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Price Control in an Islamic Economy

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ABSTRACT. The subject of price control in an Islamic economy dated to early seventh century (AD). It was later critically addressed and developed by the Islamic jurists between eleventh and sixteenth centuries. The paper reviews this development using arguments advanced by four major schools of Islamic jurisprudence and other legal experts. It explores those circumstances under which price control becomes permissible and/or necessary in an Islamic economy. A critical appraisal of selective cases of price control in economic theory is made. The paper, then, condenses and codifies juristic positions on market prices to provide a theoretical framework for the study of price regulation in Islamic economics.

1. Introduction

Discussions on state intervention in free market began to reemerge in Islamic economic literature in the 1950s. Islamic economists sought to redefine margins of state intervention by raising the questions: why, when, where and how the intervention will be justified. Their literary efforts led them to divergent conclusions on the matter as it had happened with the early jurists between eleventh and sixteenth centuries. Unlike the jurists who explicitly analyzed the legality or its absence in state action from jurisprudential point of view, the Islamic economists concentrated analytical efforts on the relevance or irrelevance of market mechanism in synchronizing individual and societal interests to establish permissibility of price regulation. One group of these economists that includes Siddiqi (1972:138), Kahf (1981:106), Mannan (1982:5) and Naqvi (1983:52) is of the opinion that attainment of such synchrony of interests under unfettered market operations is unlikely. The other group that includes Haikal (1983:158-60), Ghanim (1984:87) and Mahboob (1992:43) is of the opinion that market mechanism guarantees harmony and synchrony of interests and produces prices that conform to the aim of the Islamic law.

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The intention of this study is not to take unqualified position on the ongoing debate, but to attempt at putting the records straight with a view to removing doubt on the *Shari'ah* position on the market price. It is pertinent to acknowledge that Mahboob (1988) has made a good attempt to outline theoretical mechanics of Islamic market by relating it to Contestability Theory.(1) Despite his vehement criticism of supporters of government intervention he did not seem to take guard against similar, if not stronger, criticism. It will be clear to us in section 5 that when jurists were ruling on price control, details of which are presented in the next section, they were guided by the condition of the presence or absence of significant *gharar* (uncertainty) and its socio-economic implications. Contemporary Islamic economists can carry out research on market prices and find solutions to current problems keeping in mind this condition of uncertainty. Mahboob did the opposite. He actually started his analysis with two simplifying assumptions; freedom of entry to the market and availability of full information to buyers and sellers about market conditions typical of traditional economic theory. This should raise the question; what, then, is the difference between Islamic and conventional theory of prices?

The objectives of this study are; first, to scrutinize cases of price control in conventional economics and introduce contemporary scholars of the Islamic Law to certain results in economic literature and, second, to reconstruct Islamic theory of Price control. To achieve these objectives, this study analyzes some contemporary cases which require price control by relating them to Islamic jurisprudence (*fiqh*). It then attempts theoretical reconstruction by condensing juristic opinions on the market price.

The following section examines *fiqh* records and finds some legal justifications for selective price control in Islamic economy. Section 3 reviews and evaluates some reasons for price control in conventional economics. Its focus is on imperfect markets and market failure. Price control has certain advantages and disadvantages too. Section 4 examines both sides of the issue by looking at the pros and cons of its implementation. While section 5 draws inferences by use of deduction on jurisprudential position on new cases of price regulation, it also condifies the general themes of that position on market price to provide theoretical constructs for the study of price regulation in Islamic economics. In this theoretical effort, the study addresses two concurrent Questions; (i) which of the market established prices can be considered as valid under the Islamic economic system and (ii) are all the validly established prices automatically acceptable thereby ruling out price regulation under such circumstances? In providing answers to these questions two principles of the *Shari'ah*, namely, the principle of "no-injury" and the principle of *maslaha* (expediency or just interest) served as the bases of our opinion that even if all participants in the market follow the rules of exchange in a manner suggested by Zarqa (1991), certain market prices will fall short of acceptance. This fact gives rise to the need for price control in various commodity, factor, currency, security, real estate, utility and other modern markets. Section 6 compares and contrasts Islamic and conventional conception and

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(1) Contestability theory is a generalized version of the theory of perfect competition developed by **Baumal *et.al*** (1982).

treatment of monopolies as well as approaches to regulatory practices. Section 7 concludes this study pointing out that price control is not commonplace in an Islamic economy in the normal times but selected cases are admissible when their need becomes established.

2. Justification of Price Control in Traditional *Fiqh*

Commodity and factor prices have been determined in the market since the beginning of indirect exchange in pre-Islamic times. Islam acknowledged this social arrangement and modified it to meet the *Shari'ah* requirements for the Islamic economic system. The deficiencies in the market were mended by the Prophet through teachings and participation. The jurists developed juristic details regarding intervention in the market from the principles administered by the Prophet. They laid down the foundation and procedural rules for price regulation. These authorities in the Islamic Law based their respective judgements on two facts. First, a *hadith* reported by Anas that "one person came to the Prophet and requested him to fix prices in the market but he refused. Another man came and made the same request; the Prophet said it is Allah who pushes prices up or down, I do not want to face Him with a burden of injustice".(2) Second, Imam Malik's report on Caliph Umar's intervention in the market by dismissing a seller for selling at a lower price. He recorded an incident in *Muwatta* reported by Yunus bin Saif and Saeed bin Musayyab that: "Umar bin Khattab passed by Hatib bin Balta'ah who was selling dried grapes in the market. Umar told him either to raise the price or leave the market". Imam Shafi'i (1973), however, has presented another version reported from Dawud bin Saleh at Tammar, as a rejoinder to Imam Malik, that after rethinking Umar went to Hatib's house and told him, 'that whatever I told you was neither an expert's opinion nor a verdict. It was only a personal concern for welfare of people. So, you can sell it at whatever rate you like and wherever you like.'

Imam Shafi'i noted that his version did not contradict Imam Malik's, only that Malik got partial version of what had actually transpired. He concluded that on the authority of this narration nobody other than the owner "... has the right to appropriate it (commodity) or part of it without the complete willingness of the owner except under the condition where it becomes obligatory for the owner to sell his goods. And this situation is not one of them" (Ibn Taimiyah, 1976:26).

It was based on these reports that the four major schools of *fiqh*, namely, Maliki, Hanafi. Shafi'i and Hanbali schools reached their respective but conflicting conclusions on price control in Islamic economy. Let us first examine those areas in which there is difference of opinion among the jurists.

Followers of Imam Shafi'i and Imam Ibn Hanbal oppose price control in the market. They are of the view that the social authority has no right to fix prices for two reasons: abundance and scarcity of goods upon which cheapness and dearness depend

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(2) Sunan Abu Dawud, *Kitabul buyu', babul tas'ir.* Also reported by Tirmidhi, *Kitabul buyu'* and Ibn Majah, *Abwab al Tigarat* among others.

are divine phenomena; and, if price rise resulted from natural causes, then price fixation is an act of injustice on the sellers. The Maliki and Hanafi schools argue on the contrary that price control is legitimate and it does not necessarily amount to meeting injustice on either parties to exchange.

Imam Shamsuddeen Ibn Qudamah al-Maqdisi (d. 682 A.H.), a Hanbali jurist, argues that the Head of State has no right to regulate prices of goods in the market. He quotes the *hadith* reported by Anas and writes:

> Two facts can be derived from the hadith. First, the Prophet did not control prices despite people's pressure on him which should suggest that it is disallowed. If it were lawful the Prophet would have yielded to their demand. The second point is that the Prophet equated price control with injustice (*zulm*) and injustice is forbidden. The goods whose price was sought to be controlled were property of a man (trader). And that man cannot be prevented from selling his goods at an agreed upon price by the two parties, i.e. the buyer and the seller (Ibn Qudamah, 1374:44).

He criticized all forms of price control and concluded that it always led to price rise, discouraged imports and encouraged capital flight, promoted hoarding and inflicted hardship on people. He writes:

> In a way the control of price may give rise to price rise. The traders from outside will not bring their goods in a place where they would be forced to sell them at a price against their wish. The local traders would hide the goods instead of selling. People would get less than their need, so they would offer a higher price to obtain the goods. Both parties (sellers and buyers) would lose; the sellers because they were prevented from selling their goods, and the buyers because they were prevented from fulfilling their needs. So this act will be termed as forbidden (Ibn Qudamah, 1374:44-5).

He then concluded that price control does not only constrain complete freedom of enterprise but it has two harmful effects which he derived by means of economic analysis. Firstly, when there is shortage of supply price control creates black marketeering and, secondly, consumers do not get their needs satisfied.

It is quite clear that the views expressed by Ibn Qudamah are based on the *hadith* he quoted. Since the *hadith* is the base, it is desirable for a proper understanding and interpretation of the tradition, to investigate the circumstances that brought up the demand for price control. The *hadith* tells us about the price rise during Prophet's time but does not throw light on its causes. It can be deduced from Ibn Qudamah's statements that grains were imported in Medina at that time. Therefore, if the price is already high outside Medina, then to impose a fixed price on local traders would undoubtedly have been injustice resulting in the adverse effects he had anticipated. Nor had the *hadith* explained whether the rise in prices was a result of hoarding or any deliberate attempt at profiteering and the Prophet refused to act even in such conditions. A critical look at these two different scenarios indicates that the reasons behind price rise, at that time, were natural; a fact reinforced by a *hadith* recorded by

Tabarani: "People were plagued by famine so they said, Oh Prophet of God, fix the price for us..."(3) The facts that grains were imported and it was a period of famine, made the refusal of the Prophet very clear and meaningful, given the circumstances.

What if the circumstances were different , for example , a situation whereby local traders resorted to hoarding thereby causing rise in prices? Will it be correct to quote the *hadith* and forbid price control or term it as illegal? Imam Ibn Taimiyah has extensively discussed this situation and he writes:

> Imam Muslim reports in his *Sahih* from Muammar bin Abdullah that the Prophet said that hoarding is practiced only by a sinner (wrong-doer). A hoarder is a person who buys the grains that are most needed by people with a view to putting them out of their reach so the price will rise. Such a man commits injustice against people. So the authorities have the right to force such trader to sell the grains at the market price when people need it... That is why the jurists are of the opinion that if a person needs another person's grains (for his survival) then he can buy it from him at the market price even against the wish of the owner, and even if he insists on charging a higher price. The owner deserves only the market rate (Ibn Taimiyah, 1976:14).

Ibn Taimiyah extended his analysis to certain conditions under which price control is not only permitted but is necessary as well:

> If the control of price forces traders to sell their goods at a price they do not agree with , or if it prevents people from transacting things which Allah has made lawful for them, and when it implies injustice, it is not permitted. On the other hand, when it facilitates administration of justice among people; i.e. when traders are forced to sell the commodity which they are obliged (by law) to sell at the market price, or they are being prevented from undue profiteering, then price control is not only permissible but it becomes obligatory (Ibn Taimiyah, 1976;15).

Following some extensive analysis he concluded that: "When people's needs and necessities cannot be safeguarded without a fair price control, then a price control based on justice will be implemented for them - no more, no less" (Ibn Taimiyah, 1976:37).

The followers of Imam Abu Hanifa, like the Malikis, have expressed the same opinion regarding price control that if it is unavoidable in the interest of people then it can be exercised. Hanafi views are articulated in the *Hedaya* in the following words: "The Sultan has no right to fix prices for people. (Because) the Prophet said Allah is the price-giver... also because declaration of price is the right of the seller... So the Imam should not interfere except in a condition where welfare of the people demands it..." In respect of hoarding, the judge "will order the hoarder to sell what is in excess of his needs which will be assessed generously. The *qadi* will warn him to refrain from that act. If he is caught again for the same offence, he will be imprisoned, and

(3) Tabarani Kabir, with reference to *Kanzul Ummal*, vo1. 2, *Hadith* no. 4631.

punished in a way deemed necessary to prevent him from wrongdoing and save the public from harm". If the traders insist on charging higher prices and the "*qadi* has no other means of safeguarding people's welfare except by controlling prices, then he can do so by consulting wise councellors".[(4)]

Some jurists who supported Maliki-Hanafi position prescribed the methodology for price intervention. Ibn Habib proposed that:

> Imam should summon to a meeting all parties to price negotiation, i.e. the big traders, buyers and other experts. Their opinions will be sought and assessment made on the rates at which they buy and sell in the market. An agreement will be reached on prices that are beneficial to the sellers and socially acceptable without coercion. Whosoever permitted price control would use this method.

Abul Walid Baji supported this position and argued that:

> There is no doubt in the utility of this approach as it safeguards the interests of both parties. In this way, the traders are guaranteed as much profit as is necessary for carrying out their business and will not burden people. If the rates are fixed against the wish of traders, thereby preventing them from earning profit, prices will not stabilise... (Ibn Taimiyah, 1976:29).

The controversial cases are whether it is permissible to intervene when the sellers follow the rules of exchange to put a price ceiling that they should not exceed or a price floor below which they should not charge. Majority of the scholars do not permit intervention in these cases. However, on the authority of Saeed bin Musayyab and Rabi'ah bin Abdul Rahman, Abul Walid Baji says it is permissible. Imam Malik also is quoted as saying: "Market supervisor can fix a rate for butchers and if they do not agree to sell at that price they may leave the market" (Ibn Taimiyah 1976:26)

They will not be forced to sell but if they sell, they will have to sell at the fixed price.

The gist of the above discussion is that the Islamic government will control prices if it becomes necessary particularly in the face of monopolistic and monopsonistic practices. Likewise under emergency situations such as war or famine and in any event of need. Enforcing controls in these cases is necessary. A relevant question here would be; after the establishment of the permissibility of price control, under which circumstances the modern Islamic state should impose it? An attempt is made in section 5 to provide the answer. The next section provides an abridged review of economic literature on price control.

(4) Marghinani, *Hedaya*, Volume 4, *Babul Karahiyah*

3. Selective Controls in Free Market Economies

The reasons offered for price control in the free market economies are usually dichotomized into normal-time and emergency (Galbraith, 1952:28-51). While the former is argued for preventive and corrective measures, the latter is for achieving the objective of resource mobilization and distribution in wartime or in the event of natural calamities. For the purpose of this study we will not need to review the entire spectrum of the literature in view. It will suffice to analyze that aspect of it that deals with imperfect markets and the market failure.

3.1 Imperfect Markets

The markets we seek to examine here include monopolies, quasimonopoly, duopoly and oligopoly. Wide-ranging arguments were given by economists in favour of price control under these market structures.

(i) Monopoly: Ordinary and Natural

In the strictest sense, the term monopoly designates a market where there is only one seller of a commodity for which there is no close substitute. This is sometimes referred to as 'absolute monopoly'. Economists like Lipsey (1971:255) argue that this type of monopoly is usually perpetrated by force or by threat. Potential competitors can be intimidated by possibilities ranging from sabotage to a price war. This means that the general public is held at ransom by a single seller who dictates the market price.

A number of methods were employed to check excessive monopoly powers. In the United States, for example, Sherman Act of 1890 outlawed monopolistic practices (Samuelson, 1973;523-4). Also in India, Monopolies and Restrictive Trade Practice Act of 1969 is intended to curb the concentration of economic power and to check monopolistic and restrictive trade practices by dominant enterprises (Kumar, 1982:911).

Two distinct concepts - economies of scale and economies of scope - developed in economic literature. While the former is as old as utility theory, the latter is only of recent origin (Panzar & Willig, 1981). To determine which is the most efficient among a group of competing firms, economists traditionally tested for the existence of scale economies in the firm's cost functions; and to ascertain scope economies, cost savings due to joint production is usually tested for. Sharkey (1982) used industry cost functions and developed the theory of natural monopoly. If costs of producing 100 units of a good x are less for the monopolist than they would be for a group of firms operating independently, i.e. if costs are subadditive, then it is more efficient to allow the monopolist to produce the total industry output. Under this situation the monopoly is termed 'natural monopoly'.

Legal controls are imposed on natural monopolies particularly the public utilities;(5) controls generally taking the form of restriction on pricing (Eatwell, 1987:1069). Through price regulation, the state can minimize welfare distortions by having one firm produce the industry output. Free market economies find justification of controlling natural monopolies in their cost advantages which give rise to exercising monopoly powers. Available literature on the subject of natural monopoly points to the fact that it is socially desirable to regulate them and socially harmful to allow their unfettered operations.

(ii) Duopoly and Oligopoly

The market in which there are two sellers is called duopoly. When a few sellers supply the bulk of market demand, the market is called oligopoly. Duopoly is a special case of oligopoly. Economists have traditionally treated both markets in a similar manner and the arguments given for two sellers are assumed to apply to a few (Tisdell, 1978:213). All the few sellers are assumed to be interdependent and capable of exerting considerable influence on the price.

To appreciate why prices of oligopolies are regulatable they have to be viewed in the context of their formation. Most cartels aim at maximizing joint profits by means of predatory pricing. If they succeed their action will not differ from that of a monopolist. But where marginal costs are declining in the industry , total output should be allocated to one supplier if joint profit is to be maximized. The remaining non-producing firms will be compensated far not producing. A scheme is usually designed for members to share profit extorted through exhorbitant prices. Epstein and Newfarmer (1980:46) explain, with reference to International Electric Agency, that compensation payments are inducements to non-producing members who know in advance that they will not supply the market. It is due to these tendencies that oligopolies are controlled through anti-trust laws and regulatory agencies and commissions.

(iii) Quasi-Monopolies

Quasi-monopoly is a market that emerges when a cartel breaks down as a result of having some members undercut the collusively set prices. Scherer (1980:69) notes that the act of fixing price at monopolistic level creates incentives for sellers to expand output beyond quantity that will sustain the agreed upon price. After the cartel structure breaks down as a result of chiselling a new market structure emerges and that is called ‘quasi-monopoly’.

Quasi-monopolies do exist in reality, for example, the Organization of Petroleum Exporting Countries (OPEC). There is no specific way of dealing with quasi-monopolies in regulatory literature. They are generally treated as oligopolies for regulatory purposes.

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(5) Things ranging from canals, bridges, railroads, gas, metro-transport; to water, electricity and postal services are considered as public utilities. **Brown** and **Sibley** (1986:25) acknowledge that they are characterized by natural monopoly.

3.2 Market Failure

Market failure is divergence between social and private calculations which makes the market unreliable source for achieving socially set goals. A market failure is said to occur when: (i) there are no enough markets, (ii) by acting secretively (consumers and producers) conceal information, and (iii) resource allocation is inefficient. Things treated by the literature include public goods and public utilities, information asymmetry and complementarity of means . We will however make explicit only that aspect that directly relates to pricing.

Most of the market arrangements found today are oligopolies. This phenomenon though predominant in developing economies (Greenwald & Stiglitz, 1986), is widely found in the developed economies (Bacon & Eltis, 1976). Lack of adequate number of markets inhibits efficient resource allocation and free flow of information. Economists like Scitovsky (1954) and Coase (l960) discussed various aspects of this phenomenon and offered several suggestions for its cure such as creation of future market and property rights re-assignments. These proposals are meant to increase the number of markets with a view to 'completing' them.

Adding more markets may have unintended consequences. For example, if the informed person realizes that the uninformed person is going to make inferences based indirectly on his action then he would pretend to be uninformed. Economists recognize that in this case every agent becomes monopolist in one of the created markets; in which case he can understate demand and not take price as given. This is the phenomenon of 'free riding' that suggests why the creation of markets may not be a viable solution to market failure. On the supply side, an agent who has privileged information will artificially restrict output, charge monopoly price and make extra-normal profits.

Given information asymmetry of the market failures and the tendency of both consumers and producers to capitalize on it plus the fact that market cannot be corrected by appealing to the agents to behave competitively, the only viable alternative is to impose price controls.

The facts which we organized and presented in section 2 and in this section reveal that both jurists and conventional economists acknowledge the indispensability of price control if private and/or social interests are to be safeguarded under certain market conditions. However, price control has advantages, and disadvantages as well. Let us summarize them in the following section.

4. Pros and Cons of Selective Price Controls

Inasmuch as price control facilitates administration of justice and equity in certain cases, it is also associated with considerable real and nominal costs. We begin by itemizing the advantages.

i) Suppression of Inflation: In both periods of peace and war inflation can be suppressed or contained when price control is supplemented by indirect measures like credit control and public borrowing. Inflationary pressures if left unchecked will erode real income, discourage investment and create shortages.

ii) Prevention of Price War: Competition in the market sometimes assumes adverse dimensions. For example, a large producer with financial advantage may engage small producers in a price war by undercutting market-price. Imposing a pries floor below which sellers must not charge will protect interest of the small enterprises.

iii) Balanced Terms of Exchange: Pegging agricultural produce prices at a certain level would stabilize their value vis-a-vis that of the manufactures; protecting real income of the peasantry from erosion thereby.

iv) Control Rates of Monopoly Profit: Monopolies as we saw seek to maximize profits (joint or otherwise) through predatory pricing. Monopolies like water utilities can exploit people’s need and charge high prices. Fixing water tariffs and regulating them will prevent this tendency to a great extent.

v) Ensure Fair Returns to the Factors of Production: Price fixation would safeguard the interests of labour, capital and entrepreneurship whenever such interests are at stake.

vi) Elimination of Cost of Information: Information asymmetry imposes heavy costs on the society. If prices emanating from a market with information asymmetry are not controlled people will stop patronizing that market. This will create hardship and result in welfare loss. If, however, the market is of essential goods or services people will be forced to buy under duress and contempt on the sellers. People will labour in this case to acquire as much knowledge of the commodity in question, which is not attainable. Price control here will obviate such futile and strenuous exercise.

vii) Stabilization During Emergency: There are adverse effects of large-scale resource mobilization during war such as black marketeering and hoarding. Price control and rationing are devised to prevent this from happening.

viii) Ensure Equitable Distribution of Benefits and Costs of Exchange: Fairness and equity which are the cornerstones of exchange theory can be guaranteed only through price regulation under certain circumstances. The analysis that follows in the next section deals with some of these cases.

Although price control has the above-cited advantages, it is associated with some disadvantages which we summarize below.

i) Disequilibrium in the Market: Market under price control becomes destabilized due to distortion of its normal mechanism of exchange and allocation. Perhaps the most common consequence is shortage amplified by hoarding. Hoarding encourages emergence of middlemen and touts who run black market of the controlled items. It usually leads to general fall in efficiency resulting from bureaucratic frustration of the private sector. And, control of prices in the market gives temporary relief from inflation. In the meantime, current demand for the controlled items accumulates.

ii) Disequilibrium in the Economy: During full-scale mobilization as in wartime, government must make several specifications regarding utilization of plants, materials and inputs. This has inevitable consequences such as creation of forced savings and saving-investment inequality.

iii) Real and Nominal Costs: Inconveniences and huge financial expenditure for providing adequate administrative machinery for designing and implementing policies. Costs of pricing products and services of monopolies are quite formidable. Price variations in public utilities are considered as means of equitable cost distribution and efficient pricing. The desired degree of variations in prices can not be achieved without making metering appliances complex and hence costly. In emergency periods, and particularly during wars, to maintain stability, measures to restrain expansion of incomes are required. Prices should be stable and wages and rentals should not be under pressure. All these demand effective techniques and efficient management to check sudden increases in monetary variables.

Some issues raised in section 3 were explicitly dealt with by the jurists. There are other issues therein not explicitly addressed by them due to their non-existence at their times. One of the tasks of the next section is to draw inferences on those cases with a view to laying the ground for theorizing on price regulation in a modern Islamic economy.

5. Implicit Cases in *Fiqh*

Natural monopoly was not articulated by the jurists, therefore, they did not explicitly treat cost advantages. It is evident, however that taking cost advantage to optimize production and ease supply of commodities is an objective of the *Shari'ah*. Ibn Ashur (1956:188) notes that; "Easing production and distribution of commodities is the most important objective of exchange in the *Shari'ah*". Therefore, scale and scope economies are desirable attributes in the light of the Islamic Law.

Quasi-monopoly was not conceived by the jurists. They, however, analyzed a competitive market in which some sellers undercut ruling market price and sell at less than 'price of the equivalent'. The motive behind this 'noble' act could be good but the element of doubt regarding its adverse general consequence led some jurists to contest its legality. In fact, Caliph Umar's action recorded by Imam Malik was based on similar calculations and that is why we find two opposite views; some supporting control and others calling for non-intervention. But quasi-monopoly is illegal and unacceptable in Islamic economic practice.

The phenomena of market failures were fairly conceived but not articulated by the jurists. They laboured extensively to analyze what may be termed as 'breakdown of competition', a form of market failure not acknowledged by conventional economists. Islamic jurisprudence did not clearly explain whether the divergence between social and private interests is a sufficient condition for price intervention. It raised many questions regarding degree and extent of its effects and impact and/or its indispensability prior to any pronouncement on the state action. It recognized the fact that such divergence is a strong possibility. The jurists believe that realising a perfect balance[6] is unlikely and therefore the market may fail.

Shari'ah would demand that cases of market failure be critically examined if they qualify for intervention. For example, presence of too few markets whose operations do not inflict harm or jeopardize people's rightful interests will not call for price control. Justification of price fixation would require establishing that masses of people will inevitably be hurt by free pricing.

The fundamental problem of information asymmetry is addressed by the jurists in the general rules of exchange. The jurists have allowed minimum but unavoidable uncertainty relating to quantity, time of delivery or payment, price, etc. The argument given for condoning minimal uncertainty is that its complete prohibition will lead to human sufferings and hardships. How do we identify and measure this minimum whenever we are confronted by uncertainty? Perhaps this has not been explicitly worked out by the *fuqaha* but can be deduced beyond doubt from Ibrahim-Beg (1939:90), a Hanafi jurist, analysing *ghabn* (overvaluation or under-valuation):

> *ghabn* means undervaluation, in most cases it is small. In this case it is referred to as negligible *ghabn*. But in some cases we also encounter significant *ghabn* which may be regarded as excessive. The difference between these two is observable from the rates estimated by valuers of the commodity in question. For example, suppose a house is sold at 1,000 Egyptian Guineas and after the sale different estate valuers estimate its value at 1,100, 900 and 1,050 respectively, this is negligible *ghabn*. But if all the valuers value it at more than or less than 1,000 then the buyer or the seller is excessively cheated.

Imam Malik observed that it is for the preservation of fairness that *gharar*-based exchange was prohibited (Ibn Rushd, n.d.:146). Likewise, Ibn Taimiyah (1976:132) argued: "The evil of *gharar*-based exchange is breeding animocity and taking undue wealth by fraudulent means, i.e. taking money by lying, without a legal right". The jurists believe that it is most probable that under this condition information will be concealed (*gish*) and high prices will be charged.

(6) For an exhaustive discussion on his principle see Shatibi (1975:15-17). Some Islamic economists such as Chapra (1982:82) and Mahboob (1992:62) contradicted this position based on the opinion that in a truly Islamic environment (society or market) the divergence is unlikely.

Our analysis so far should lead us to rediscovering the principles that govern price intervention in the Islamic Law and these are: the principle of *no-injury* and the principle of *maslaha*. Elaborate discussions of the respective principles are found in Shatibi (1975:347-63) and Abu Zahra (1952:336-52). It suffices here only to state the principles. Simply stated, the principle of no-injury demands that no action whatsoever, deliberate or unintentional, will be used to cause harm on oneself, another person or the society. The principle of *maslaha*, on the other hand, demands that when a situation arises where procuring one interest implies the loss of another, then greater interest should be pursued in preference to the lesser. With regard to loss or injury reverse will apply, i.e. the greater will be avoided by tolerating the lesser. Basically, *maslaha* is about securing greater interest. We will attempt here to answer the questions we raised in the introductory section with the help of these principles. However, it will be very difficult indeed to discuss all the possible cases which would arise in the course of providing those answers. Therefore, we will discuss only a few cases in the light of these principles. What should be made clear *apriori* is that the *Shari'ah* objective is to remove injury. But when, for whatever reason, that injury is unremovable the principle of *maslaha* shall be applied. Let us begin with the principle of no-injury which will indicate to us when market prices are valid or invalid.

5.1 Valid and Invalid Prices

The *Shari'ah* has categorised prices as valid or invalid. By *valid price* we mean the price established in a market in accordance with the dictates of the Islamic Law, i,e. a price emanating from a market free from any *deliberate* attempt to cheat , defraud , obfuscate, lie, disguise or withhold relevant information. Valid price is that price that satisfies all possible *Shari'ah* legal requirements in the process of formation. This price may be altogether or only partially fair and just; because fairness and justice are not entirely based on legal considerations but validity is exclusively a legal concept.(7)

In respect of valid prices the jurists intuitively envisaged that the *Shari'ah* takes a dual stand, i.e.. allowing them to reign in the market or reject them where they conflict with fairness and justice and/or societal interests. This will be made clear in the next subsection.

An invalid price, on the other hand, is that price which does not follow the *Shari'ah* legal requirements in the process of formation. It is likely, but not always, to be higher than normal price. Invalidity of price may occur under two different contexts; it may result from deliberate violation of legal rules, for instance, resorting to coercion (*ikhrah*) or false bidding (*najash*); or , it may result from autonomous factors such as ignorance of the seller. Consider the former. Suppose a firm hid some defects of its product by, say, packaging or false advertisement, whatever price it charged is invalid. Similarly, if it manipulated supply by creating artificial scarcity the price

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(7) For an analytical discussion of the concepts of fairness and justice in pricing in Islamic jurisprudence, see my rejoinder (1991) in "Two Aspects of Exchange in Islamic Jurisprudence: Rejoinder", *Review of Islamic Economics*, Vol. 4, No. 1, 1995/1416 H. pp. 17-27.

charged is invalid. Invalid prices will emerge in the market if producers form cartels to exert influence on output or debar others from competing in the market, etc.

Invalidity may occur even under normal conditions. For example, if goods jointly-offered for sale are expected to be homogenous but some are found sub-standard, the uniform price charged across the board is invalid. The *Shari'ah* will not give consideration to the intention of the seller. Let us illustrate this with the help of an example. A factory produced batteries in a pack of 100 pieces and charged a hundred Nigerian Naira (N100.00) per packet. By assumption all the pieces in each packet are homogenous on the basis of which mutual consent of exchange of money for batteries had taken place. If a portion of those batteries is found defective, the N100.00 price charged on that packet is invalid. According to the Hedaya (1979:245) when these types of cases arise: "The sale is completely invalid; that is, it does not hold good even with regard to true one (commodity), although the seller should have specified the prices of both (standard and sub-standard)". The jurists would argue that if the proportion of defective items, say batteries, is negligible, this much *gharar* can be condoned. But then, if the frequency of such incidence persists uncertainty will not be tolerated and the price will be invalid.

Let us consider another case in which some uncertainty regarding quality is already being condoned. Suppose there exists a market where fresh unprocessed butter is sold at one Naira (N1.00) per kilogram. Suppose again a kilogram of butter after processing is expected to yield between 1.5 liter and 1 liter of water-free liquid butter. If a kilogram bought yielded less than 1 liter, the price charged on it is invalid. By and large, prices which cannot be separated from all forms of injury are simply invalid.

It is evident that valid prices are likely to have some serious loopholes, a phenomenon explicitly analyzed by Zarqa (1991) on distribution of benefits. When such loopholes with regard to fairness or justice appear in the market injury becomes inevitable. Under these conditions a different approach will be needed and that will be price regulation. What are these conditions after all?

5.2 Acceptable and Unacceptable Prices

For a market price to be acceptable it has to be valid. Invalid prices are totally unacceptable. Does it mean that all valid prices are automatically acceptable? To provide the correct *Shari'ah* position on this question let us identify two forms of valid prices; acceptable and unacceptable valid prices.

5.2.1 Acceptable Valid Prices

Acceptable valid prices are of two types: those which are free from any loopholes and distribute benefits and costs of exchange fairly and equitably; and, those with some loopholes but unlikely to cause disputes or conflicts among parties to exchange.

(a) Valid price with no loopholes regarding fairness or justice, can be conceptualized in the context of a contestable market in a manner similar to Mahboob

(1992). Suppose there exists a natural monopoly in the market, say, a telecommunication firm operating analogue system. By implication its tariff rates are at efficient level such that a new entrant to the market will not make positive profits at those prices. But suppose an entrant contests the market, and taking advantage of technological innovation introduces a digital system which is more efficient than the analogue system. This gives the entrant a leverage to drastically reduce existing tariff rates and establish new competitive prices in the telecommunication market. Since contestability assumes costless reversal of investment and absence of sunk costs, the incumbent firm will not suffer any actual or potential injury as a result of the entry and subsequent cut in the 'erstwhile' valid prices.(8)

This argument can be conveniently extended to other market structures such as duopoly, oligopoly or perfect markets. At any point in time, prices emanating from contestable markets can be regarded as valid because they meet the legal requirement and have no injurious effects, intended or unintended. Under-cutting market prices in this context is different from the context reported by Imam Malik in section 2; a beneficial act resulting from 'hit-and-run' that enhances economic welfare. In this respect Mahboob's analysis and conclusions are quite relevant and should be retained in Islamic economic analysis. But is his methodology which ignores uncertainty also relevant?

(b) In real life many cases of valid price with some loopholes regarding fairness and justice but unlikely to cause disputes or conflicts between parties to production and exchange, may arise after the legal aspects have been met. Let us analyze some of these cases.

Consider the presence of an oligopoly of petrol dealers who supply a vast market. Put the market price at N1.00 per liter when served through a station's pump. Suppose the dealers, for some reason, refused to abide by this price but made no attempt to hoard or adulterate the fuel and decided to hike the price to between N1.20 and N1.50. Again, suppose the fuel users have adequate knowledge and information but still consent to pay higher prices for fuel. In this case, if mutual consent, contract fulfillment and lack of *ghish* (cheating) are yardsticks of the *Shari'ah*, the petrol market has met these criteria thereby producing valid prices. Only that the element of *gharar* associated with their refusal to sell at the known price infringes upon the rule of fairness and this may be condoned at least in the shortrun. The reason is, when the level of uncertainty is low, social injury will be small. Again, consider a perfectly competitive market for Quartz watches. Let us say that the industry offers the market large quantities of wrist watches. The probability of a piece being defective is, say, 10% and is well-known. But each standard watch is expected to last maximum of four (4) years. Suppose 1,000 persons actually bought the watches at the same time out of

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(8) Critics like **Calem** (1988:171-3) and **Cairns** and **Mahabir** (1988:270-2) contested the internal logic of the theory. Reversability of capital and absence of sunk costs over-simplified the theory. Of course, Baumol (1982:2) agrees that: "perfectly contestable markets do not populate the world of reality any more than perfectly competitive markets do... perfect contestability, then, serves not Primarily as a description of reality, but as a benchmark for desirable industrial organisation..."

which 500 persons enjoyed the watch's service up to the terminal year; 300 persons up to 3 years; and 200 persons' watches (i.e. 20% of the watches) broke down after 1 month in use. Since the life expectancy varies (i.e. 0-4 years) and this is fairly known to all participants in the market, the uniform price charged is valid despite the presence of uncertainty and moderate divergent outcome of 20% substandard pieces instead of 10%. A critical mind will ask, what is the difference between this price we termed as valid and the prices of batteries and butter we termed as invalid in the previous subsection? The answer is that in respect of the batteries homogeneity of product was assumed and strongly expected which failed to materialize. With regard to butter both the upper and lower levels are well-known and strongly expected which also did not materialize. Under this condition nobody has the exact knowledge about the minimum life period of a watch. The only information available to us is that it ranges between zero and four years. Therefore, some *gharar* about quality will be tolerated and the price will not be rejected.

Let us raise another pertinent question at this juncture and that is: Are there prices that fulfill the legal requirements but are likely to create tension and disputes among people?

5.2.2 Unacceptable Valid Prices

It is the objective of the *Shari'ah* to preserve fairness in the distribution of benefits and costs of exchange among people. But the jurists understood that very often this objective remains unfulfilled due to the potential divergence between price and exchange-value resulting in non-equivalence. Zarqa (1991:34) brought this to our knowledge: "Islamic jurists envisaged that the price at which two parties exchange is often disproportionate to the exchange-value of the commodity. They called the difference *ghabn*..." In real life *ghabn* or over-pricing is experienced in all forms of markets, particularly where information asymmetry abounds. Let us explain with the help of some examples beginning with some ordinary cases.

To begin with a general case, in most of the Muslim countries today the rate of increase in money wages is more than the rate of supply of goods demanded. Because of this imbalance in demand and supply, it becomes easy for sellers to increase prices. Whenever this motive is realized as is the case in contemporary Nigeria, human sufferings become widespread. With the increase in price of essential commodities input prices shoot up to increase cost of manufacturing and, so, another increase in market price. Thus a vicious circle of price rise emerges. Because of this, fixed wage earners suffer a great loss even though they interact in the market and bargain to buy at a mutually agreed price. On the other hand, sometimes it happens that prices of some commodities, particularly agricultural products, go down considerably and the peasantry suffer a great loss as well. Both these situations arise in the context of normal operation of the market mechanism and, therefore, prices will be considered valid. Should the governments of Muslim countries accept these prices that bring about distress and animosity? To counter this situation they are bound to impose price control.

Let us now examine some specific cases . Consider a drug industry where firms produce several brands of paracetamol. Suppose the *i*th firm introduced a new brand of the same quality and standard and created a new demand without, however, violating any of the legal rules. Assuming that this firm took advantage of its product differential and charged a high price for its brand of paracetamol. Let us further suppose that people are willing to pay the higher price for that brand, without compulsion. The higher price is in essence valid. However, the jurists are of the view that the new demand created by the *i*th firm will not justify any increase in its paracetamol price. If the firm insisted on charging more, it will be prevented. Ibn Taimiyah rules that: "Anyone who creates demand for what he possesses of food or clothes should know that it is obligatory on him to sell at known price without his choice. People will not pay him more for his goods" (Ibn Taimiyah, 1381-87 H., 29:300). Thus any attempt in this regard to charge a higher price will not be acceptable by the Islamic state even though people may be willing to pay more.

The cases of possible rejection of valid prices are more rampant under asymmetrical information conditions. These conditions may arise from an act of *ghish* or may result from market failure. It is the opinion of Zarqa that under information asymmetry benefits of exchange tend to accrue to one side and the other side sustains losses: "... one of the two parties will appropriate larger portion of benefit or the entire benefit and the loser, despite all efforts, will go empty-handed. This implies that one party got what he did not deserve, therefore , it leads to disputes and animosity" (Zarqa, 1991:46). What are the conditions under which these exchange relations aries?

Consider a hypothetical case where profit-sharing (*qirad*) bonds are traded on a stock exchange. To avoid jurisprudential complexities, let us assume constant nominal prices of bonds as they are traded. Valid bond prices may be established if prices in the stock exchange follow the *Random Walk Theory*.[(9)] Due to information asymmetry, however, corporate insiders and stockbrokers may use superior knowledge of bond yields (negative or positive) to make economic profit. Suspicion regarding actions of those who know the future yields could lead to disputes. In fact, Elgari (1993:4-7) is of the view that under present conditions where *gharar* and *jahl* are well-rooted, *gish* is a very strong possibility. Prices emanating from stock exchange ought to be regulated by the Islamic state unless where asymmetry is minimized to the acceptable level.

So far we discussed only those situations in which injury can be eradicated or avoided through regulation. The question here is, will there be other situations under which injury through pricing policies is certain? There is a continuum of such policies ranging from complex and unascertainable ones described by Baron and Myerson (1982), Sappinton (1983), Baran and Besanko (1984), Riordan (1984), and later Zarqa (1991) (in the treatment of *tatfif*) at the one end; to ascertainable and measurable ones like price discrimination and cross-subsidization at the other end. For our analytical purpose, we will only deal with the latter.

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(9) *Random Walk Theory* establishes that the actions of investors cause prices of securities to follow no specific trend, i.e. price changes of stocks occur in a random fashion. It implies that serial dependence in stock price change is slight and not sufficient to yield prediction rules for profitable investment (**Fama**, 1965).

Price discrimination, on the supply side, is generally disallowed by Islam because it results in exploitation of a section of the society. Ibn Taimiyah (1976:13) equated it with usury when he ruled that sellers must not charge lower prices from hagglers and higher ones from those ignorant of the market price. Cross-subsidization, on the other hand, is a recently developed concept in economics which Faulhaber (1975) has elaborated. It involves fixing higher prices for some consumers who are made to subsidize lower prices enjoyed by other consumers. Under what market conditions will this injury be certain and unavoidable?

Natural monopolies like water, electric and railroad utilities are characterized by huge capital investments. Technical conditions in these enterprises make it difficult to breakeven by resorting to average or even marginal cost pricing. If these essential services are to be provided firms must find ways of breaking-even or earn 'quasi-rent'. There are virtually two ways in which a firm facing investment indivisibilities can break even; either to raise price above marginal cost or resort to price discrimination. The first option is usually adopted by a single market firm and the second option by a multi-market firm. Because of these reasons free market pricing of natural monopoly products must surely lead to injury on certain section(s) of the society whether price regulation is imposed or not. Imposition of control in these cases is the demand of the *Shari'ah* in compliance with the principle of *maslaha*.

The preceding case refers to state intervention in ensuring provision of basic services by means of price control. When supply is ensured by making production condition feasible through pricing policies, price control can be used to ensure fairness and justice in the distribution of costs of these services. Let us illustrate this by the help of an example. Consider an electricity generating firm whose demand varies according to time of the day. In this case marginal costs of supply vary according to time or period of supply. Change in cost of supply (at various time/period) with the existing capacity (with a mix of plants of different capacities) makes energy costs (variable costs) vary during different hours. Faced with unevenly distributed demand, plants are operated in accordance with the rule that most efficient ones are operated first, followed by less-efficient ones in the merit order of operations. Capacity is determined by the highest demand, i.e. the "system peak". During "off-peak" hours considerable spare capacity will be available. Differential tariff on time-differentiated demand is recognized. This requires breaking down supply hours into peak and non-peak periods. The former attracting high rate charges and the latter lower ones. Justification for peak-capacity charge is based on the fact that every peak user imposes on the utility an incremental cost of the capacity he draws but such causal relationship does not exist between off-peak use and capacity costs. It would, therefore, be unfair to levy capital costs on the off-peak user. This analysis can be extended to all non-storable commodities such as telecommunication.

In practice, especially in the United States, disputes and conflicts among consumer classes and within consumer classes often erupt in utility markets. A section of the consumers often accuse utilities of making them cross-subsidize another section by charging them high rates. Other firms facing the cross-subsidizing firms have opposite concern. They dislike low prices and they are apt to appeal to the authority that they are victims of predatory pricing. It is obvious, therefore, since the *Shari'ah* disallowed imposition of unaccounted costs, price regulation in these activities must be imposed to safeguard people's interests.

Our analysis indicates that although there is a gap of centuries between the time jurists were researching in price control and now when economists have developed it, there is significant analytical scope to deduce implications for Islamic economics. Let us now examine the areas of agreement and disagreement between Islamic and conventional approaches to price control.

6. Convergence and Divergence Between Islamic and Conventional Approaches to Price Control

There are several areas of agreement and disagreement between Islamic and conventional positions on price regulations. Let us examine them starting with the areas of agreement.

Both Islamic and conventional economics have exhaustively examined imperfections in the market and agreed that in such cases selective price control is necessary. Analytical effort in economics concentrated on absence of competition but in *fiqh* it concentrated on 'breakdown of competition' already in existence. Price controls in special cases in which individuals cannot safeguard their interests is socially expedient in both disciplines. That is why we find unanimity of support for price fixing under asymmetrical information conditions. Also the two disciplines concur on the limited role of the market mechanism in bringing about socially desirable results under certain normal situations. But in emergency, its relevance in distributing essential items of consumption and resource transfer has been completely ruled out. This makes presence of the state more or less permanent in Islamic and capitalist economies. However, total rejection of the market system from ideological standpoint of communism is extreme and unacceptable to Islam.

Floors on wages and ceilings on profits and rentals in wartime are also acceptable to both sections of economists. Economists agree that excessive arms expenditure exert inflationary pressures often warranting controls. Islamic economists will not insist on 'wage of the equivalent' in these times. Because if the demand for skilled labour is on the increase and that of the unskilled labour on the decline, the market price of the latter may not meet basic needs of workers. Likewise sudden increase in wages of the former will inevitably accelerate inflation. In the same way we can argue for other sources of income.

Creation of future markets in which input prices are fixed in the present is acceptable to both Islamic and conventional economics. Jurists allowed payment at present for goods to be delivered in the future.

Basically, there is one major area of divergence between the two approaches to regulatory practices and that is in their respective conception of monopoly. Orthodox economics analyzes market structures but juristic discussion of the forms of market is secondary, their primary concern is with the mechanics of the market. Because of its concern with behaviour, Islamic analysis did not make cost advantages explicit in analyzing market operations. This is because the jurist did not treat cost as direct tool of exercising monopoly powers. Orthodox economists recognized this possibility and used it as the chief argument for price control in the public utilities. This fact made the concept of monopoly in *fiqh* and that in economics fairly different.

Monopoly conceived by the *Shari'ah* in the Qur'anic and *hadith* texts is that enterprise that withholds supply of commodities with a view to profiteering. This enterprise may be an ordinary or natural monopoly or may be a collection of firms like oligopoly. This monopoly is essentially characterized by withholding or contracting output to charge high price. Thus the presence of a single firm that enjoys economies of scale and scope in the market is not considered as monopoly from *fiqh* point of view unless it resorted to hoarding or any act disapproved by the Law. By corollary, therefore, contestable monopolies are acceptable to the *Shari'ah*.

It is now time to summarize and conclude our discussions.

7. Summary and Conclusion

The study surveyed the positions of various schools of Islamic jurisprudence and other legal experts on price control and found extreme as well as moderate views for and against price control. All schools of *fiqh* agree that under imperfect conditions such as hoarding or other fraudulent acts price control is permissible. They also agree that in all cases where individuals cannot safeguard their interests price regulation can be imposed. Some jurists are of the view that even in normal times price fixation with consultations and mutual consent is permissible. The overall contention is that need-satisfaction , avoidance of injury and preservation of just interests are central objectives of the *Shari'ah* which have to be achieved through price control whenever market mechanism, for whatever reason, fails to safeguard them.

The main conclusion to be drawn is that price control is not commonplace in an Islamic economy. However, selective price controls are admissible when their need or necessity arises despite real and nominal costs associated with implementation. Each case identified for control will have to be scrutinized on its own merit; because, our analysis of the rules of *fiqh* indicates that an act may be forbidden in one situation where it serves no interest and allowed in another where it is found to serve just interest.

Treatment of prices in an Islamic economic system exclusively from the legal point of view is erroneous because it overlooks the fact that fairness and justice are not entirely based on legal considerations. It is perhaps for this reason that Siddiqi (1981:59) concluded that: "Islamic analysts are not quite sure if the working of the market will ever result in prices that satisfy Islamic norms... The concept of just and fair prices... oscillates between what modern economists regard as 'normal' and what Islamic economists will find satisfying to their norms". This ambiguity is minimized by this study.

Another error found in Islamic economic analysis is the acceptance of neo-classical assumption that full information is attainable and made equally available to all participants in the marketplace. In reality, as in *fiqh*, information is heterogenous and unequally distributed, individuals can exploit superior knowledge to their advantage.

One other major error is to look at economic concepts as a source of the *Shari'ah* position on Islamic market. Self-interest and invisible hand are some cases in view. Self-interest and neutral economic behaviour are not necessarily facts of life or even human nature, such motivations being largely determined by the nature of society itself. We are reminded by Georgescu-Reogen (1967:286) that societies have differed in their emphasis on this matter.

What we outlined so far is a general framework for price regulation in an Islamic economy. But these general points need to be supplemented by more specific works on price control in Islamic economics. Perhaps the development of a theory of public utility pricing from Islamic perspective will be quite relevant at this point in time. Even though the study is a general one, we feel it provided greater insight into the principles of price regulation in modern Islamic markets than the previous writings.

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التسعير في اقتصاد إسلامي

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المستخلص : بدأ النظر في موضوع التسعير في الاقتصاد الإسلامي في أوائل القرن السابع الميلادي وعالجه الفقهاء بالتحليل والدراسة بين القرن الحادي عشر والقرن السادس عشر. ويستعرض هذا البحث التطورات في هذا الموضوع من خلال أدلة المذاهب الأربعة في الفقه الإسلامي، كما يدرس آراء عدد من الفقهاء ويبحث عن الأوضاع التي تبرر أو توجب التسعير في اقتصاد إسلامي، ويمحص بعض حالات التسعير في النظرية الاقتصادية التقليدية. ويلخص البحث مواقف الفقهاء وآراءهم حول أسعار السوق فيقدم بذلك إطاراً نظرياً لدراسة إدارة الأسعار في الاقتصاد الإسلامي.