceivers among them in the garb of the faithfuls who professed to be Muslims but at heart were not. Allah assures the believers in the verse that the false ones would become exposed when tried and tested with adversities; they would fail the test. An authentic commentary on the verse reads as follows:

Mere lip profession of faith is not enough. It must be tried and tested in the real turmoil of life. The test will be apparent in all kinds of circumstances in individual life and in relation to the environment around us to see whether we can strive constantly and put God above self. Much pain, sorrow and self-sacrifice may be necessary not because they are good in themselves but because they will purify us like fire applied to a goldsmith's crucible to burn out the dross. Abu Yusuf Ali: The Message of the Glorious Qur'an, Text, translation and commentary, Cairo/Beirut P. 1029, n. 3423

The very next verse 29.3 clarifies that Allah did put to trial and test such deceivers before and Allah will surely make evident those who are truthful and will surely make evident the liars. Where is the notion of uncertainty in this all? The Qur'an instead talks of the certainty of many future events to take place like the resurrection of the dead, their assembly before their Creator on the Day of Judgment, and of people entering Heaven or Hell based on their deeds during their stay on the planet Earth.

Finally, I checked the translations of verses in point 3; surprisingly, they have nothing to do in my understanding with decision making under uncertainty or cost effectiveness as Mirakhor claims

Notice that Baqar-as-Sadr does not separate uncertainty from risk; he keeps the two unified. However, he - unlike Knight - holds that the profit which the owner of capital - cash or commodity - obtains is not based on risk taking; he receives the justification for it on the basis of its proprietorship and allowing to the entrepreneur. its use in business (Iqtisaduna – Our economy, 1984, 75).

The future outcome of all human activities – financial or non-financial - is shrouded in uncertainty. Whatever be the result – favorable or adverse - the faithful have to take it as the will of God smilingly; *tawakal* is the answer. Publications of faith neutral institutions – local or global – must be closely examined for their Islamic content. See also Zubair Hasan: *Risk and Islamic Finance: A misunderstanding corrected* in Abdul Rafay editor (2020): Hand book of Islamic Finance, Chapter 24, IGI, USA

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