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Shari‘a, Economics, and the Progress of Islamic Finance: The Role of *Shari‘a* Experts

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Discussing the role of *shari‘a* experts in the development of Islamic economics and Islamic finance calls for a look at the nature of economics and the focus of *shari‘a*. The chief concerns of economics over the ages have been efficiency and equity. *Shari‘a*, in the broader meaning of the word that gives primacy to objectives over rules and regulations, shares these concerns. However, this may not apply to *shari‘a* as it relates to *fiqh*, referring to laws codified at a particular time and place. The historical context in which we approach our subject today sends mixed signals. The schools of traditional *shari‘a* learning have long been tilted toward teaching codified *fiqh* with few insights into the objectives of *shari‘a*, or *maqasid al-shari‘a*. But new assignments given to *shari‘a* scholars trained in these schools have increasingly called for paying attention to objectives while interpreting the rules. To what degree this challenge has been met is a question this paper explores. The paper begins by describing what has happened in the name of Islamic economics during the last century. It then assesses where Islamic finance stands today. Focusing on the gap between vision and reality, the paper points out the limitations of *shari‘a* advising as it is currently practiced, and calls for remedial measures to make it more wholesome and effective.

THE ISLAMIC ECONOMICS PROJECT

Islamic economics was conceived in the early part of the twentieth century as an antidote to socialism and capitalism—an Islamic response to what was perceived as godless Western ideologies. The emphasis was to be on justice. Freedom from colonial rule, exploitation, and oppression was to be accompanied by a return to Islam, which stood for the elimination of

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poverty and the reduction of unequal distribution of wealth. Islam would help to secure these goals without the socialist regimentation that deprived people of their freedom and robbed them of their property. Islamic economies would not allow labor to be exploited by capitalists, nor the environment to be spoiled by greedy profit seekers. The appeal in all of this was an appeal to the objectives of Islam, the *maqasid al-shari'a*. There were few references to *fiqh*, or *shari'a* in the sense of laws and regulations as codified in early Islamic history. Those who championed this alternative vision were mostly modern educated people, university teachers, journalists, political activists, and poets. Even among the *'ulama* expounding the Islamic economic system, very few could be characterized as experts in *fiqh* or Islamic law. Although it was asserted that the Islamic economic system would be free from interest and gambling-like speculation, the *mechanics* of interest-free banking did not occupy the center stage. That came much later, in the 1970s. Focusing on the mechanics of banking without interest brought in the *shari'a* experts. Before discussing the role of the *faqih* (the *shari'a* expert) in the successful launch of Islamic finance in the last quarter of twentieth century, there is something further to note regarding the history of the Islamic economics project.

In the early 1970s, I produced a survey of writings on Islamic economics to that time, in English, Arabic, and Urdu.[2] Out of the 700 items included in the bibliography, only eight were dated before 1920. Out of these, only two dealt with the subject of interest, and the remaining dealt with distribution of wealth (2), history (2), trade (1), and *waqf*, or pious endowments (1). Of the 14 entries in the following decade only one dealt with interest, and the remaining were spread over other subjects.

The first writings on interest-free banking appeared in the 1940s. Out of a total of 28 writings on Islamic economics during that decade, only three were on interest-free banking. Among the remaining, *zakat* and the Islamic economic system in general were the most common topics. Though the authors in this period included *'ulama* trained in traditional schools, they did not write about interest-free institutions.[3] We have 156 entries for the 1950s that include several writings on interest and interest-free institutions, but in this period the writings on socialism, capitalism, and other aspects of Islamic economy far outnumber these. All writings on

[2] This work was originally presented at the First International Conference on Islamic Economics held in Mecca in 1976. It is included in Khurshid Ahmad, ed., *Studies in Islamic Economics* (Leicester: The Islamic Foundation, 1980); as well as in Ahmad, *Muslim Economic Thinking: A Survey of Contemporary Literature* (Leicester: The Islamic Foundation, 1981). An Arabic translation was later published by the Islamic Economics Research Center in Jeddah.

[3] See items 393, 419, and 526 in the bibliography of the survey mentioned in note 2.

interest-free banking in English, Arabic, and Urdu until 1967 are listed in the appendix of my book, *Banking without Interest*.[4] Out of the 18 items listed there, nine belong to the 1960s, two to the 1950s, and three to the 1940s. Four items are not dated.

Few, if any, among the authors of these books are *'ulama*. As the above-mentioned survey would show, most of the writings on interest-free Islamic banking came in the 1960s and 1970s.[5] The flood of technical material on the subject started after the period surveyed, that is to say, after 1975. This is the period in which *shari'a* experts came into the picture in a big way.

SHARI'A EXPERTS

The above statistical survey raises three points. First, the project of Islamic economics launched in the twentieth century was much wider in scope than the introduction of Islamic finance, as it was mainly focused on providing a just and humane alternative to the emerging ideologies of those times, namely capitalism and socialism.

Second, the role of *shari'a* experts in launching that project was at best marginal. This is not to belittle the role of *shari'a* scholars but to put it in proper perspective. As we proceed to describe, they do play a very significant role in the contemporary practice of Islamic banking, in contrast to the early days of the Islamic economic project noted above. However, their role is rather technical, whereas the main project from which Islamic finance branched out was civilizational, oriented as it was toward the *maqasid al-shari'a,* which have little to do with technicalities. As will be shown in the following, *shari'a* experts have been doing what their training equips them to do, and they have been doing it well. Unfortunately, their training is no longer well designed to serve the *maqasid al-shari'a* in an environment that differs from that which is represented in the books they study. This places the entire burden of identifying the *maqasid* involved in a matter, as well as finding ways and means of securing them, on the individual *shari'a* expert. Furthermore, the *shari'a* advisory function also involves monitoring the consequences of adopting a certain course, and in light of lessons learned, changing course if necessary. The *shari'a* experts do care for *maqasid al-shari'a.* As argued elsewhere, there are numerous recent examples of *fatawa* (sing. *fatwa*)

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[4] Nejatullah Siddiqi, *Banking without Interest* (Leicester: The Islamic Foundation, 1997). The book was first published in Urdu in 1969.

[5] There were 246 of these writings in the 1960s, followed by 176 writings in the first five years of the 1970s. It should be noted that 72 out of the 700 items in the bibliography are not dated.

given on the basis of *maqasid*.[6] The problem is not of willingness to take *maqasid* into account. The challenge comes from the nature of the task in the new environment. These are tasks calling for not only economic analysis, but also drawing upon the latest developments in other social sciences such as sociology, psychology, political science, and management. In the absence of proper institutional arrangements for training and necessary backup in terms of fundamental research, instances of malfunction have been increasing in recent years. This in turn has caused anxieties in the market and raised the possibility of a backlash in terms of consumer rejection.

Third, it is only natural that the progress of the Islamic financial industry be evaluated in the context of the larger project of Islamic economics of which it is an offshoot. That many find Islamic finance to be failing in serving the larger goals of Islamic economics should not be a shock, particularly in view of the short period of time since the 1970s when its actual practice started, and in view of the complexity of the task at hand.

The first few *fatawa shar'iyya* that deal with Islamic banking and finance, and provide us with a window into the role of *shari'a* experts in the development of Islamic finance, date back to the late 1970s and early 1980s. They originated in the Dubai Islamic Bank, Kuwait Finance House, and Faisal Islamic Bank in the Sudan.[7] Most of the early *fatawa* deal with well-known contracts like *mudaraba* and *musharaka* along with *tijara* (trade). *Murabaha* was not in the picture in this early phase, nor were *salam* and *istina'*. We are not sure about leasing (*ijara*), but it may have been on the agenda of Kuwait Finance House. Issues relating to trade dominated the scene, giving rise to questions and answers relating to guarantees and bills of trade. There was no conscious effort to find Islamic substitutes for conventional financial products (which differed from what was obviously the focus at the time: finding Islamic ways to do what needed to be done). In the 1980s the two big conglomerates, Dar al-Mal al-Islami and al-Barakah, established in the beginning of the decade, became the most important sources of *fatawa*, even though smaller entities like the

[6] *Fik-o-Nazar* 43, no.2 (Oct–Dec 2005): 3-24. This is an Urdu paper on *maqasid al-shari'a* and contemporary Islamic thinking.

[7] *Fatawa* of the *shari'a* boards of Kuwait Finance House and Faisal Islamic Bank Sudan are available on their respective websites: www.kfh.com and www.fibsudan.com. The website of Dubai Islamic Bank (www.alislami.co.ae) does not give details nor are its *fatawa* available in print, to the best of my knowledge. However, several collections of *fatawa* from different sources are now available in print, on CD-ROM, and online. Among them are the economic fatwas marketed by Harf, available online at www.harf.com. See also www.al-islam.com.

Jordan Islamic Bank had independent *shari'a* boards. Some of these *fatawa* are available in print.

The emergence of Islamic financial institutions (Islamic banks, Islamic insurance companies, Islamic investment companies, etc.) was preceded by a great deal of homework, which involved *shari'a* experts. Some of these works are available in the form of committee reports.[8]

The involvement of *shari'a* experts in the project was also crucial in lending legitimacy to the newly established Islamic financial institutions. For the Muslim masses under colonial rule, western financial institutions were an extension of colonialism, an instrument of exploitation like other colonial institutions. Introducing banks and insurance companies in Muslim societies was therefore always suspect, as the history of the nineteenth century shows. Government officials and businessmen with a vested interest would have never succeeded in selling these institutions to the people.

It is time to mention state-sponsored bodies occupied with the task of the "Islamization" of banking operations in Pakistan, Iran, and Sudan. *Shari'a* experts served on these bodies, either as members, as in the case of the Council of Islamic Ideology in Pakistan, or as advisors to the central bank of the country, a pattern later followed in Malaysia and Indonesia. Both of these countries have in-house committees of *shari'a* experts. Most of the pronouncements of the Council of Islamic Ideology and other official bodies mentioned above are available in print.

Around this time, in the middle of 1980s, big multinational financial corporations started operating in the Islamic financial market. Whereas the two biggest Islamic conglomerates, Dar al-Mal al-Islami and al-Barakah, were managing funds around five billion dollars each at the peak of their success, Citibank, HSBC, and ABN AMRO were managing hundreds of billions of dollars. Each started aggressively, first to prevent their rich Arab clients from deserting them in favor of Islamic banks, and then to mop up the surplus liquidity in the oil-rich Muslim countries. The small but rich Muslim countries of the Persian Gulf also entered the fray at the official level. Even after the introduction of *murabaha*, *ijara, salam,* and *istisna'* during the 1980s, the Islamic financial market needed more sophisticated financial products to handle the estimated three hundred billion dollar funds under management at the dawn of the twenty-first century. The impulse to try to duplicate conventional financial products seemed natural.

Some important departures from early practice in the matter of *shari'a* advising should be noted at this stage, as they may prove to have implications for the study of the role of *shari'a* experts. Most of the

[8] Siddiqi, *Banking without Interest*, 185-188.

shari'a experts serving the Islamic financial industry in its infancy were not well versed in the English language.[9] Western multinationals marketing Islamic financial products needed *shari'a* experts who could read, write, and speak English. That was a scarce commodity in the late 1980s and continues to be so. Secondly, we find increased secrecy and reduced transparency in this later phase. Being private institutions, the new entrants were under no obligation to make public all that their *shari'a* experts told them. Thirdly, those issuin*g fatawa shar'íyya* in the early 1970s had come from an environment in which a *fatwa* was seen as a public good, but this was not an obvious consideration in the different environment where conventional legal experts charged hefty fees per hour of consultation. The move to follow that same practice of hefty fees in Islamic juristic advising seemed to be a natural next step. Lastly, wide publicity of *fatawa* in the early phase served the additional purpose of assuring the niche markets for Islamic financial products that they were being served the *halal* products they cherished. But with the passage of time, the importance of this function was overshadowed by the advantages of reaping the gains of innovative moves.

SHARI'A **ADVISING UNDER STRESS**

In anticipation of further empirical research, one can only surmise that the trend of focusing on duplicating conventional financial products through Islamic financial engineering started in the 1990s and came to dominate the scene in the new century. The most important areas seem to be *sukuk* duplicating bonds and *tawarruq* duplicating bank-loans. Leaving detailed empirical research for more competent scholars, we proceed to describe the malfunction in *shari'a* advising that has occurred in the case of *tawarruq,* as one example.[10]

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[9] Names and brief CVs are available on a number of the websites mentioned above.

[10] One who needs cash first buys something on credit, becoming indebted for a certain sum of money to be paid at a future date, and then sells that thing for cash. The cash to be paid in the future is larger than the cash one receives in the present. This method, used earlier for tiding over individual difficulties, has been recently institutionalized by some Islamic financial institutions. Some helpful information is available on the Internet. We have briefly dealt with the issue in "A Survey of the State of the Art in Islamic Banking and Finance in Theory and Practice," which will be published by the Islamic Research and Training Institute, Islamic Development Bank, Jeddah. One recent publication on the subject is Ahmad Muhammad Khalil al-Islambuli, "Al-Murabaha wa al-inah wa al-tawarruq bayn usul al-bunk wa khusumihi," *Journal of King Abdulaziz University: Islamic Economics* 18, no. 1 (2005): 59-68, http://islamiccenter.kaau.edu.sa/english/index.htm.

The view that declaring *tawarruq* to be *shari'a* compliant is a case of malfunction in *shari'a* advising is based on two grounds. Firstly, it was necessary to evaluate the *masalih* (benefits) and *mafasid* (harms) involved, given that adoption of this practice on a large scale by financial institutions was an entirely new initiative without precedent in the history of Islam. In the words of some scholars, *tawarruq masrafi* is qualitatively different from *tawarruq* practiced at the individual level, person to person. Secondly, evaluating *masalih* and *mafasid* in the case of widespread practice of *tawarruq* has been beyond the capacity of *shari'a* experts, generally speaking, as it requires expertise not provided in *shari'a* schools. It is necessary to look at the ultimate macroeconomic consequences of approving this product. It is not possible to detect the full extent of the *mafsada* (harm) involved without doing so. The *maslaha* (benefit) cited by those approving the product mainly relates to the individuals, but it is smaller than the public harm that would occur. In accordance with a well-established *qaida* (dictum), the smaller private gain has to be given up in order to avoid the larger public harm.[11] Unfortunately, the macroeconomic part of the argument never came into focus in the deliberations on the subject. It could not be considered because the kind of training that is required to assess the probable harm in the adoption of *tawarruq* is not available in *shari'a* schools. The ability to conduct economic analysis in order to delineate the consequences of allowing *tawarruq* is not present among *shari'a* experts, generally speaking.

One of the banes of the modern financial system is the proliferation of debt. Debt instruments dominate the financial scene. From money creation and supply of credit to investment and capital formation in the domestic market and at the international level, the proliferation of debt has accelerated everywhere. Islamic economists since the earliest years, and increasingly during the last three decades,[12] have pointed out that almost all of the major ills of the contemporary economic and financial system are rooted in this phenomenon. Predominance of debt leads to instability. It creates opportunities for gambling-like speculation. It increases disparities in the distribution of wealth, as it is based upon interest. Islamic economists have advocated an asset-based system of creating money and extending credit, in which money loans would occupy a marginal role. The problem with *tawarruq* is that it introduces money in the present, which is offered in exchange for a larger amount of money in the future. It thus

[11] See rule 26 in *The Majelle* (Lahore: Law Publishing Company, 1980).

[12] I have reported some of these works in the fourth chapter of my book, *Riba, Bank Interest and the Rationale of Its Prohibition* (Jeddah: Islamic Development Bank, Islamic Research and Training Institute, 2004). The publication is available online at www.irti.org.

opens the door for debt proliferation. As noted earlier, arguments given in favor of *tawarruq* demonstrate an unawareness of the macroeconomic consequences of debt proliferation.

CONCLUSION

It is not possible in this brief paper to go into further detail discussing the reasons for the malfunction in *shari'a* advising. It has occurred, and can occur again. The issue needs to be discussed seriously, and addressed at the appropriate level of scholarship. It would be most unfortunate if the discussion were to degenerate into a blame game. The matter is far too complex to be dealt with in terms of pronouncements of right and wrong, or sincere or suspect motivation. In emphasizing the complexity of the issue, let us remember that economists were called upon by sponsors of *shari'a* boards and advisories to assist the *shari'a* experts. They participated in several conferences and seminars organized to sort out matters such as inflation and indexation. They continue to be invited to participate in non-voting capacities in such bodies as the OIC-sponsored Fiqh Academy at Jeddah, the Fiqh Council of the Muslim World League at Mecca, and the Islamic Fiqh Academy in India. It remains to be researched how far this association has served its purpose. If the association still leaves much to be desired, why is that the case? In the days of specialized expertise, it may be too much to expect any one person to be an expert on the whole of *shari'a* or in all branches of *fiqh*. How realistic is it to expect one person to be an expert in both *shari'a* and economics? All that can be said with certainty is that the current practice of *shari'a* advising and auditing, buttressed by occasional hearings given to economists, is vulnerable to further malfunction. As to how the problem may be fixed, we have yet to even grapple with that problem. I do not claim to offer any quick fix. It is important, however, to recognize that a problem exists, and that this problem deserves serious attention.

Banking, insurance, and investment were not the only financial institutions taking off from the Islamic economics project launched many decades ago. In several countries with a Muslim majority the project covered other areas of the economy such as trade, commerce, and international economic relations. The establishment of the Islamic Development Bank and its numerous subsidiaries is an eloquent testimony to that. Even in countries where Muslims live as minorities, there have been considerable efforts to reorganize *awqaf* (pious foundations) and harness them once again in service of the goals they served in Islamic history, such as improving education and health care. What have sprung up in many cases are official as well as private institutions for the collection and disbursement of *zakat*. *Shari'a* scholars have had a strong role in the conception as well as direction of these institutions. Last but not least, the teaching of Islamic economics and finance, as well as research in related subjects, have spread throughout the landscape of Muslim education, with the *'ulama* often taking a leading role.

In conclusion, *shari'a* experts have played an important role in the progress of Islamic economics and finance. However, there has been a degree of malfunctioning that needs further investigation and correction. Furthermore, the issues we face are far too complex to be handled properly without some conceptual as well as structural changes in *shari'a* advising. The future of Islamic economics and finance may well depend on rising to this challenge.