

MARKET MECHANISM IN ISLAM : A HISTORICAL PERSPECTIVE

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Abstract

The paper attempts to analyse the concept of market mechanism in Islamic literature, as developed by the Muslim scholars. The ideas of Muslim scholars are, at large, remained unexplored who had offered rather detailed and sophisticated discourse on market and pricing mechanism. Our study is confined to the ideas of following representative personalities such as Abu Yusuf, Al Ghazali, Ibn Taimiyah and Ibn Khaldun. The paper concludes with the note that considerable ideas on the market and pricing mechanism were found with the Muslim scholars long before the mid-eighteenth century, and that the views of Islamic writers were far detailed and clear. This requires reconsideration on Schumpeter's statement about mechanism of pricing that nothing worth mentioning existed before the middle of eighteenth century. Especially the contribution of the Arab-Islamic scholars to economic thought be rehabilitated in the science of economics for the sake of doctrinal continuity as well as objectivity.

1. Introduction

The present paper aims to study and analyse the concept of market price mechanism in Islamic literature as conceived and developed by the Muslim scholars. The reason for choosing the topic is a statement by late Joseph Schumpeter in his *magnus opus*, *The History of Economic Analysis* which the present writer could not verify due to contrary evidences to which

he came across during his research work. According to Schumpeter, "As regards the theory of the mechanism of pricing, there is very little to report before the middle of the eighteenth century..".¹ There are enough reasons to believe that the Muslim scholars and experts who led the world during and before the Middle Ages in science and civilization, philosophy and business, trade and industry, etc., and who transmitted Greek philosophy and ideas along with their own additions and traditions to the West,² must have discussed and analysed economic problems and issues faced by them, such as production, distribution, market formation, price determination, etc. Unfortunately, their ideas, at large remained unexplored. Due to enormous material on the subject we will be selective in our presentation and choose the following thinkers to discuss their ideas:

1. Abu Yusuf (731-98 AD) 2. Abu Hamid Al Ghazali (1058-1111 AD)
3. Ibn Taimiyah (1263-1328 AD) 4. Ibn Khaldun (1332-1404 AD)

Relying primarily on the original Arabic language sources, I hope to come up in this paper with certain findings which will be a modest contribution to the history of economic thought.

2. Concept of Pricing as Early as 8th Century AD

Muslim scholars, writing prior to the medieval European scholastics, offered rather detailed and sophisticated discourse on market and pricing mechanism. The earliest record that I have been able to discover, of increase and decrease of production with respect to price changes, is in Abu Yusuf³ (731-798 AD). But instead of attempting any theoretical account of demand and supply and their effect on prices, Abu Yusuf states:

*There is no definite limit of cheapness and expensiveness that can be ascertained. It is a matter decided from heaven; the principle is unknown. Cheapness is not due to abundance of food, nor expensiveness due to scarcity. They are subject to the command and decision of God. Sometimes food is plentiful but still very dear and sometimes it is too little but it is cheap.*⁴

In the above Abu Yusuf seems to be denying the common impression of a negative relationship between supply and price. It is in fact true that price does not depend on supply alone — equally important is the force of

demand. Therefore, increasing or decreasing price is not necessarily related to decrease or increase in production. Insisting upon this point, Abu Yusuf says that there are some other reasons also but these he fails to mention for the sake of brevity.⁵ What are these other reasons? What did he have in mind? Perhaps shifts in demand, or in country's money supply, or hoarding and hiding of goods, or all of these? In the opinion of Muhammad Nejatullah Siddiqi, Abu Yusuf's remark should be taken to be a statement of something he observed: the possible coexistence of abundance and high prices and of scarcity and low prices. Abu Yusuf dealt with the issue of grain prices incidentally while arguing in favour of proportionate taxes as against a fixed rent on land. He was not discussing price determination as such, so he could not relate the phenomenon he observed to changes in the supply of money. His remark does not amount to a denial of the role of demand and supply in the determination of price.⁶

3. The Process of Market Evolution as Seen by al-Ghazali

Abu Hamid al Ghazali⁷ (1058-1111 AD) provides a surprisingly detailed discussion of the role and significance of voluntary trading activities and the emergence of markets based on demand and supply forces in determining prices and profits. For al Ghazali, markets evolve as part of the "natural order" of things, an expression of the self motivated desire to satisfy mutual economic needs. A full appreciation of the depth and breadth of his insights becomes evident from the following:

Perhaps farmers live where farming tools are not available. Blacksmiths and carpenters live where farming is lacking. So, the farmer needs blacksmiths and carpenters, and they in turn need farmers. Naturally, each will want to satisfy his needs by giving up in exchange a portion of what he possesses.

But, it is also possible that when the carpenter wants food in exchange for tools, the farmer does not need the tools. Or, when the farmers need tools, the carpenter does not need food. So such situations create problems. Therefore, pressures emerge leading to the creation of trading places where various tools can be kept for exchange and also warehouses where farmers' produce can be stored. Then customers come to obtain these goods and markets are established. Farmers bring produce to the markets and if they

cannot readily sell or exchange what they possess, they sell them at a lower rate to the traders who in turn store the produce and sell to the buyers at a profit. That is true for all kinds of goods.⁸

He is also explicit on regional trade:

Then, such practices extend to various cities and countries. People travel to different places to obtain tools and food and transport them. People's economic affairs become organized into cities which may not have all the tools needed and into villages which may not have all the food-stuffs needed. People's needs and interests necessitate transportation. Then, a class of traders who carry goods from one place to another emerges. The motive behind all these activities is the accumulation of profits, undoubtedly. These traders exhaust themselves by travelling to satisfy others' needs and to make profits and then these profits too are eaten by others.⁹

Al-Ghazali, thus, clearly suggests the 'mutuality' of economic exchange, which necessitates specialization and division of labour with respect to regions and resources. Further he recognizes that trading activities add value to the goods by making them available at a useful place and time. Motivated by participants' self interest, exchange leads to the creation of profit-motivated middlemen, or traders. Though accumulation of wealth in this manner was not viewed as among the noblest activities in the prevailing environment, he recognizes it as essential to the proper functioning of a progressive economy. Moreover, while discussing the trading activities, he also mentions the need for safe and secure trading routes and remarks that the state should provide protection so that market can expand and the economy can grow. He shows a sound understanding of the interactions of demand and supply, as well as the role of profits as part of a divinely ordained scheme of things. He even provides a well-defined ethical code for the business community.¹⁰

3.1 Demand, Supply, Prices and Profits

Though al-Ghazali does not discuss demand and supply in modern terms; numerous passages from his works demonstrate considerable depth in this respect. He is referring to an upward-sloping supply curve when he says that "if the farmer does not get a buyer for his produce, then he sells at

a very low price".¹¹ His awareness of market forces is evident, when, concerning high food prices, he suggests that the price should be induced down by reducing demand, implying a leftward shift in the demand curve.¹² He also seems to have some insights into the concept of price elasticity of demand: *"a cut in profit margin by price reduction will cause an increase in sales and thus in profits"*.¹³ He likewise recognizes "price-inelastic" demand, for he says that since food is a necessity, trading in food should be minimally motivated by profits, as exploitation through excessive prices and profits could occur, and that since profits represent an 'extra', they should be, in general, sought from non-necessities.¹⁴

Like other scholars of his era, al Ghazali discusses price and profits more or less together, without clear reference to costs and revenues. While expressing some disdain, though not condemnation for profit seeking, he recognizes the motivations for, as well as sources of, profits. Profits are viewed as the return on risk and uncertainty, as *"they (traders and businessmen) bear a lot of trouble in seeking profits and take risks and endanger lives in voyages."*¹⁵

As indicated above, al Ghazali is critical of "excessive profits. He insists that sellers should be guided by 'profits' of the 'ultimate' market — i.e., the Hereafter.¹⁶

4. Market Mechanism as Conceived by Ibn Taimiyah

Ibn Taimiyah¹⁷ had a clear notion of the voluntary exchange, free-market economies, and how prices tended to be determined through the forces of demand and supply. He says:

*Rise and fall in prices is not always due to injustice of some people. Sometimes its reason is deficiency in production or decline in import of the goods in demand. Thus, if the desires for the good increase while its availability decreases, its price rises. On the other hand if availability of the good increases and the desires for it decrease, the price declines. This scarcity and abundance may not be caused by the action of any people; it may be due to a cause not involving injustice, or sometimes it may involve injustice.*¹⁸

This statement partly reflects a commonly held view at the time, that is, rising price is the result of injustice, or transgression, on the part of sellers or possibly the result of manipulation of the market. However, Ibn Taimiyah argues that there could be other factors. He states that rising or falling prices could be due to market pressures. Then he discusses some of the factors that influence demand and supply, and his insights, while not quite as elegant as one finds in contemporary texts, nevertheless, are remarkably profound for the era he represented.

He mentions two sources of supply: domestic production and imports of the goods demanded. A change in supply is described as an increase or decrease in the availability (supply) of the goods. He describes demand for good in terms of 'desires for the good' — suggesting 'taste' in contemporary terms, a key determinant of demand (another being 'income', which he did not mention explicitly).

The above quotation from Ibn Taimiyah clearly suggests what we now call 'shift' in demand and supply schedules. Thus, at a given price, demand increases and supply decreases, leading to a price rise. Or, conversely, at a given price, supply increases and demand decreases, leading to a price decline. Similarly, depending upon the extent of change in supply and/or demand, the change in price may be large, small, or zero. Various such possibilities seem to be implied in the above quotation. Elsewhere, he is more explicit:

*If people are selling their goods according to commonly accepted manner without any injustice on their part and the price rises due to decrease of the commodity or due to increase in population, then this is due to God's doing.*¹⁹

Here, Ibn Taimiyah suggests that the reason for price increase may be either a decrease in supply or an increase in population (number of buyers) — that is, an increase in market demand. Thus, a price increase due to reduced supply (leftward shift) or increase in demand (rightward shift) is described as an 'act of Allah' — obviously, referring to the impersonal nature of the markets.

From the foregoing it is also obvious that Ibn Taimiyah distinguishes between two factors that may cause shifts in demand-supply schedules and thus affect the market price: automatic market pressures and sellers' transgression (i.e., due to hoarding).

It might be noted also that while Ibn Taimiyah traces the effects of changes in demand and supply on market prices, he does not seem to identify the effect of higher or lower prices on quantity demanded or supplied (i.e., movements along the respective schedules). However, in his *al Hisbah*, he refers to an earlier jurist, in that administrative setting of too low a price that leaves no profit results in a corruption of prices, hiding of goods (by sellers) and destruction of people's wealth.²⁰

Thus, he seems to be aware of a direct relationship between price and quantity supplied. Further, he is also pointing to the disincentive effects from 'administratively fixed' price which is 'too low' (obviously relative to some 'normal' price), and which could reduce profits and encourage hoarding.

4.1 Other Factors Affecting Market Demand and Supply

Elsewhere, Ibn Taimiyah identifies some other determinants of demand (and supply) which can affect the market price - such as i) intensity and magnitude of demand, ii) relative scarcity or abundance of a good, iii) credit conditions, and iv) discount for cash payments. The following brief quotations are illustrative:

People's desire is of different kinds and varies frequently. It varies according to the abundance or scarcity of the good demanded. A good is much more strongly desired when it is scarce than when it is available in abundance. It varies also depending on the number of demanders. If number of persons demanding a commodity is large, its price goes up as against when their number is small.

It is also affected by the strength and weakness of the need for the good and by the extent of the need, how great or small is the need for it. If the need is great and strong, the price will increase to an extent greater than if the need is small and weak.

The price also varies according to the customer with whom exchange is taking place. If he is well-off and trustworthy in paying debts, a small price from him is acceptable to the seller which (price) would not be acceptable from one who is known for his insolvency, delay in payment or refusal of payment due.

In talking about the desirability of contracts, he says, "This is because the purpose of contracts is (reciprocal) possession by the two parties (to the contract). If the payer is capable of payment and is expected to fulfill his promise, the objective of the contract is realized with him, in contrast to the case if he is not fully capable or faithful regarding his promise. The degrees of capability and faithfulness differ. This applies to the seller and the buyer. ... The price of what is available is lower than the price of what is not (physically) available. The same applies to the buyer who is sometimes able to pay at once as he has money, but sometimes he does not have (cash) and wants to borrow (in order to pay) or sell the commodity (to make payment). The price is lower in the former case."²¹

An increase in the number of buyers, causing an increase in price (other things being constant) is indeed well-recognized. However, the size of need as distinct from its intensity (both may be viewed as suggesting 'taste') refers to the commodity's place in the basket of goods desired by the buyer. If this interpretation is correct, Ibn Taimiyah has associated high price with intensity of need as well as the good's relative importance in the totality of a buyer's requirement.

Further, Ibn Taimiyah suggests the relevance of credit to sales. The above quotation implies that if credit transactions are common, the sellers must face uncertainties as to future payments (say, between a more versus less credit-worthy customer) when quoting prices. Further, he is also aware that a seller might offer "discounts" for cash transactions. Clearly, Ibn Taimiyah's arguments not only demonstrate his awareness of the demand-supply forces, but also his concern with incentives, disincentives, uncertainties, and risks involved in market transactions. Both represent significant contributions to economic analysis, especially when one bears in mind the era during which Ibn Taimiyah was writing.

4.2 Competitions and Imperfections in the Market

It should be noted here that while Ibn Taimiyah never uses the term 'competition' (a concept that emerged much later in the evolution of economic thought), nor describes the conditions of perfect competition in contemporary jargon, it is clear that his awareness of the 'competitive market' assumptions is unambiguous. Thus, he writes that "to force people to sell objects which are not obligatory to sell, or restrict them from selling a permissible object, are injustice and therefore, unlawful".²² In contemporary terms, this clearly refers to full freedom to enter or exit a market. Further, he is critical of collusion among buyers and sellers.²³ Homogeneity and standardization of the product is advocated in his condemnation of adulteration of the product and of fraud and deception in its presentation for sale.²⁴ He emphasizes knowledge of the markets and the commodity, as the contract of the sale and purchase depends on consent and 'consent requires knowledge and understanding'.²⁵

Ibn Taimiyah is against excessive regulation when market forces are free to work resulting into determination of a competitive price. With regard to market imperfections, he recommends that if sellers abstain (through hoarding) from selling their goods except at a higher price than the customary or 'normal' price and people need these goods, then they will be required to sell them at 'the price of the equivalent'.²⁶ Incidentally, this concept is synonymous to what is also described as 'just price'. Further, if there are elements of monopoly (especially in the markets for food and other necessities), the state must intervene to ensure that monopoly power is restricted.²⁷

From the foregoing discussion it is obvious that Ibn Taimiyah had a clear perception of the well-behaved, orderly markets, in which knowledge, honesty, fairplay, and freedom of choice were the essential ingredients. Thus it is in this contextual background that one must appreciate and evaluate his analysis of the functioning of market and mechanism of pricing.

5. Ibn Khaldun on Market and Pricing

From the Muslim scholars who wrote on market and pricing, the last in our scheme of discussion is Ibn Khaldun²⁸ (1332-1404) who has been mentioned by Schumpeter in two places in his *History of Economic Analysis*, though not in context of his economic thought.²⁹ In his famous work of *al-Muqaddimah*, under the heading *Prices in Towns*, he divides the goods into necessities and luxuries. According to him, when a city expands and its population increases, prices of necessities decrease comparatively and those of luxuries increase. The reason given by him is that the foodstuffs and similar commodities being the necessities of life get the first and the foremost attention of every man and thus their supply increases; causing prices to fall. On the other hand, the production of luxuries and conveniences does not attract the attention of every one, while their demand increases due to changes in life patterns causing their prices to increase. In this way Ibn Khaldun gives a reasonable account of demand and supply and their effect on prices. He also notes the role of competition among the demanders and increasing cost of supply due to taxation and other kinds of duties in the town.³⁰

At other place, Ibn Khaldun describes the effect of increased or decreased supply on prices. He says:

"... When goods (brought from outside) are few and rare, their prices go up. On the other hand, when the country is near and the road is safe for travelling, there will be many to transport the goods. Thus they will be found in large quantities, and the price will go down."³¹

The foregoing quotation shows that like Ibn Taimiyah, Ibn Khaldun also considers both demand and supply to be important in determination of prices. Ibn Khaldun then goes on to say that a moderate profit boosts trade whereas very low profits discourage traders and artisans and very high profits decrease demand.³² Indeed, Ibn Khaldun goes beyond Ibn Taimiyah in his clear mention of the elements of competition and different costs of supply on which Ibn Taimiyah is not very explicit. After his statement of demand and supply, Ibn Khaldun cites examples of different goods and their supply in different countries and their high or low prices according to their availability. He merely makes these observations but does not prescribe any price control policy. He seems to be more concerned

with the facts while Ibn Taimiyah is interested in policy issues. As we have seen, Ibn Taimiyah does not confine his analysis to discussing the effect of increase and decrease in demand and supply on prices, but he opposes fixation of any price as long as market forces work normally. In case of imperfection in the market or injustice on the part of suppliers he recommends price control.³³

6. Conclusion

Unfortunately, Ibn Taimiyah and Ibn Khaldun were born on the eve of a decline in Muslim sciences and culture. Therefore, the theory expounded by them could not be improved upon to any degree.

From the foregoing discussion, it is obvious that considerable ideas on market and pricing mechanism existed long before the mid-eighteenth century. In fact, views of writers cited in this paper show that they had a clear notion of the working of the market and were trying to grapple with other related issue also.

End Notes

1. Schumpeter, A. J., *History of Economic Analysts*. London: George Allen and Unwin, 1972, p. 305.
2. Ibid, p. 87; Whittaker, Edmund., *Schools and Streams of Economic Thought*. Chicago: Rand Mc. Nally & Co. 1961, p. 16; Gordon, Barry, *Economic Analysts Before Adam Smith*. London: The Macmillan. 1975, p. 154.
3. Abu Yusuf, the chief justice in the court of caliph Harun al Rashid, wrote the first book on taxation system of Islam, entitled *Kitab al Kharaj*. It was written at the request of the caliph to be used by him as manual on taxation.
4. Abu Yusuf, *Kitab al Kharaj*. Beirut: Dar al Ma'rifah, 1979, p. 48.
5. Ibid.
6. Siddiqi, Muhammad Nejatullah, 'Abu Yusuf ka Ma'ashi fikr (Economic Thinking of Abu Yusuf), in *Fikr-o-Nazar* (Aligarh), vol. 5, no. 1, January 1964, p. 86.
7. Abu Hamid al Ghazali an eleventh century Arab scholar, born in Tus in 1058 and died there in the year 1111 AD., among his several writings one

- widely recognized as the most significant is his four-volume *Ihya' Umm al din* (The Revival of Religious Sciences). Scholastics generally accepted his views. (Meyers, Eugene A., *Arabic Thought and the Western World*, New York, World Frederick Ungar Publishing Co. 1964, pp. 39-40).
8. Al-Ghazali, Abu Hamid. *Ihya' Umm al Din*, Beirut: Dar al Nadwah, n.d., vol. 3, p. 227.
 9. Ibid.
 10. Ibid. vol. 2, p. 75, 78, 79.
 11. Ibid. vol. 3, p. 227.
 12. Ibid. p. 87.
 13. Ibid. vol. 2, p. 80.
 14. Ibid. p. 73.
 15. Ibid. vol. 4, p. 118.
 16. Ibid. vol. 2, pp. 75-76, 84.
 17. Taqi al Din Ahmad bin Abd al Halim, known as Ibn Taimiyah was born at Harran (present Turkey) in 1263 and died in Damascus in 1328. His works *al Hisbah* and *al Siyasah al Shar'iyah* mainly consist of his economic ideas. He stand out distinctively as one among at least 35-40 prominent Arab scholars, who wrote on a variety of specific economic issues.
 18. Ibn Taimiyah, *Majmu' Fatawa Shakh al Islam Ahmad Ibn Taimiyah*, Riyadh: al riyadh Press, 1381 AH, vol. 8, p. 583.
 19. Ibn Taimiyah, *Al Hisbah fi Islam*, Cairo: Dar al Sha'b, 1976, p. 24.
 20. Ibid. p. 41.
 21. Ibn Taimiyah, *Majmu' Fatawa*, op. cit., Vol. 29, pp. 523-25.
 22. Ibn Taimiyah, *al Hisbah*, op. cit. p. 41.
 23. Ibid. p. 25.
 24. Of. Ibid. p. 21.
 25. Of. Ibid. pp. 49, 50.
 26. Ibid. p. 25.
 27. Ibid. pp. 25-26.
 28. Ibn Khaldun, called among the fathers of economic science (Boulakia, J. David, "Ibn Khaldun: A Fourteenth Century Economist", *Journal of Political Economy*, vol. 39, No. 5, September 1971 pp. 1165-1118) was born in Tunis in 1332 and died at Cairo in 1406. His brilliant work *al Muqaddimah* (An Introduction to History), considered the most sublime and intellectual achievement of the Middle ages, is a treasury of many sciences, like history, psychology, geography, economics, etc.
 29. Schumpeter, Joseph A., *History of Economic Analysis*, op. cit. pp. 136, 788.
 30. Of Rosenthal, Franz (tr.) *The Muqaddimah of Ibn Khaldun*, New York: Princeton University Press, 1967, vol. 2, pp. 276-78.

31. Ibid. p. 338.
32. Ibid. pp. 340-41.
33. For a detailed discussion on 'price regulation policy as suggested by Ibn Taimiyyah. Please refer to:
Islahi. A.A., *Economic Concept of Ibn Taimiyyah*. Leicester. U.K.. 1988. pp. 97-101.