



# ***Ijtihad* in Development of Islamic Banking**

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## **Introduction:**

In nearly all the countries and communities of Islam, *Shari'ah* is experiencing a resurgence. Muslims every where aspire to a life that is more Islamically cultivated. This trend is particularly transparent in the realm of finance, banking and insurance, where calls for Islamization are now familiar ones. Such life, however, can't be pulled out of any vintage *Shari'ah* book, no matter how "time-honored" that book is. This is because life never remain constant. The celebrated works in Islamic jurisprudence are glorious. However, they were written for a different era, addressing dissimilar situations and relating to distinct people. *Shari'ah*, nevertheless, is forever robust. To be relevant to every time and every place, *Shari'ah* does have the facility that gives it the power to keep-up with changes and diversity. It has its own "built-in" means of evolution. Otherwise, *Shari'ah* will not be able to respond to the needs of Muslims at all times. We all know that no institution can thrive without responding to the contemporary needs of people. Religion is no exception. *Ijtihad* is the soul of *Shari'ah* and its disposition for an everlasting revival.

Since the 4<sup>th</sup> century Hejira (10<sup>th</sup> AD) Muslims lived under a "convention" that the "gate of *Ijtihad* is closed". This came after the completion of the four major schools of Islamic jurisprudence when Muslims thought that annals of *Shari'ah* are then complete. It lead to virtual stagnation in legal research as the function of a *Shari'ah* scholar

became just the repetition of what is already in the books. It is only recently that felt the need for such effort became very pressing.

### **Meaning of *Ijtihad*:**

*Ijtihad* in *Shari'ah* means the total expenditure of effort by a qualified jurist in order to infer, with a degree of probability, the rule of *Shari'ah* from detailed evidence in the sources. These sources being *Koran, Sunnah, Ijma* (consensus) and *qias* (analogy). *Ijtihad* can be directed to inferring rules of *Shari'ah* that are applicable to a prevalent situation, or to the extension of the application of an established rule to a particular unfolding situation. *Ijtihad* is not an “human” extension to *Shari'ah*. It is part of *Shari'ah* itself. Hence inferring new rules by use of the principles of *Ijtihad*, is *Shari'ah* means of renovation and revitalization

### **The limits of *Ijtihad*:**

Though it is the means of *Shari'ah* resilience, *Ijtihad* is, neither, a source of anarchy and chaos, nor a means of transforming *Shari'ah* from a divine to a man-made law. For *Ijtihad*, as we mentioned above, is not a human source of law. Utility, custom and the general good of the individual and the community at large are all well taken and considered in the process of *Ijtihad*. However, they are not themselves the source of law. They are relevant only in as much as they are lending weight to, for example, the choice of one possible analogy over another in the case of *qias*. Without such a limitation, *Shari'ah* will, by time, lose its virtue and its divine character, which is never the outcome of *Ijtihad*.

This proposition does not only sets the limits of *Ijtihad*, but it also sets the limits of *Shari'ah* tolerance of hermeneutic exercise. On the other hand, *Ijtihad* don't include extraction of *Shari'ah* ruling from clear (un probable) texts. For example, The Koran says that "Alms are for the poor and the needy and those employed to administer the funds; for those whose hearts are to be reconciled...etc."(Sura IX no. 60). Knowing that *Zakah* is to be paid to the poor, needy.....etc. is not *Ijtihad* because this is clear in the statement of the text. But deciding that those whose hearts are to be reconciled, though mentioned in the text, are paid part of the *Zakah* only because Islamic ummah was weak at the early days of Islam, and from this inferring that now (at the time of Khalifat Omer Ibn al-khattab) we don't need them no more and hence eliminate their share of *Zakah*. This is a famous example of *Ijtihad*. That is what the second Khalifa, who was a great "mujtahid" did.

### **Ijtihad in the words of one great Islamic scholar:**

The following is an excerpt from the book of *Elaam Almuaggean*, the famous book of the great scholar; *Ibn Alqayyem* concerning *Ijtihad*:

"[our statement about *Ijtihad*] is the lucid righteousness: being ceaselessly set on the narratives is, always, going astray in *Shari'ah*, and an ignorance of the intention of leading learned men. He who gives *fatwa* based solely on what is narrated in the books, ignoring differences in people's norms, habits, their era, circumstances and signs of their conditions is misguided and misleading. His harm to religion is worse than harm inflicted by one physician prescribing to all and every one out of only one book of medicine. Rather, this ignorant *mufti* is more harmful to the body and religion of Muslims" (*Ibn Alqayyem P. 77-78*).

## **Some examples of present-day *Ijtihad* in the field of Islamic banking:**

In the second half of this century, and after the demise of colonialism, Muslims realized that the conventional institution of financial intermediation which is based on a borrower-lender relationship and interest is not in line with *Shari'ah*. They started looking into their history and jurisprudence to find a substitute. A model of Islamic bank was based on Mudarabah, replacing the borrower-lender relationship with a profit and loss sharing arrangement. To meet the needs of society and to compete with conventional banks, while still working within the boundaries of *Shari'ah*, Islamic banks needed a tremendous efforts in this area *Shari'ah* research and a great deal of *Ijtihad*. In-fact, the emergence of Islamic banks was a blessing to figh, because it created a strong case for “opening the gate of *Ijtihad*”.

It is no surprise that the most significant *Ijtihad* of the present-day is in the field of finance and banking. This is because Islamic banking is the most notable component of the Islamic economic system, that was brought to life in this era. To be able to meet the challenge of modern life, while remaining within the boundaries of *Shari'ah* a great deal of *Ijtihad* was needed for Islamic banking, because the issues facing these new banking institutions had no ready-made ruling in *Shari'ah*. “*Ijtihad*” was needed to infer from the original sources the appropriate rules. *Shari'ah* boards in Islamic banks and the figh Academies all over the

Muslim world responded to this challenge. Some examples are given below:

### **1- The promise as a commitment in Murabaha:**

Although, Islamic banks have to do “real” and not purely monetary transaction, their primary function is financial intermediation. Yet they are required to offer viable and practicable substitute for conventional banking. Like any other financial intermediary a major concern is matching assets with liabilities. For this reason, Islamic banks can’t actually engage in a merchant-like activities, like maintaining warehouses with large inventory of goods and equipment...etc. Yet, it is required from *Shari'ah* point of view to render finance through actual purchase and resale of such goods and equipment. It is a rule of *Shari'ah* that, to sell anything one is to have actual possession first. When an Islamic bank is approached by a client who wants to buy an airplane, for example, the bank can’t enter into a sale contract unless it already owns and posses such plane. Certainly this client can promise that if such equipment is purchased by the bank, he will buy (on installment) and give a profit to that bank. However, a promise in *Shari'ah* is non-committal, for if a commitment is averted then it is no longer a promise but an actual sale contract which is not allowed at this stage. Some contemporary scholars found that in the *Maliki* school, a promise becomes obligatory once the promised find himself in a predicament due to that promise. This *Maliki* position is, infact, in the realm of benevolent contracts (like gifts) and

not exchange contracts (like sale). The *Ijtihad* of these *fugaha* was to adopt the same criteria for the contract of Murabaha, although it is a sale contract. Therefore, once the bank buys that airplane, it will actually be in a great predicament if the client decides not to buy. The contemporary *Ijtihad* is to rule that such a promise is actually a vow. Hence if that client decides not to buy, the bank can dispose of the airplane by sale to the next possible buyer. If loss is incurred (other than time value of money), the bank will have a recourse of the client. This is the essence of the ruling of the Islamic fiqh academy of the organization of Islamic Conference in Jeddah.

## **2- Constructive liquidation of Mudarabah:**

Mudarabah is a partnership in profit, where one agent (*rubal-mal*) provides capital, and the other (mudarib) provides labor or management. The two agents contract on dividing profit by what ever ratio they agree on at the time of contracting. However it is a *Shari'ah* requirement that Mudarabah is liquidated. Portion of profit can only be done after actual liquidation. This is because, without dissolution, we can't be certain that value was actually created in excess of the original capital which is the owner-ship of the financier. Because the idea of Islamic banking was based on Mudarabah particularly in its liability side, this becomes a problem. This is because investment accounts are mostly short term (3, 6, 12 months), while assets created by use of these funds are mostly longer in term. Weekly, Monthly, or even Quarterly. Liquidation is not practicable and at times plain impossible.

A major achievement of *Ijtihad* was made by *Shari'ah* boards of many Islamic banks, is that it is sufficient to do “constructive liquidation” via accounting procedures and then portion profit based on that constructive liquidation. This made the Mudarabah a viable and practicable substitute for time deposits.

### **3-Reciprocal lending:**

The loan contract in *Shari'ah* is, always, for benevolent purposes. *Qard-hassan* is the only form of lending allowed. No interest or any compensation is allowed to be advanced by the borrower to the lender. *Shari'ah* is very strict in this matter to the point that any conditions imposed by the lender on the borrower is considered suspicious and generally not allowed even if they are non monetary. In particular, giving a loan to some one with a condition that he gives a reciprocal one later is not allowed and considered usurious. When Islamic banks started, they needed, among other things, to have correspondent banks all over the world.

Through correspondence banking, remittances, transfer, L.C's...etc. can be made. This requires opening an account, and setting credit line by the Islamic bank at each and every correspondent bank. Conventionally such banks will earn interest on credit and pay interest on debit accounts. Certainly Islamic banks can as much as possible maintain credit in these accounts and waive their right to earning of interest. Nevertheless a correspondent bank will never give “free” credit when such is needed. Rather than earn and pay interest, the solution was to work out an arrangement whereby an Islamic bank gives up its right to earn interest on their accounts. Instead, the correspondent bank will



extend credit, at no interest, for the same amount and number of days in which the account was in credit. This is done on the basis of daily balances. It was ruled, by more than one Fatwa body, that, since the purpose of this arrangement is to avoid *riba* and not to earn it, then it can be acceptable with certain conditions. One more significant *Ijtihad* of contemporary scholars.