Proceedings of the Fifth Harvard University Forum on Islamic Finance: Islamic Finance: Dynamics and Development
Cambridge, Massachusetts. Center for Middle Eastern Studies, Harvard University. 2000. pp. 109-113

Shari'a Principles and Their Application

Examples from Islamic Finance

Muddassir H. Siddiqui [*]

ABSTRACT

The Qur'an and the *sunna* are not books of law or *shari'a*. They are sources of theological, ethical, spiritual and legal guidance. In these sources we find some laws but mostly we discover the objectives of the *shari'a* and its guidance for developing further Islamic rules and laws. We must distinguish between the principles and the rules (*ahkam*) of the *shari'a*. The principles of the *shari'a*, as mentioned in or derived from the text of the Qur'an, are permanent and applicable at all times and in all circumstances. *Ahkam* may be permanent, or open to modification as the time and place require. Changes in *ahkam*, however, must be based on and justifiable under the principles of the *shari'a*. Muslim jurists need to develop Islamic criteria for determining the permissibility and impermissibility of specific financial with an understanding of the underlying *shari'a* reasoning and wisdom (*hikmah*) behind various prohibitions mentioned in the Qur'an and the *sunna*. For instance, jurist must look into the purposes and rationale for the prohibition of usury (*riba*) and then develop a precise definition of usurious transactions. Modern financial transactions must be examined on the basis of the golden principles of the *shari'a*, and not merely on the basis of their conformity to the form at the expense of the substance. Islamic products should not merely camouflage the interest element contained in traditional products; they should rather conform to both the letter and the spirit of *shari'a* concerns, while at the same time representing transactions that are commercially viable when compared to conventional products.

I. THE SOURCES OF ISLAMIC LAW

The Qur'an and the *sunna* of the Prophet are the two basic sources of the *shari'a* or Islamic law. The Qur'an is the divine scripture revealed to the Prophet. The *sunna* consists of the Prophet's sayings, (*aqwal*), actions (*a'mal*) and confirmations (*taqrir*, that is, what he approved and/or did not object to among the actions of others in his presence). There is a mistaken impression that *qiyas* (analogy), *ijma'* (consensus of opinion) and *ijtihad* (the endeavor to develop the rules of the *shari'a* from the latter's sources) as sources of Islamic law. In fact, these are only tools to develop the rules of the *shari'a*.

The Qur'an and the *sunna* are the two sources of guidance (*hidayah*), but are not a constitution or codes of law, as these terms are commonly understood among modern scholars of jurisprudence. The two sources serve as guides to Muslims, and set very broad parameters within which Muslims may develop constitutions and legislation, promulgate rules and regulations, and enact and apply rules of enforcement, to meet society' s changing needs.

The legal injunctions in the Qur'an and the *sunna* are found in various forms. Some are specific, such as the prohibition against eating swine-flesh. Most are more general, such as the injunction to keep one's covenants and to not indulge in usury. The general injunctions are seldom accompanied by precise elements for the underlying prohibition or permission. In fact, a very small portion consists of purely legal verses, such as the verses describing the punishment for murder or the distribution of inheritance.

However, it would be wrong to conclude, as some have done, that the Qur'an and *sunna* are inadequate for the complex legal needs of humanity at various times. A closer analysis of the sources of the *shari'a* shows that what appears to be purely ritualistic, doctrinal or historical on the surface can actually play an important role in enacting regulations for a Muslim community. For instance, the Qur'an says:

> O mankind, We created you from a single male and female and made you into nations and tribes that you may know one another. Indeed, the noblest among you in God's sight is one who is most righteous among you.[i]

[*] Independent Sharia Consultant, Washington, D.C.

This verse is not accompanied by a legal injunction, or specifically prohibited actions, but nevertheless provides principles for a society to develop its own detailed code of ethics and laws, under which no discrimination on the basis of race or ethnicity can be tolerated.

The concepts of life after death and accountability in the Hereafter, which are repeatedly mentioned in the Qur'an, may appear in the first instance as irrelevant to regulating life on earth and therefore are not legal norms. The Prophet Muhammad is reported to have said:

> O people you come to me with your claims, and perhaps some of you are more persuasive in their argument in front of me than the others. I [the Prophet] only judge on the basis of what I hear. Thus if I give someone something, which in reality, does not belong to him, he may take it, but remember he will only be taking a piece of hellfire.

Imagine the positive effect of this saying on a society struggling to control floods of frivolous lawsuits and exaggerated demands for compensations by plaintiffs who do not hesitate to falsify claims of injury, or to blame others for their own negligence.

Thus, the fact that these two sources do not set forth a set of laws for all circumstances of human behavior is not a deficiency. In fact, it is arguably a blessing that the *shari'a*, instead of establishing a rigid, code of law, by its very design allows a society to develop its own rules, and to modify the rules to meet changing circumstances, so long as such rules, and the procedures under which they are promulgated, remain within the limitations (*hududullah*) set forth by the *shari'a*.

Rules (*ahkam*) are identified or developed and human actions are scrutinized in the light of the guidance derived from the understanding (*fiqh*) of the Qur'an and *sunna* in their *entirety*. A matter should not be judged by reading and quoting a single verse and mechanically applying it to a contingency. A jurist (*faqih*) should comprehend and understand the objectives (*maqasid*), the principles (*usul*), the priorities (*awlawiyat*), the reasoning (*hikam*) and the elements (*'ilal*) of all permissions and prohibitions in the Qur'an and *sunna*. The jurist should also have knowledge of the conditions and the circumstances in which the rules are to be applied. Understanding (*fiqh*) of the totality of the two sources and the circumstances is a must for a scholar to be able to give practical, consistent, rational and comprehensive answers to meet the changing needs of society. A competent jurist must possess intelligence (*hikmah* and *firasah*) and piety (*taqwa*) in order to comprehend the sources in totality, and apply them to meet the challenges of the time.

During the early stages of the development of the Islamic *fiqh*, Muslim scholars exercised a dynamic approach to interpretation, and developed detailed rules (*ahkam*) appropriate to their times and circumstances. Unfortunately, this form of *ijtihad* ceased to be practiced by Muslim societies many centuries ago. Most Muslim societies have ceased to administer the *shari'a* in daily life through an organized and dynamic legal system. As a result, most *shari'a* rules today are the product of theoretical deliberations and debates among Muslim scholars and jurists, and not of legal precedents created by judges operating within a dynamic Islamic legal system, dealing with real cases, and arriving at practical resolutions.

Because of the long stagnation in *ijtihad*, for various historical, political and social reasons, the Muslims scholars of today are struggling to bridge the gap – a large gap – between the rules (*ahkam*) as found in the old books of Islamic jurisprudence, and the demands of modern Muslim societies in developing a comprehensive Islamic code, which is relevant and responsive to contemporary needs. There are many reasons why the process of bridging the gap is fragmented and proceeding at a slower pace than is desirable. The primary reasons are as follows:

- The enormity of the task and the lack of resources. Also, the lack of political and ideological freedom in most Muslim countries does not permit adequate mobilization of existing resources.
- Muslim societies lack truly independent Islamic legislative bodies or even *fiqh* committees whose credibility is not questioned by the majority of the population.
- Many Muslims fear departing from long-established ways, and prefer strict allegiance (*taqlid*), to a particular school of law (*madhhab*) or sect, and hold the statements and opinions of early jurists to be eternal and unchangeable expressions of the *shari'a*.
- The fear of being thought advocates of "radical" solutions.
- The fear of being labeled "westernized" if one accepts a form of business transaction or law developed by non-Muslims. As a student of both *shari'a* and American law, I can confidently state that the vast majority of U.S. secular laws do not conflict with the *shari'a*. In fact, in many cases, such laws provide a more effective way of implementing and enforcing the objectives (*maqasid*) of the *shari'a*. There is no reason why a Muslim should not benefit from the efforts and the experiences of others in improving his own life, since the ultimate source of all cures for human physical, spiritual or social ailments is Allah, regardless of who discovered it first.

- Few Muslim scholars today are equally familiar with the rules of Islamic jurisprudence and *maqasid* of the *shari'a*, and the objectives of modern laws, accounting, business, economics and other fields.
-

II. ISLAMIC FINANCE AND ISLAMIC LAW

With some exceptions, Muslim scholars are moving slowly toward examining some of the fundamental issues related to Islamic finance. For example, there is no doubt that both the Qur'an and the authentic *sunna* prohibit *riba*, and condemn it in the strongest terms. However, the exact definition of *riba*, the elements and components of a usurious (*ribawi*) transaction and the objectives behind the prohibition are yet to be analyzed by Muslim scholars in a rational and objective manner. The second caliph, Umar, regretted that the Prophet was unable to identify all the forms of *riba*, due to his death soon after the revelation of its prohibition. It is reported in Ibn Majah, that Umar said: "the last verse related was the verse of *riba*, and then the Messenger of God was taken. He had not explained it to us. So leave *riba* and doubt [*ribah*]." The Prophet is reported to have said: "*Riba* is of seventy-three types. The least of them is like a man having sexual intercourse with his mother."

It seems Muslims scholars are still searching for filters, screens and tests for determining a transaction as usurious, or purifying a usurious transaction by using those filters.[ii] Generally speaking, most Muslim scholars today consider any unequal exchange (sale or loan) between two identical items usurious. Factors such as inflation, time value of money, exploitation of the needy (*zulm*), the rate of the additional amount (reasonable, single or multiple), and a host of other criteria which may provide a more workable definition are considered irrelevant by most.

Market interest, according to the prevalent opinion of the vast majority of scholars, is considered to be the same as *riba* and the terms are often used interchangeably. There is felt to be no difference between a pure interest-based transaction, such as one involving borrowing $1,000 dollars for one year at a 5% interest rate, and a transaction in which interest is charged as an integral part of a financing transaction for the purchase or lease of a house or goods.

The inability of scholars to reach a consensus on the definition of the forms of *riba* has resulted in some Muslims rejecting otherwise perfectly valid conventional forms of business transactions and offering as "Islamic alternatives" transactions which differ only in form, but not in economic substance from their conventional counterparts.

III. PRACTICAL ISSUES IN ISLAMIC FINANCE

Having discussed the historical and theoretical aspects of the *shari'a*, I now turn to some of the more specific concerns and challenges facing Muslim scholars and lawyers in drafting contracts for Islamic products in America. I will only highlight some of the issues to point out the nature of the practical challenges in developing a viable and marketable Islamic product within the precepts of the *shari'a* and in compliance with U.S. laws.

A. *Shari'a* Issues

As mentioned earlier, the vast majority of Muslims and *shari'a* committees view paying interest on borrowed money as *riba*. The *shari'a* committees have thus approved certain Islamic forms of transaction which are structured as sale, lease and partnership, (*murabaha, ijara* and *musharaka*) contracts and combined them with varying lengths of long term installment payments options, as an Islamic alternative to lending on interest-based contracts. This creates various problems when a lease (*ijara*) or partnership (*musharaka*) transaction is used for what is essentially a financing transaction on an installment basis. More specifically, they create challenges in areas such as who (the tenant/consumer or the landlord/financier) bears the risk of loss and reward resulting from the appreciation of the property, who should be held responsible for the maintenance of the property, and how to determine the rent (e.g. using prevalent interest rates, rent indexes, etc.). On their own, these challenges are not as difficult to overcome. In the United States however, a consumer compares his Islamic product with the risks, rewards, and responsibilities or (lack thereof) with the other conventional alternatives available to him, expecting the Islamic product to at least match such alternatives, if not better them.

B. Islamic Vendor Concerns

Most vendors offering *shari'a*-compliant home financing Islamic products in the U.S. today are either conventional banks or mortgage companies operating under relevant U.S. federal and state laws. Even institutions owned and operated by Muslims, providing home financing services, have to operate under the same laws. There are no separate laws for Muslims to set up an Islamic bank or home financing operation in America. U.S. laws are basically written to implement the purposes and objectives of a Western secular

system. The purpose and scope of services of an ideal Islamic bank, for example, would be to engage in *mudaraba*, pooling financial resources of individual Muslims depositors/investors, investing them in profit-making business ventures and sharing with them any profit or loss. Banks in the West are not allowed to do this. Their primary objective is to take deposits, lend money and provide other financial services. Thus, Islamic vendors organized under U.S. banking laws have to make sure that they do not violate their charter and applicable local laws while providing services to Muslim consumers in accordance with the *shari'a.*

C. Sources of Funds

Islamic vendors in the U.S. today acquire the funds necessary to assist Muslim consumers either from investors and depositors, or by assigning their contracts in the secondary market to entities such as Fannie Mae or Freddie Mac. Organizations such as the latter two have their own charters and laws, which they are mandated to follow. If an Islamic provider intends to pass his contracts to any one of these organizations, it can only use documents, such as notes, mortgages or deeds of trust provided or approved by these organizations. All this places challenges and constraints on the Islamic vendor, who must comply with the *shari'a*.

D. Consumer Concerns

Costs: A Muslim consumer rightly expects that the closing costs, markup or rent for buying a home Islamically should not be more than the closing costs and the rate of interest for comparable conventional mortgage products.

Taxes: A Muslim consumer is subject to the same tax liabilities and privileges as any other U.S. resident. One of the major benefits afforded by U.S. laws to buyers of homes using borrowed money on interest is the reduction in annual tax liability. A U.S. Muslim taxpayer rightly expects to also be able to minimize his tax liability. This requires drafting the contract in such a way that, while the Muslim consumers' monthly payments under the Islamic contract include a portion defined as markup or rent, such portion of the payment should also fit the standards and criteria set by the Internal Revenue Service to qualify it as deductible interest payment. Failing to do so renders Islamic products prohibitively expensive and thus unmarketable.

Title Transfer and Other Fees: Some aspects of rigid compliance with *shari'a* rules can result in the payment of title transfer fees twice. This concern is known as the "double stamp duty dilemma" in the UK. In the UK, an attempt is being made to change the laws to resolve this concern. Drafters of Islamic contracts in the U.S. need to find some other practical means to avoid double taxation within the existing applicable laws of various states in the U.S.

The *shari'a* requirements, the legal constraints, the expectations of a Muslim consumer and Islamic vendor, together with the absence of an integrated and cohesive Islamic legal system, pose a great challenge for drafters of Islamic contracts not only in the U.S. but also in most Muslim countries. However, one cannot wait for ideal conditions to exist to practice one's religion. The process must continue and the search for fundamental issues and substantive solutions accelerate. It is heartening that *shari'a* scholars and world-class bankers, economists and lawyers, who seldom communicated in the past, are now brainstorming in Karachi, Kuala Lumpur, Bahrain, Geneva, London, Washington and Cambridge, searching for solutions which are not only *shari'a*-compliant but are responsive to the expectations of Muslim consumers as well as funds suppliers.

IV. CONCLUSION

We should not be discouraged if the initial response leaves many concerns unanswered. These efforts will eventually give way to more in-depth analysis of the substance of modern financial transactions, and subject them to the objectives (*maqasid*) of the *shari'a*. Solutions based on rationality and substantive justice, as guided by the principles of the Qur'an and *sunna*, will ultimately prevail. Perhaps there is wisdom in not pushing new ideas at a speed which neither the scholars not the present Muslim community can absorb. Having a thriving Islamic banking and financial system, even if not perfect, is certainly better than having none.

The current developments in the field of Islamic finance and jurisprudence should therefore be viewed as an evolving and transitory process. In time, new ideas and realistic solutions shall gain ground and shape the life of Muslims positively. Islam is a religion of nature and human conscience, and the forces of nature and rationality will play a major role in sorting right from wrong, and technical from substantive. Human conscience guided by revelation and honest collective *ijtihad* will produce the right answers. As the Prophet Muhammad said, "My people shall not collectively agree on falsehood."

[i] Qur'an 13:49.
[ii] As recent *fatawa* from Al-Azhar University make clear.