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# What Can Islamic Banks Do Besides Eliminating *Riba*?

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## ABSTRACT

Is the broader objective of Islamic finance only to eliminate *riba*? What are the social implications and larger economic benefits of an Islamic financial system? The paper will address the above questions and will evaluate the success of the industry in light of the answers to these questions. What are banks doing to eliminate poverty? Has Islamic finance become the roost of the few, or has it been able to address the needs and aspirations of the general populace? In other words, have the claims of the universality of Islamic finance been justified?

## I. INTRODUCTION

The purification of sources of income is a very important subject in Islam, one which Muslims take very seriously. According to the Qur'an and the Sunna, those whose income is not pure must face the consequences in both this world and the Hereafter. Accordingly, in the pre-colonial era all dealings in Islamic communities were conducted on *shari$^c$a*-compliant bases. After the colonial powers took control in Muslim countries, however, the legal, financial and the banking systems were drastically altered. In the postcolonial era, pioneering Muslim economists and *shari$^c$a* scholars began the discussion on how to return to Islamic values. The later development of Islamic banking came about as a result of this theoretical movement.

The prohibition of interest, generally understood to refer to any increment over and above the principle, is common to all the Abrahamic religions, and is found in other religions as well. A recent doctoral dissertation presented to the University of Aberdeen contains one of the finest discussions of the conceptions of interest in Islam, Judaism and Christianity.

The modest inception of Islamic banking came about with the establishment of the Dubai Islamic Bank in 1975. The businessmen involved wished to have a different banking system from the conventional one: they wanted to bank without interest. This movement was initiated by the public, not the government. Indeed, the nascent institutions faced severe challenges: from the conventional banking system, the environment itself, the other banks, and the regulators. Many official organs did not like this movement, and in some parts of the world, even today, regulators are wary, for various reasons. There was also no widespread public awareness of these movements; this has changed, as the success stories in Islamic banking indicate.

There are many reasons why global financial institutions are interested in this movement. They considered it a good opportunity for investment, and perhaps as a challenge for the conventional interest-based capitalistic system. The basic difference between the Islamic and the conventional system is simple. The conventional bank advances a loan, and the client pays with money plus money, i.e., interest. In the Islamic model, however, the banks are not allowed to lend money, but may sell goods and services, through which they may earn.

The main objective of the pioneering Islamic banks was to eliminate *riba*, which was usually taken to mean interest on loans advanced. We must be aware, however, that the theoretical considerations prohibiting *riba* were not exclusive to this practice, but are part of the effort to construct an entire system, and to have economic and social justice within this system. This why it is essential that the objectives and philosophies of Islamic banks be in line with the teachings of the Qur'an and Sunna. They must be guided by the comprehensive principles of the Islamic law as derived from these basic sources, not just the compulsion to eliminate *riba*, in order to be considered purely Islamic. Thus, all teachings imposed on Muslims, in buying selling these things are also applicable to Islamic banks.

## II. HONESTY AND SPECULATION IN ISLAM

The most important Islamic teachings related to business encourage honesty and fair trade. Thus trade manipulations, malpractices, hoarding, black marketing, cheating, profiteering, short weighting; all are among the greatest of sins. It is very tempting for businessmen to make a quick profit by cheating, or by hiding the defects in

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their merchandize, and thus those who are really honest are held in very high esteem. Spending for good causes, for the welfare and the benefit of people is encouraged, and wastefulness and overindulgence are prohibited, *israf*. Justice in all dealings and transactions is a basic tenet: thus one cannot say that the end justifies the means, or that an enemy or non-believer may be cheated. The prohibition of gambling and other risk-related purely speculative activities based on luck are also prohibited in the Islamic market today.

## III. Increasing Awareness of Banking and Islamic Finance in Muslim Societies

What are the most important achievements attracting depositors in societies with less developed public interest in banking? Prior to the advent of the Islamic banks, most Muslims were under-banked. The main reason is that most Muslim communities did not want to deal with banks, because of the prohibition of interest. Islamic banking's great achievement was to attract Muslim depositors, who learned to be satisfied with the security that derives from depositing wealth in a bank. This encouraged saving and investment activities, since it is a human tendency to spend money one has access to, and to save money which is held in a secure, less accessible place. Islamic banks thus encouraged individual Muslims, families and even children to save and invest. This also leads to the channeling of depositor funds toward productive and commercially beneficial activities. Moreover, Islamic finance relieved Muslims from trading in prohibited sectors or activities; a welcome relief, since previously there was no guarantee that banks and insurance companies would abstain from unacceptable transactions. Islamic institutions have also organized and streamlined *zakat* and charity, with set standards for auditing Islamic financing institutions on how to calculate *zakat* for stock, equity and account holders.

Disseminating the knowledge of Islamic law prior to the advent of Islamic financial institutions was minimal, because it hadn't been used for generations. Scholars tended to lack confidence, and there were very few qualified in this subject. Now, with the increasingly mainstream practice of Islamic finance, the number has risen. Moreover, Islamic finance also encouraged the *takaful* movement, which has gained wide acceptance in the international financing community, including by the World Bank and the IMF.

## IV. Conclusion

To restrict the definition of Islamic finance to the prohibition of *riba* is to undervalue it. There are two key parts to the term to which one must pay attention. One is "finance": the field is not only a spiritual endeavor, but is a viable and growing industry in the practical world of business, on par with conventional finance. In this regard, the increasing importance given to organized finance in Muslim societies, among the rich and poor, is of use to both the users and the providers of Islamic financial services. Muslims become aware of the advantages of saving and investing, and are relieved from the necessity of indulging in forbidden practices.

The second half of the term is "Islamic." Practitioners in this field are bound to obey all the injunctions of Islam: from finding alternatives to interest, to the fair and equitable distribution of *zakat*. Moreover, faith-based financial institutions, more than any other, must remain above even the imputation of dishonesty or wrongdoing. Islamic finance is a rapidly growing sector, and it is the duty of its practitioners to always look beyond the restricted goal of eliminating *riba*, to bring *shari*ᶜ*a*-based finance to the forefront of equitable social development for all Muslims.