Why The Nobel Prize Of Economics (2012) Enhance the Position of Islamic Finance towards Repugnant Markets?

Part 1

By Maan Barazy

Certified Shari'a Adviser and Auditor (CSAA- AAOIFI Certified) - MA Islamic Comparative Jurisprudence - BS International Economics - Managing Partner And CEO of Data and Investment Consult-Lebanon

"How did commercial, banking, and similar money-making pursuits become honorable at some point in the modern age after having stood condemned or despised as greed, love of lucre, and avarice for centuries past?"

Max Weber quoting Benjamin Franklin on the virtues of responsible lending and borrowing

ABSTRACT:

Our understanding of market stability and the predictability of financial crisis has fallen short of the concept of repugnance. Repugnance creates distortion in market design and might be a catalyst to financial crisis. Roth argues that "the real repugnance that some people feel toward some transactions means that economists interested in proposing and designing markets must take this repugnance into account." If one hopes to design more efficient and ethical systems of exchange, cultural notions of repugnance can't simply be dismissed as irrational. This would seem to be an argument with implications beyond economics. When repugnance is taken into consideration; markets were most stable; a case in point is the behavior of Arab and Islamic market mechanisms under international financial crisis. Regulators have put outstanding weight into designing deterrence system for crisis and operational fraud; hence it would have been more rewarding to study causes of repugnance in the system. There is a greater need today for international markets to understand the notions of interest-free exchanges LARIBA and particularities of Arab markets exchanges if one hopes to design more efficient and ethical systems of exchange, cultural notions of repugnance can't simply be dismissed as irrational. Markets looses their efficiency and some markets become limited because the very existence of a market in some goods is considered repugnant. A repugnant market becomes therefore an area of commerce that is considered by society to be outside of the range of market transactions and that bringing this area into the realm of a market would be inherently immoral or uncaring. In my conclusion I will also bring the motion of repugnance closer to the international system understanding of growth which is repugnant in Islamic dictums.

A Bank for international settlements Working Papers (No 381) "Reassessing the impact of finance on growth" http://www.bis.org/publ/work381.pdf; Stephen G Cecchetti and Enisse Kharroubi give breath taking results on the study the complex real effects of financial development and come to two important conclusions. First, financial sector size has an inverted U-shaped effect on productivity growth. That is, there comes a point where further enlargement of the financial system can reduce real growth. Second, financial sector growth is found to be a drag on productivity growth. Our interpretation is that because the financial sector competes with the rest of the economy for scarce resources, financial booms are not, in general, growth enhancing.

Alvin E. Roth nomination to the Nobel economics prize 2012 has enhanced our understanding of how markets work; and give us some insights on behavior of agents and irregularities in market design. But further his concept of "repugnance" bring forward positive contribution to Islamic finance and Arab markets stability both under free interest rates exchanges; financial notions and mechanisms. Roth, whose "market design" bridges economics and operations research, is known for developing algorithms to find the best available matches in real-world situations:

Conclusion

A Muslim involved in businesses, purchasing and selling, should learn the legal rulings on trade transactions. They should also learn the valid and invalid conditions of any business deal in order to make themselves aware about the legal complications in such dealings. Similarly, Muslims can find legal solutions about the controversies arising from trade transactions contract most of which result from ignorance of such Islamic injunctions, rulings and conditions by seller, buyer or both.

التخطيط..

إذا كنت تخطط لسنة فازرع قمحاً

وإذا كنت تخطط لعشر سنوات فازرع أشجاراً

أما إذا كنت تخطط للحياة فدرّب الناس وعلّمهم

الحكيم الصيني كوان تزو

medical residencies, public schools and kidney transplants from living donors. Starting from an understanding of game theory and rational agents preferences; his contribution to kidney donors matching is outstanding since such markets don't actually involve monetary exchanges. These include medical residencies, in which both sides care about exactly whom (or what characteristics) they're matched with. Each side has a ranking of its preferences, and the trick is to get everybody as highly ranked a match as possible. Having an auction wouldn't solve the problem, because the highest bidder for a given partner wouldn't necessarily match the partner's preferences.

Roth is the George Gund Professor of Economics and Business Administration at Harvard Business School (HBS) and in the Economics Department at Harvard's Faculty of Arts and Sciences (FAS). He received the Nobel prize for his work on the design and functioning of such markets, which was done in large part at Harvard. He shares the prize, officially named the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel, with Lloyd S. Shapley, A.B. '44, of the University of California, Los Angeles.

Background

One of Roth's more interesting notions, is his work on repugnance as a constraint on markets - the costs imposed by the fact that certain cultures find the buying and selling of certain goods and services to be too icky. To my knowledge the notion of repugnance has not been brought forward in any discussion of the predictability of financial crisis nor in the argumentation of efficient markets design.

In his 2007 paper, Repugnance as a Constraint on Markets, Roth considers several examples of repugnancy costs. For instance, it is illegal to eat horse meat in California. But it is not illegal to kill horses -- just not for the purpose of eating them -- and many people in the state come from societies where eating horse is socially acceptable. He also discusses dwarf -tossing, an activity banned in many places and widely viewed as morally repugnant, though the physically similar sport of "wife-carrying," is widely accepted. Roth notes that a dwarf-tossing ban in France was overturned after one dwarf sued on the grounds that it violated his right to employment.

In less wacky sections, Roth discusses why carbon trading schemes are now considered acceptable, but it is considered unethical to pay developing countries to take in waste from the rich world, any why paying mercenaries is considered less ethical than expecting young citizens to die for their country. There's also the charging of interest, a practice that only being acceptable in Europe around the 14th and 15th century and is still considered unethical in Islamic societies today, resulting in a cottage industry of sharia-compliant financial services. Repugnance therefore creates distortion in market design and might be a catalyst to financial crisis. Roth argues that "the real repugnance that some people feel toward some transactions means that economists interested in proposing and designing markets must take this repugnance into account." If one hopes to design more efficient and ethical systems of exchange, cultural notions of repugnance can't simply be dismissed as irrational. This would seem to be an argument with implications beyond economics.

The point is illuminating for Islamic finance practitioners since arguments towards stable markets underline the fact that interest rates and fixed income are factors of repugnance and therefore such denominators are causes of distortion in market design and the mere fact that they are unacceptable factors to some agents leads to negative forces in the system.

This paper moves into this direction; namely:
1-Our understanding of market stability and the predictability of financial crisis has fallen short of the concept of repugnance.
2-When repugnance is taken into consideration; markets were most stable; a case in point is the behavior of Arab and Islamic market mechanisms under international financial crisis.
3-Regulators have put outstanding weight into designing deterrence system for crisis and operational fraud; hence it would have been more rewarding to study causes of repugnance in the system.
4-There is a greater need today for international markets to understand the notions of interest-free exchanges LARIBA and particularities of Arab markets exchanges if one hopes to design more efficient and ethical systems of exchange, cultural notions of repugnance can't simply be dismissed as irrational.
5-Markets looses their efficiency and some markets become limited because the very existence of a market in some goods is considered repugnant. A repugnant market becomes therefore an area of commerce that is considered by society to be outside of the range of market transactions and that bringing this area into the realm of a market would be inherently immoral or uncaring.
6-Pointing to inefficiencies, tradeoffs, costs and benefits in conventional markets, might lead to an improvement of the understanding of the need of an Islamic based finance system and the expected role it needs to play in building and designing efficient markets of the 21st century.
7-In my conclusion I will also bring the motion of repugnance closer to the international system understanding of growth which is repugnant in Islamic dictums. A Bank for international settlements Working Papers (No 381) "Reassessing the impact of finance on growth" http://www.bis.org/publ/work381.pdf; Stephen G Cecchetti and Enisse Kharroubi give breath taking results on the study the complex real effects of financial development and come to two important conclusions. First, financial sector size has an inverted U-shaped effect on productivity growth. That is, there comes a point where further enlargement of the financial system can reduce real growth. Second, financial sector growth is found to be a drag on productivity growth. Our interpretation is that because the financial sector competes with the rest of the economy for scarce resources, financial booms are not, in general, growth enhancing. This evidence, together with recent experience during the financial crisis, leads us to conclude that there is a pressing need to reassess the relationship of finance and real growth in modern economic systems. More finance is definitely not always better; the authors say.

What is repugnance?

Roth says that his essay Repugnance as a constraint on markets "examines how repugnance sometimes constrains what transactions and markets we see. When my colleagues and I have helped design markets and allocation procedures, we have often found that distaste for certain kinds of *transactions is a real constraint, every bit as real as the constraints imposed by technology or by the requirements of incentives and efficiency".*

- *Is a constraint on transactions and markets*
- *Takes the form of distaste for certain kinds of transactions such as the one imposed by technology or by the requirements of incentives and efficiency"*
- *Can change over time, it can persist for a very long time, although changes in institutions that reflect repugnance can occur relatively quickly when the underlying repugnance changes.*

As to our common knowledge of repugnance I chose to adhere to Wikipedia quoting: The term wisdom of repugnance describes the belief that an intuitive (or "deep-seated") negative response to something, idea or practice should be interpreted as evidence for the intrinsically harmful or evil character of that thing.

How does it impact working of markets? Well, those products/services which a society deems as repugnant (but are useful like an exchange for trading kidneys) will not trade in the usual way as the other products. First, there will be a reluctance to come forward and offer such products and second even if they do come, the outcomes are not going to be efficient as these markets will have only very few takers.

We can see the importance of this by looking at another paper of Roth's, not cited by the committee, on repugnance in markets. Roth demonstrates that some markets are limited because the very existence of a market in some goods is considered repugnant. A repugnant market is an area of commerce that is considered by society to be outside of the range of market transactions and that bringing this area into

the realm of a market would be inherently immoral or uncaring. For example, many people consider a market in human organs to be a repugnant market or the ability to bet on terrorist acts in prediction market to be repugnant. Meanwhile, other people consider the lack of such markets to be even more immoral and uncaring because trade bans (e.g. in organ transplants and terrorism information can create avoidable human suffering.

A key idea on bearing interest rates to loans; a practice banned from Shari'a; is quoted below:

Lending money for interest is an example of a market that was once widely repugnant, and no longer is, (with the important exception that Islamic law is commonly interpreted as prohibiting it). State usury laws in the U.S., and Islamic banks in some countries, are examples of modern expressions of this repugnance. Near the beginning of his essay "The Spirit of Capitalism," Max Weber quotes Benjamin Franklin on the virtues of responsible lending and borrowing, and near the end of the essay Weber (1930, p74) asks "Now, how could activity, which was at best ethically tolerated, turn into a calling in the sense of Benjamin Franklin?" Hirschman (1977, page 9) paraphrases Weber's question as "How did commercial, banking, and similar money-making pursuits become honorable at some point in the modern age after having stood condemned or despised as greed, love of lucre, and avarice for centuries past?" (See Persky, 2007 in this journal, and the references there, on the Jeremy Bentham/Adam Smith arguments about usury, and Kuran, 1995 in this journal on Islamic banks.)

Roth pinpointed in different quotations and research papers illustration to repugnant markets; and that although "the trend of increasing prosperity will continue, but that it will not necessarily (as Keynes predicted in 1930) bring us all lives of leisure"; for example he showed how different practical daily lives practices might become repugnant in different instances and vice versa such as

- *Taking performance enhancing drugs will go from being repugnant today to ordinary in the future.*
- *Use computers for access to more and more data, may become repugnant in some respects, as privacy of personal data moves to the forefront of civil rights issues.*
- *Some kinds of medicine, including reproductive medicine along with other aspects of reproduction, will become commoditized, while others, such as genetic manipulation of various sorts, may become repugnant.*

It is because of such derivation of those choices and the non-stable character of human choices along decades and the nature of rationality in human psychology highlights that the study of repugnant transactions will be increasingly important and an important factor in understanding dynamics of market design. Charging interest was once considered sinful; indentured servitude was once deemed acceptable. And in early 19th century Britain, for example, anatomists were allowed to work only on the cadavers of executed murderers. Therefore crucial to the theme of this paper is Roth dictum that "The persistence of repugnance in many markets doesn't mean that economists should give up on the important educational role of pointing to inefficiencies and tradeoffs and costs and benefits. Neither should we expect such arguments to immediately win every debate.

Being aware of the sources of repugnance can only help make such discussions more productive (not least because it can help separate the issues that are fundamentally empirical—like the degree of crowding out of altruistic donations that might result from different incentive schemes compared to how much new supply might be produced—from areas of disagreement that are not primarily empirical).

This is in fact what I seek to work on in the coming paragraphs namely that; as market crisis and upheavals have been more frequent in the last decades; pointing to inefficiencies and tradeoffs and costs and benefits in conventional markets, might lead to an improvement of the understanding of the need of an Islamic based finance system and the expected role it needs to play in building efficient markets of the 21st century.

Roth believes that advocates of well regulated markets could more clearly address the concern that markets are hard to regulate perfectly and that at least some repugnant transactions would likely slip through even the best regulatory barriers.

References

1.An Economics Nobel For Saving Lives; By Virginia Postrel ; http://www.bloomberg.com/news/2012-10-16/an-economics-nobel-for-saving-lives.html; Bloomberg.com

2.Roth built on Shapley's theories about the best ways to match "agents" in markets — for example, students matched with schools or organ donors with patients needing organs — and conducted experiments to further illuminate Shapley's work. He also helped to redesign existing institutions to improve their functioning.

3. Roth, Alvin E. "Repugnance as a constraint on markets," Journal of Economic Perspectives, 21(3), Summer, 2007, 37-58.

4.Keynes, John Maynard (1930), "Economic Possibilities for our Grandchildren", Essays in Persuasion, New York: W.W. Norton & Co., Leider and Roth 2010

5.Roth, Alvin E. "The Economist as Engineer: Game Theory, Experimental Economics and Computation as Tools of Design Economics," Econometrica, 70, 4, July 2002, 1341-1378.

6. Roth, Alvin E. “Repugnance as a constraint on markets,” Journal of Economic Perspectives, 21(3), Summer, 2007, 37-58.
7. Roth, Alvin E. "What have we learned from market design?" Hahn Lecture, Economic Journal, 118 (March), 2008, 285–310.
8. I have listed in the appendix to this paper all the areas that Roth considers as repugnant
9. Quoted in his paper: 100 years
10. An Economics Nobel For Saving Lives; By Virginia Postrel ; http://www.bloomberg.com/news/2012-10-16/an-economics-nobel-for-saving-lives.html; Bloomberg.com
11. Roth built on Shapley’s theories about the best ways to match “agents” in markets — for example, students matched with schools or organ donors with patients needing organs — and conducted experiments to further illuminate Shapley’s work. He also helped to redesign existing institutions to improve their functioning.
12. Roth, Alvin E. “Repugnance as a constraint on markets,” Journal of Economic Perspectives, 21(3), Summer, 2007, 37-58.
13. Roth, Alvin E. “Repugnance as a constraint on markets,” Journal of Economic Perspectives, 21(3), Summer, 2007, 37-58.
14. Roth offers many examples of repugnant markets like insurance products for children & old, gambling and betting markets, adoption, etc. Then he shows how it leads to problems in market design and how he tried to solve them in some cases. The Gale-Shapley algorithm, for instance, was devised in 1962, when Lloyd Shapley was 34. It concerns maths problem known as the stable marriage problem: if you have an even number of men and women, can you always come up with a set of marriages where there are no two people of opposite sex who would both rather have each other than their current partners? (1960s maths problems: usually heteronormative.) If you can, then the marriage is "stable".
15. Repugnance as a Constraint on Markets; Alvin E. Roth; Forthcoming, Journal of Economic Perspectives, 2007; Harvard publications.
16. Keynes, John Maynard (1930), “Economic Possibilities for our Grandchildren”, Essays in Persuasion, New York: W.W. Norton & Co., Leider and Roth 2010
17. Roth, Alvin E. “The Economist as Engineer: Game Theory, Experimental Economics and Computation as Tools of Design Economics,” Econometrica, 70, 4, July 2002, 1341-1378.
18. Roth, Alvin E. “Repugnance as a constraint on markets,” Journal of Economic Perspectives, 21(3), Summer, 2007, 37-58.
19. Roth, Alvin E. "What have we learned from market design?" Hahn Lecture, Economic Journal, 118 (March), 2008, 285–310.
20. Quoted in his paper: 100 years
21. I have listed in the appendix to this paper all the areas that Roth considers as repugnant.
22. Some of his examples are poignant as well as repugnant, "...the French Ministry of the Interior, in 1991, issued a statement saying that “dwarf tossing should be banned"... a French dwarf, who had been employed by a company called Société Fun-Productions, successfully sued in French courts to have the bans overturned. However the bans were upheld on appeal... on the grounds that “dwarf tossing… affronted human dignity…” The dwarf then brought his complaint to the UN... he stated “that there is no work for dwarves in France and that his job does not constitute an affront to human dignity since dignity consists in having a job.” However the UN committee found in favor of France..."
23. Significant discussion can be found here : Decentralized Markets, and market failures--congestion, unraveling, market culture [Updated 10/3/11 :Roth, Alvin E, "Marketplace institutions related to the timing of transactions, and reply to Priest (2010)" October, 2010. (Here is the shorter version that is forthcoming in Journal of Labor Economics, maybe in April 2012)]
24. Repugnant Markets [Updated 6/01/12: My paper "In 100 Years" includes some speculation on transactions whose repugnance may change one way or another in the future (and it got a nice plug here--apparently Stephen Dubner has an attraction to repugnance...:)]
25. Market for Law clerks [Updated7/20/12: Here are the dates and rules in the Federal Judges Law Clerk Hiring Plan for 2012, but the plan, which has been on it's last legs for a surprisingly long time, may finally be dead: see my blog post The Federal Law Clerk Hiring Plan is pretty much over]
26. AEA market for new economists [Updated 1/4/11: Peter Coles, John Cawley, Phillip B. Levine, Muriel Niederle, Alvin E. Roth, and John J. Siegfried , " The Job Market for New Economists: A Market Design Perspective," Journal of Economic Perspectives, 24,4 (Fall) 2010, 187-206].

Why The Nobel Prize Of Economics (2012) Enhance the Position of Islamic Finance towards Repugnant Markets?

By Maan Barazy
Certified Shari'a Adviser and Auditor (CSAA- AAOIFI Certified) - MA Islamic Comparative Jurisprudence - BS International Economics - Managing Partner And CEO of Data and Investment Consult-Lebanon

"How did commercial, banking, and similar money-making pursuits become honorable at some point in the modern age after having stood condemned or despised as greed, love of lucre, and avarice for centuries past?"
Max Weber quoting Benjamin Franklin on the virtues of responsible lending and borrowing

Building efficient markets in an Islamic concept

Al Roth's Nobel 2012 recipient of the prize in economics contributed immensely to game theory, experimental economics, and market design. Those "correlation" studies showed that developments in economics came together to form the field of market design. A solid foundation to this is game theory—the study of the "rules of the game" and the strategic behavior that they elicit.

Key to our argument is therefore:

- The significance of Roth works in relation to Islamic markets following his papers on repugnance. According to Roth, "We need to understand better and engage more with the phenomenon of 'repugnant transactions,' which, I will argue, often serves as an important constraint on markets and market design."
- The repugnance factor as a direct cause of market crisis

Islamic finance is based on a theory and practice of profit sharing investment against the backdrop of current western finance it does not engage market players in an oligopoly; therefore a kind of an exchange between rational agents regulated by the principles of game theory - seeking to maximize each player interest - contention goes against Islamic dictums; since in such a system the maximization of the interests of the whole community need to be taken into account.

Of course Islamic markets do not function as conventional ones; further, although they interact in the same environment however the behavior of the players is different. Game theory has a lot of observations to say on the psychology of the players and one can say that its main raison d'être is the study of the behavior of agents.

It is crucial here to denote that Islamic finance seeks to move towards exchanges in a utilitarian philosophical turnaround; meaning that markets seek the greatest good for the largest amount of individuals. Close to this concept is the Islamic concept of Taa'azim Al Massaleh (the greater maximization of interests). Roth qualifies as repugnant the failure of making people engage in transactions that would make them all better off.

In an interview Roth says :

"As an economist who wants to understand things as they are, I wondered why we don't have some of the markets that economists like. Economists have the point of view that voluntary transactions should always be fine. If two people engage in a voluntary transaction, it must be because they both want to, and it makes them better off. The kinds of things I'm calling repugnant are transactions that some people don't want other people to engage in".

Roth's paper, "Repugnance as a Constraint on Markets ," looks at a wide range of practices."We need to understand better and engage more with the phenomenon of 'repugnant transactions', which, I will argue, often serves as an important constraint on markets and market design." Although; Roth works on repugnant markets received a great deal of comments and criticisms ; however, repugnance impose serious constraints on various kinds of transactions.

Islamic Markets; Interest Rates and Efficiency

As Roth works enlighten us also on the inappropriateness of certain kinds of market transaction, even when this inappropriateness falls short of outright repugnance, however the concept of maximization of profits which eradicates constraints of market design lead us to analyze why stability is hence jeopardized and imposes constraints on financial systems while questioning the very nature of what is an efficient market?

As to Roth: to function properly, markets need to do at least three things .

- They need to provide thickness—that is, to bring together a large enough proportion of potential buyers and sellers to produce satisfactory outcomes for both sides of a transaction.
- They need to make it safe for those who have been brought together to reveal or act on confidential information they may hold. When a good market outcome depends on such disclosure, as it often does, the market must offer participants incentives to reveal some of what they know.
- They need to overcome the congestion that thickness can bring, by giving market participants enough time—or the means to conduct transactions fast enough—to make satisfactory choices when faced with a variety of alternatives.

A juxtaposition of those precepts to the behavior of present day international exchanges and markets is undoubtedly true. It is not the place nor the space here to provide for examples of how international markets have failed to guarantee to their players thickness; safety and congestion.

However; key to those failures is the concept of interest rates mechanisms as practiced by speculators in the open market; and how actually growth has been a precept of the enlargement of the markets. Roth argument meets a recently published paper by the Bank for international settlements (Working Papers - No 381) “Reassessing the impact of finance on growth” ; Stephen G Cecchetti and EnisseKharroubi give breath taking results on the study the complex real effects of financial development and come to two important conclusions. First, financial sector size has an inverted U-shaped effect on productivity growth. That is, there comes a point where further enlargement of the financial system can reduce real growth. Second, financial sector growth is found to be a drag on productivity growth. Our interpretation is that because the financial sector competes with the rest of the economy for scarce resources, financial booms are not, in general, growth enhancing. This evidence, together with recent experience during the financial crisis, leads us to conclude that there is a pressing need to reassess the relationship of finance and real growth in modern economic systems. More finance is definitely not always better; the authors say. “Inside Finance literally bids rocket scientists away from the satellite industry. In a sarcastic manner the researchers say that the result is that people who might have become scientists, who in another age dreamt of curing cancer or flying to Mars, today dream of becoming hedge fund managers” the paper quotes.

Interest rates; Riba as a factor of repugnance and market disability

Roth cites the example of “Lending money for interest is an example of a market that was once widely repugnant, and no longer is, (with the important exception that Islamic law is commonly interpreted as prohibiting it). State usury laws in the U.S., and Islamic banks in some countries, are examples of modern expressions of this repugnance”.

His reference is Max Weber; he states: Near the beginning of his essay “The Spirit of Capitalism,” Max Weber quotes Benjamin Franklin on the virtues of responsible lending and borrowing, and near the end of the essay Weber (1930, p74) asks “Now, how could activity, which was at best ethically tolerated, turn into a calling in the sense of Benjamin Franklin?” Hirschman (1977, page 9) paraphrases Weber’s question as “How did commercial, banking, and similar money-making pursuits become honorable at some point in the modern age after having stood condemned or despised as greed, love of lucre, and avarice for centuries past?” (See Persky, 2007 in this journal, and the references there, on the Jeremy Bentham/ Adam Smith arguments about usury, and Kuran, 1995 in this journal on Islamic banks.)

Another example which is also dear to Islamic finance and practice is life insurance prohibited under Islamic jurisprudence: Some kinds of repugnance are also intermixed with concerns about providing incentives for bad behavior. The very idea of life insurance (‘you want to set a price on your life, and then place a bet on your date of death?’) seems to have had to overcome some initial repugnance in the early 1800s (Zelizer, 1979). The incentive issue was often addressed by “insurable interest” laws specifying who could be a beneficiary of life insurance. As discussed by Justice Oliver Wendell Holmes Jr. in a 1911 Supreme Court case: “A contract of insurance upon a life in which the insured has no interest is a pure wager that gives the insured a sinister counter interest in having the life come to an end.” Even today, life insurance for small children raises questions about motives. The insurance industry lobbies against Stranger (or Investor) Owned Life Insurance (SOLI) and “viatical settlements,” which are third party markets and funds that purchase life insurance policies from elderly or terminally ill patients who wish to realize the cash value of their policies while still alive. The arguments against such funds often focus on the repugnance of having life insurance held by an entity that profits from deaths (in contrast to insurance companies, which make money when their customers continue living). Of course, sellers of annuities also profit from untimely deaths, too. For some flavor of the discussions about these issues, see Silverman (2005).

There are 4 explicit references in the Holy Qur’an to interest. Cumulatively, they clarify Islam’s position on the subject. It is useful to say that those verses were delivered to the prophet Mohamad in different times interval since interest was profoundly rooted in pre-islamic times and therefore its eradication needed some time intervals in order to be acceptable . Shortly after the conquest of Makkah in 8AH, the most comprehensive and damning indictment of interest was delivered in the Qur’an in Surah Baqarah verse 275-280, where Allah says; ‘Those who take usury will not stand on the Day of Judgment except as he who has been driven mad by the touch of the Demon. …… Oh you who believe give up what remains of Riba if you are believers. But if you do not then listen to the declaration of War from Allah & his messenger (SAW). If you repent, yours is your principal and nothing more…….’ In the year 10 AH, The Prophet (SAW), in his famous last sermon at Mount Arafat said; ‘All interest obligation shall henceforth be waived. Your capital however is yours to keep. You neither wrong, nor be wronged. Allah has judged that there be no Riba and that all interest due to Abbas ibnAbd Al-Muttalib shall henceforth be waived’ Hadith

The problems with interest may be deceptively difficult for us to appreciate, but the Ban on interest by Allah is absolute. In fact, so despised is Riba, that the unparalleled curse of a ‘declaration of war’ from Allah (SWT) & his Messenger (SAW) is directed towards those who refuse to give up interest.

The picture of repugnance therefore comes from the origins of modern banking which go back to the Goldsmiths of the 16th Century who stored gold on their premises for individuals who needed somewhere to safely deposit their wealth. Receipts were then issued to those who availed of this service. When the receipt was subsequently presented to the Goldsmith, the gold would be returned. As time went on the general public started to buy and sell using the paper receipts in place of actual gold pieces or coins.

This paper based system relied heavily on the ability of the Goldsmiths to return the gold on demand and is the origin of the obligatory promise on each and every banknote stating ‘I promise to pay the bearer on demand the sum of X pounds’. At this critical juncture, the Goldsmith’s discovered one of the greatest unethical money making ideas of all time. The Goldsmith’s realised that people were not returning to them regularly for their gold and relying instead entirely on the receipts which were now being exchanged as legal tender. As long as the public had confidence in these receipts then they could be printed and issued without any corresponding increase in the amount of gold being deposited. The market could then be flooded with these artificial receipts, which would be used as legal tender. This would allow huge loans to be forwarded to the general public, thereby earning the Goldsmiths interest. As time went on and their credibility was enhanced, the Goldsmiths realised that they needed to hold less and less gold in relation to receipts issued leading to the birth of the ‘fractional reserve system’. Fractional reserve is therefore a deceptive system which allows an expansion in the supply of paper money without a corresponding rise in the assets held by the bank.

This new money is only available to society through taking an interest bearing loan from the bank, and has been the cornerstone of the Western economic system from the days of the Goldsmiths back in the 16th Century to the present day. Consequently, the money that we own is not backed at all by real assets. It is simply and purely worth only the paper it is written on and is only deemed to have additional value because society has confidence in the economic system. Banks are given too much power the ability to create money gives banks and other financial institutions incredible levels of power by permitting the creation of artificial wealth for which they have carried out no corresponding real economic activity. This elite have an unacceptable level of control over society’s well being. Abuse of this power takes many diverse forms but can perhaps best be understood by examining the impact of debt on the third world.

Economic growth was hindered as money was permitted to attract a rate of return, banks are able to generate profits through interest. Banks will invariably prefer to lend to those who have the greatest collateral because they represent the lowest risk of default. Those who have the most viable business plans are not always those who have the greatest collateral. Consequently, interest based banking inhibits economic growth by failing to promote the best business ideas which, if supported would result in higher economic growth.

Those with the most collateral are by definition the wealthiest in society, By giving these people preferential access to money, capitalism has a persistent tendency to favour the rich and discriminate against the poor, ensuring that the rich just keep getting richer, and the poor just get poorer.

Conclusion

Game theory examines the ways that various people “play” their interactions with others. All games take place on at least two levels. The first is material gain or loss (often quantifiable, and the focus of most formal game theory), and the second, psychological perception of having won or lost (rarely quantifiable until recently, ignored). In honor-shame cultures, the perception of others’ actions plays a much stronger role than “rational” concerns about material gain and loss regardless of relative advantage which, in principle, governs civil society behavior (rational choice theory). Rational choice theory, focused on quantifiable self-interest as a motivation, tends to downplay emotional components of game playing. It discusses fixed- and variable-sum games. The following discussion analyzes the cultural and emotional dimensions of a player’s preference for one strategy over another, and focuses on zero-, positive- and negative-sum games. Game theory optimality is one of the concern of distributive economic justice in Islam. “Taazim al maslaha” we have shown is fundamental in bringing forward stable exchange systems; in Roth’s terms: congestion; safety and thickness.

To go back to the Bank for international settlements Working Papers (No 381) “Reassessing the impact of finance on growth” http://www.bis.org/publ/work381.pdf; Stephen G Cecchetti and EnisseKharroubi give breath taking results on the study the complex real effects of financial development and come to two important conclusions: One of the principal conclusions of modern economics is that finance is good for growth. Cecchetti and Kharroubi quotes: “The idea that an economy needs intermediation to match borrowers and lenders, channeling resources to their most efficient uses, is fundamental to our thinking”. And, since the pioneering work of Goldsmith (1969), McKinnon (1973) and Shaw (1973), we have been able to point to evidence supporting the view that financial development is good for growth; they say. More recently, researchers were able to move beyond simple correlations and establish a convincing causal link running from finance to growth. While there have been dissenting views, today it is accepted that finance is not simply a by-product of the development process, but an engine propelling growth; they add.

Accordingly the argument was one of the key elements supporting arguments for financial deregulation. If finance is good for growth, shouldn’t we be working to eliminate barriers to further financial development? As to the authors to assert: it is fair to say that recent experience has led both academics and policymakers to reconsider their prior conclusions. Is it true regardless of the size and growth rate of the financial system? Or, like a person who eats too much, does a bloated financial system become a drag on the rest of the economy?

At first, these results may seem surprising. After all, a more developed financial system is supposed to reduce transaction costs, raising investment directly, as well as improving the distribution of capital and risk across the economy; the writers assert. These two channels, operating through the level and composition of investment, are the mechanisms by which financial development improves growth. But the financial industry competes for resources with the rest of the economy. It requires not only physical capital, in the form of buildings, computers and the like, but highly skilled workers as well. Finance literally bids rocket scientists away from the satellite industry. In a sarcastic manner the researchers say that the result is that people who might have become scientists, who in another age dreamt of curing cancer or flying to Mars, today dream of becoming hedge fund managers.

Stephen G Cecchetti and EnisseKharroubi quotes: "there is an important sense in which this description of the consequences of a financial boom is no different from those of the dotcom boom of the 1990s, or the impact of any other boom tied to more tangible output; they say. Booming industries draw in resources at a phenomenal rate. It is only when they crash, after the bust, that we realise the extent of the overinvestment that occurred. Too many companies were formed, with too much capital invested and too many people employed. Importantly, after the fact, we can see that many of these resources should have gone elsewhere. Following the dotcom bust innumerable computers were scrapped, office buildings vacated and highly trained people laid off".

Appendix: Table 1 Markets In Which Some Transactions Are, Or Were Once, Repugnant

Human Remains

- Cadavers for anatomical study, organ donation, bone and tissue
- Live donor organs (kidneys, livers)

Labor

- Indentured servitude, slavery
- Volunteer army, mercenary soldiers
- Discrimination on race, gender, handicap, marital status, etc.

Reproduction and sex

- Adoption
- Surrogate mothers, egg and sperm donation, abortion, birth control
- Prostitution, pornography
- Bride price, dowry
- Polygamy, gay marriage

Words, ideas, and art

- Obscenity, profanity, and blasphemy
- Cultural treasures, art, and antiquities

Risk

- Life insurance for adults, children, and strangers
- Gambling
- Prediction markets

Finance

- Short selling, currency speculation
- Interest on loans

Pollution markets:

- Tradeable emissions entitlements
- Dirty industries in less developed countries

"Price gouging"

- After natural disasters
- Ticket scalping

Religion/Sports

- Sale of indulgences, ecclesiastical offices, etc. ("simony")
- Endorsements/payments for amateur versus pro athletes

Drugs and sports

- Food, drink, and drugs
- Horse and dog meat
- Alcohol (Prohibition)
- Marijuana and narcotics

Vote selling and Bribery

Dwarf-tossing

1. Roth came to Harvard in 1998 from the University of Pittsburgh, where he had already established a reputation in experimental economics. That same year marked the debut of Roth's biggest market-design experiment to date: a redesign of the National Resident Matching Program to improve placements for couples seeking medical residencies in the same city.
2. Repugnant Markets and How They Get That Way Q&A with:Alvin E. Roth; Published July 30, 2007 Author: Martha Lagace;Working knowledge Harvard Business School; http://hbswk.hbs.edu/item/5615.html
3. http://www.hbs.edu/research/pdf/07-077.pdf
4. This paper on repugnant markets has been popular in the blogosphere and the press, e.g.here, and here, and here, and (earlier) here...even though I refrained from calling it "Ick-onomics"). It also formed the basis for a BBC Radio 4 broadcast on Repugnant Markets in July, 2007. Here's the transcript, (in which I seem to say "you know" a lot) and here's the half-hour long audio recording (in which you can judge for yourself), and some related BBC news stories here and here. And here's a related story in the Financial Times on kidney exchange by Tim Harford, who conducted the BBC interviews (and who also thinks aboutbuying babies). Here's an interview on repugnance at HBS Working knowledge (their story includes a video of the North American Wife Carrying Championships). Here's a WSJ online discussion between Julio Elias and me of markets for kidneys, repugnance, and how kidney exchange seems not to arouse repugnance. The AMA ran a story in their Jan.28, 2008 issue of amednews.com on kidney markets, repugnance, and kidney exchange. Here's an April '08 Freakonomics blog connecting the discussion to the market for kidneys in Iran. There was an American Enterprise Institute symposium on Repugnance as a constraint on markets (with video and audio links) on 1/16/08: in Washington DC, the commentators were an interesting and diverse group: Sally Satel, Paul Bloom, and Michael Novak. It was followed by a Jan 31 NY Times article: Economists Dissect the 'Yuck' Factor. That article in turn was followed by this Freakonomics column: Repugnance Revisited, or: Are Economists Really 'Evil'? (I guess it's a tossup: evil or dismal?) Robin Young of NPR's Here and Now interviewed me about repugnant markets on March 25, 2008 in a piece called The "Yuck!" Factor (15 minutes). Here's a 15 minute interview onrepugnance as a constraint on market design. On my market design blog I've found myself writing about repugnance quite a bit: here is a (self updating) link to all my posts on repugnant transactions (including this one on the Opposite of repugnance: Protected transactions , which got a nice plug here.) quoted from : http://scholar.harvard.edu/roth/content/repugnant-markets
5. http://kuznets.fas.harvard.edu/~aroth/alroth.html
6. Bank for international settlements Working Papers (No 381) "Reassessing the impact of finance on growth" ; Stephen G Cecchetti and EnisseKharroubi; http://www.bis.org/publ/work381.pdf P4
7. 'The first ever verse revealed on Riba was Surah Ar-Rum, verse 39, where Allah says;'And whatever Riba you give so that it may increase in the wealth of the people, it does not increase with Allah'. The next occasion when interest is mentioned is in Surah Nisa, verse 161 where Allah says; 'And because of their charging Riba, whilst they were prohibited from it'. Then came the first explicit prohibition of Riba in 2 AH, around the time of the battle of Uhud. The commandment is found in Surah Al-Imran, verse 130 where Allah says; 'O those who believe do not consume up Riba, doubled & redoubled'.
8. Quote