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Fiqh For Today's Socio-Economic Conditions

Exercises in Islamic economics have been too much focused on *fiqh*. Whether it was the behavior of the economic agents such as consumer or the entrepreneur or the functioning of the social institutions such as property, money. Scholars sifted the vast treasure of Islamic jurisprudence for an answer to what ought to be... They did the same when asked to define the role of public authority vis a vis the economy involving such issues as taxation and public borrowing. From microeconomics to macroeconomics, management of money to public finances, in each field we worked to derive rules from *fiqh*. We did the same when confronted with such novel field as economic development and international economic relations. The rules of conduct and policies devised by wise men of Islam to implement the guidance of Allah in certain specific situations were treated as the guidance from Allah applicable to all situations.

It can easily be seen that such an approach suffers from severe limitations. This applies with greater force in affairs of life most influenced by changing conditions of living. Technology is only one of these conditions. Equally important are population and other demographic factors. The accumulation of knowledge about the environment and as well as about the self, as time passes and scientific progresses takes place, is no less important. Also important are the changes in human perceptions and aspirations that take place as a result of historical experiences. It so happens that our social relations, especially economic relations, are the most affected by these developments. Even the behavior of economic agents cannot but be greatly influenced by these changes.

There are, broadly speaking, three ways in which *fiqh* rules relating to such matters as behavior of the consumer or conduct of a trader or the functions of the market inspector (*muhtasib*) etc. are formulated. We have either a text directly applicable to an issue or the issue is amenable to analogical reasoning on the basis of a text. The third way acceptable to some schools of Islamic law if not all, is to look at the *maslaha* (benefit) intended or the *darurah* (necessity) involved and issue a decree in response to them. The text itself may be a verse in the Quran or something reported from the Prophet (peace be upon him), a *hadeeth*.

The verses of the Quran directly related to the economy are few, and most of them are laying down values and norms rather than laws or even rules of conduct. Most of the specific *fiqh* rules relating to economic transactions are based on *hadeeth*. But one cannot, despite recognizing the divinely inspired nature of the Prophetic rulings, accord *hadeeth* the same status in matters economic as one does to the Quran. There are a number of important reasons for this. The first relates to the authenticity. Whereas authenticity of the Quranic text is guaranteed by Allah, the authenticity of a report about the Prophet has to be ascertained before it is accepted as such. Secondly, a reported ruling of the Prophet must be seen in the context in which it is issued, before it can be decided whether to generalize and apply it to every one, every where, all the time. Lastly, all rulings of the Prophet are for realizing the objectives of Islam, the *maqasid al-shariah*. When circumstances change it has to be ascertained whether the original ruling serves the purpose or needs modification. To one who may think this last is no different from the previous one, it can be pointed out that the latter entails modification in what was in fact intended by the Prophet to be general, as evidenced by some policy decision of the second caliph, Umer ibn e Khattab.

It seems the great jurist were themselves fully aware of these limitations of their works, especially when it came to matter economic. This is evidenced by their reference to *urf* and *aadah*, conventions and customs that change not only over time but across space too.

It is therefore, safe to conclude that a finite body of rules framed over the earlier centuries of Islam to enable Muslims to live as Allah wanted them to live could not be used to derive from them general rules applicable in later times without first checking their background in socio economic conditions.

Prof. M. Nejatullah Siddiqi

Sixth Harvard University Forum on Islamic Finance: A Report

The Sixth Harvard University Forum on Islamic Finance was held after a gap of two years at the Harvard Law School on May 8 and 9, 2004.

Professor Frank Vogel during Chair's welcome stressed the importance of the fast-growing field of Islamic finance. He cited the Bank of England's waiver of the double stamp duty in the Islamic home financing scheme offered by HSBC in the U.K. as an example of the increased understanding of Islamic finance among Western regulators.

In his Keynote Address, John B. Taylor, Under Secretary for International Affairs at the U.S. Treasury, spoke on "Understanding and Supporting Islamic Finance: Product Differentiation and International Standards." He commented that the developments in Islamic finance are of great interest to the U.S. Treasury, which looks forward to the lively discussions on product development and differentiation and on current legal and regulatory issues that have emerged as the Islamic finance industry grows. He stressed the importance of transparency and disclosure and stated that as with conventional financing, Islamic financing will benefit from transparency, good governance, and an internationally accepted regulatory framework.

The President of the Islamic Development Bank (IDB), Ahmad Mohamed Ali, delivered his address on "Development of the Islamic Financial Industry and the Need for Regulation and Supervision." He emphasized that effective supervision is a must for Islamic financial institutions. It requires the formulation and adaptation of standards in the areas of risk management, disclosure and transparency, accounting and auditing, internal control systems, and corporate governance.

These three introductory speeches were followed by the lead session, on "Regulatory Challenges to Islamic Finance," moderated by Professor Samuel L. Hayes. Usman Ahmed of Citibank spoke about the legal and regulatory challenges facing the *sukuk* market. He said that *sukuk* bond is essentially an "interest-free" variant of a conventional bond that is structured to comply with Islamic investment principles. This is done by basing returns not on pure interest income but on profits derived from assuming the risk related to ownership of some underlying asset(s). Abdulkader S. Thomas spoke about the problems facing Islamic banks in the U.S. He observed that following the event of September 11 there is much skepticism about Islamic finance, and Islamic banks such as Amana and Khazana have been discouraged from applying for licenses. Prof. M. Nejatullah Siddiqi analyzed the tension between ethics and efficiency vis-à-vis the tension between the *maqasid* (objectives) of Islamic law and juristic derivations of that law. Prof. Siddiqi suggested that to resolve these tensions, economists/social scientists should be involved in debates about what are currently purely legal/juristic issues. Finally, Pervez Said of the State Bank Pakistan briefed participants about the regulatory framework for the Islamic banking industry in Pakistan. He noted that this framework is comparable with the existing system for regulating financial services in which users determine the pace and scope of change.

The second session of the day, "Legal Trends and New Challenges," was moderated by Professor Frank Vogel and covered the legal developments occurring in the field. Kilian Bälz discussed Islamic financing transactions in European courts. He explained that when drafting sharia-compliant agreements, the reference to the sharia in the agreement should be specific enough for a court in a non-Islamic environment to enforce it. Husam El-Khatib of the Royal Bank of Scotland suggested that Islamic banks use arbitration to enforce their agreements. He proposed that Islamic banks set up a permanent court of arbitration in order to provide flexibility and transparency and interface easily with existing regulatory and financial intuitions. Michael McMillen discussed the issue of structuring securitized sharia-compliant real estate acquisition financing in the light of a deal in South Korea.

These sessions were followed by two parallel sessions on graduate research. The first session was moderated by Ibrahim Warde of MIT. Walid Hegazy spoke about *fatwas* (Islamic legal opinions) and the fate of contemporary Islamic finance, raising three points. First, Islamic finance *fatwas* are given on the basis of narrow legal rules rather than with consideration of the *maqasid* of the *shariah*. Second, there are potential conflicts of interest because Islamic finance *fatwas* are issued by muftis (issuers of Islamic legal opinions) employed by the very same Islamic financial institutions. Third, this setup can result in a system of *hiyal* (in general terms, a system based on exceptions) in which the original *maqasid* of the *shariah* are lost. Nizam Yaquby, who is a sharia scholar, disagreed with Hegazy. With respect to conflicts of interest, Yaquby observed that the Higher Council of Islamic Banks had collected over 6000 *fatwas*, of which 90 percent were consistent across banks. Over one hundred muftis around the world issued these *fatwas*, often without knowing each other, which suggests the absence of conflicts of interest.

Hegazy's paper was followed by a presentation on Islamic banking and the politics of international financial harmonization by Kristin Smith of Harvard University. Nicolas Hardy then discussed the role of sharia scholars as a gateway between legal systems, and Islamic banking as an example of legal pluralism. He said that a consequence of this legal pluralism would be the incorporation of *fatwas*, rulings, and guidelines within state law (positive law). Abdur-Rahman Syed delved into how the philosophical justification of Islamic finance is made by its proponents and providers. He critiqued appeals to community, and made a case for how appeals to faith and reason can best justify Islamic finance as a universalist paradigm for social ethics.

M. Fahim Khan of IDB moderated the other parallel session on graduate research. Aamir Rehman discussed the establishment of sharia-compliant endowments in the United States, noting that Muslim endowments in the U.S. are growing rapidly. While realization of the need for such endowments exists, they are generally poorly managed. He observed that service providers targeting Islamic endowments need to cultivate endowment clients, focus on services, develop multiple revenue streams from single clients, and recognize positive externalities. Mansoor Shakil of Harvard Law School analyzed the risks facing Islamic banks and the impact of Basel II on their future. He discussed the risk characteristics of Islamic banks and said that while Islamic banks face risks like other banks, the nature of their risks differs at times, warranting appropriate regulation and supervision to protect depositors and prevent systemic risk.

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New Books and Articles

Books:

1. AHMAD, Wan Azhar Wan, *Public Interests (Al-Masliha al Mursalah) in Islamic Jurisprudence*, Kuala Lumpur, Malaysia: International Institute of Islamic Thought and Civilization, 2003, 161pp.
2. AYUB, Muhammad, *Islamic Banking and Finance: Theory and Practice*, Karachi, Pakistan: State Bank of Pakistan, 2002, 300pp.
3. IQBAL, Munwar (ed.), *Islamic Banking and Finance: Current Developments in Theory and Practice*, Leicester, UK: The Islamic Foundation, 2002, 449pp.
4. ISMAIL, Abdul Halim, *The Deferred Contracts of Exchange: Al-Quran in contrast with the Islamic Economists – Theory on Banking and Finance*, Kuala Lumpur, Malaysia: Institute Of Islamic Understanding, 2002, 78pp.

Articles:

1. AKACEM, M. and GILLIAM, L., 'Principles of Islamic Banking: Debt Versus Equity Financing', *Middle East Policy* (Oxford), Vol.9, No.1, 2002, pp.124-38.
2. CIZAKCA, Murat, 'Latest Development in the Western Non-Profit Sector and the Implications for Islamic Awqaf', In: M. Iqbal (ed.), *Islamic Economic Institutions and the Elimination of Poverty*, Leicester, UK: The Islamic Foundation, 2002, pp. 263-96.
3. FRAY, James D. and TAYLOR, J. Michael, 'Foreign Direct Investment in Arab Countries: A Guide to Better Understanding Islamic Financial Doctrine', In: *Strengthening Relations with Arab and Islamic Countries Through International Law: E-Commerce, the WTO Dispute Settlement Mechanism and Foreign Investment – Papers Emanating from the Fourth PCA International Law Seminar October 12, 2001*. The Hague, The Netherlands: Kluwer Law International, 2002, pp. 287-307.
4. PFEIFER, Karen, 'The Future of Young Workers Under Islamic Versus Western Economic System', In: M.S. Bahmanpour and H. Bashir (eds.), *Muslim Identity in the 21st Century: Challenges of Modernity*, London: Institute of Islamic Studies, 2000, pp.171-91.
5. RAHMAN, Shah M. Habibur, 'Islamic Banking: Issues to be Addressed', *Journal of Islamic Banking and Finance* (Karachi, Pakistan), Vol. 19, No.1, 2002, pp.25-37.
6. RAHMAN, Tanzilur, 'Mudarabah and the Pakistan Perspective', *Journal of Islamic Banking and Finance* (Karachi, Pakistan), Vol. 19, No.1, 2002, pp.7-10.
7. SAUER, James B., 'Metaphysics and Economy – The Problem of Interest: A Comparison of the Practice and Ethics of Interest in Islamic and Christian Cultures', *International Journal of Social Economics* (Bradford, UK), Vol.29, Nos. 1-2, 2002, pp.97-118.

Book Review

Riba, Bank Interest and the Rationale of Its Prohibition

By: M. Nejatullah Siddiqi

Publisher: Islamic Research and Training Institute, Islamic Development Bank, Jeddah, Saudi Arabia, 2004, pp.162.

Islamic banking and finance, despite handsome growth and expansion is still looked with mixed reactions even among the scholars working in this area. There are a growing number of literatures where researchers have questioned the purity of certain Islamic modes of financing especially the *murabaha* as it appears quite similar with the conventional interest-based financing.

The prohibition of *riba* has been emphatic and unequivocal in the holy Quran and thus has never been contested as per se by any scholar. However, what constitutes *riba* and whether the bank interest is too prohibited or not has been a matter of intense debate over the past few decades. Despite several attempts by various *Shariah* bodies and Islamic scholars to prove that interest is the same as *riba*, the matter kept on arousing fiery debate not necessarily because the arguments put in favour were always hollow but many a times people had no real alternative. However, successful operations of Islamic financial institutions the worldwide during the last couple of decades have proven that financial arrangements could be conducted without necessarily being involved in the interest or *riba*. In the light of recent growing practices of Islamic finance, this book by Prof. M.N. Siddiqi is an important contribution in dispelling the myth behind *riba* and bank interest. Starting from Islam's basic concept (philosophy) which revolves around *Tawheed* and the *Shariah* and its objectives which guides determining future course of action by individuals, society to the state, Prof. Siddiqi has thoroughly discussed the issue of *riba* and the rationale of its prohibition.

The main theme discussed in this book are the Islamic laws on the prohibition of *riba* and that how it is different from the bank interest as for the stability, efficiency and justice are concerned. He has argued convincingly that institutions of interest are the main cause behind the macro level inequality in the economy. Showed how an Islamic financial system is able to meet the various financing needs of the consumers without involving interest. Regarding the monetary management in an Islamic economy, author points that Islamic instruments for monetary management impose greater financial discipline, call for transparency and oblige governments to adhere to accounting standards and less inflationary.

Prof. Siddiqi has taken all these financial and monetary issues that are being discussed in the Islamic banking literature, removed the doubt raised by the researches, and clarified the points that have been raised at the seminars, workshops and more recently at Net.

This work is particularly more important for students as well as those working with Islamic financial institutions who wants to have an in-depth idea about the Islamic economic principles, institutions and the market. Besides this book is also helpful in ascertaining the goals of the Islamic economy.

No student of Islamic banking and finance can ignore this important reference tool if he or she wants to understand this fast growing discipline, controversial, yet competing with conventional interest-based financial system. Covering the entire financial system of modern days, this book basically seeks to argue that Islam's prohibition of interest is aimed at preventing injustice and promoting fairness, equity and efficiency.

Contd. from p.2

Tarik Dahir of Columbia Business School argued that the Islamic financial industry would soon look into hedge funds given the industry's need for medium-term investment vehicles, portfolio diversification and higher returns. Abu Umar Faruq Ahmad reported that Islamic banks in Bangladesh face legal constraints that limit their ability to compete with conventional banks and suggested that Islamic banks have their own banking acts to provide proper legal support.

On the second day of the Forum, Professor Samuel L. Hayes said that it is important in Islamic finance that investments be in line with the social and ethical teachings of Islam. He also emphasized the need for greater harmonization with the prevailing financial system.

Ahmad Jachi, of the Central Bank of Lebanon while discussing the Lebanese experience with Islamic banking touched upon monetary policy, payment systems, and intra-day liquidity vis-à-vis Islamic banking and emphasized that these issues need to be resolved to achieve a stable Islamic financial system. Nicholas Foster explored the concept of owing and owning in Islamic and western law within the general area of property rights. He compared the different approaches of the traditions, discussing the possible reasons for and consequences of the differences. M. Imran Usmani stressed the need for greater interaction between sharia scholars and finance professionals in order to develop smooth and practicable sharia-compliant systems and procedures. Rafe Haneef examined the key products currently available in the Islamic financial market. Michael Gassner briefed participants on the regulatory framework of Germany and opportunities and methods there for structuring sharia-compliant financial products. M. Kabir Hassan and M.A. Mannan Chowdhury argued that in light of increased financial innovation and the diversity of instruments offered in Islamic finance, improving the transparency of operations is particularly relevant for Islamic banks.

The second session of the second day, entitled "Revisiting Sharia Issues", generated the most debate. Prof. Mahmoud El-Gamal spoke about the limits of sharia arbitrage and the unrealized potential of Islamic finance. He argued that financial institutions could avoid *riba* and *gharar* through mutualization and prudential regulation through community-based mutual-banking and risk-sharing institutions.

Nizam Yaquby analyzed *tawarruq* transaction in which the buyer is obligated to make deferred payment, while the end purchaser is an independent third party. According to him, a majority of jurists permit *tawarruq*, in its simplest form. Their argument is based on the ruling for buying and selling. Abdulkader S. Thomas representing Yusuf Talal Doleranzao, drew the attention to classical works which remain unexplored from an Islamic finance point of view. He said that the scholarship on Islamic finance has focused on standard works of classical jurisprudence that deal with commercial transactions. M. Fahim Khan and Layachi Feddad of the Islamic Research and Training Institute discussed the need for standards for sharia supervision and sharia boards in the context of corporate governance. Arguing that consistency in sharia standards is important in view of the diversity of opinions in the sharia, they emphasized the necessity of codifying the *fiqh* (Islamic law) diversity for Islamic finance as well as standardizing the application of the sharia in the industry. Acting as moderator, Professor Vogel emphasized that a debate in which there is a dialogue between traditional and more modernist interpretations of Islam, would increase scholarship in Islamic finance.

The last session of the conference covered corporate governance in Islamic financial institutions and was moderated by Prof. M. Nejatullah Siddiqi. K. Salman Younis of Kuwait Finance House observed that market and stakeholder dynamics pose a challenge to strengthening the risk management infrastructure of Islamic financial institutions. Ibrahim Warde of MIT spoke on corporate governance and the Islamic moral hazard, suggesting that a better understanding of the Islamic moral hazard, common standards and norms, and increased due diligence would help deal with it. A. Rushdi Siddiqui and Yusuf Talal DeLorenzo of Dow Jones Islamic Indexes examined corporate governance for public and private companies from Islamic and non-Islamic perspectives. They maintained that effective corporate governance would reduce costs, lift profits, and attract better human assets toward Islamic financial institutions. Saiful A. Rosly, M.M. Sanusi, and N.M. Yasin from the International Islamic University Malaysia presented a study on the legal documentation of Islamic financial products in Malaysia. They reported that hitherto in Malaysia, cases involving Islamic banking and finance have not tested the fundamental basis of Islamic contracts; instead, they are concerned with procedural law. As a result, under the current regime it is immaterial whether a contract is sharia-based, since the applicable law and principles are identical to what governs conventional banking.

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