

# بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

## **Critical appraisal of the current states of the Islamic Economics and Finance.**

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الحمد لله وحده والصلاة والسلام على من لا نبي بعده وعلى آله وصحبه .. وبعد:

Much has been written about the current state of Islamic banking in terms of size, rate of growth, profits...etc. A cursory survey of the financial journals will show full coverage of the news and views on Islamic finance in general and a relentless follow up of its expansion into new sectors and regions. It is easy therefore to see that Islamic banking is doing exceptionally well and there are sufficient reasons to think it will continue this growth path for the foreseeable future on a global basis.

Here we are talking about “numbers”. Numbers are important because growth and performance in banking can only be expressed in numbers.

But we have to be very careful. Numbers reveal very little about (for the lack of a better term) the “Shari'ah quality” of Islamic banking.

The question I would like to address today as part of this critical appraisal, is: are we (being students of Shari'ah) satisfied with where Islamic banking is and where Islamic banking is heading in as far as Shari'ah aspects is concerned?

It would be very useful to firstly, take stock of the recent past to come to grips with the present state and to see if the future can be predicted.

We can cite at this gesture, four stages of development for Islamic banking during the last few decades.

The first was the era of the formation of the concept which roughly covers the first 3 decades of the 20<sup>th</sup> century. During that era Shari'ah scholars especially in Egypt and India the then, two major centers of Shari'ah discourse, were coming to terms with what became at that time a pressing question: Is bank interest riba? Muslims didn't know interest based lending before colonialism and they had no familiarities with

formal banking except at that era. Even at the height of Muslim civilization, there is no historical evidence to the contrary.

It was quite apparent then that commercial banks are formidable in the role they play in the economy, and they were not disputing the importance the functions played by banks. Doing away with the whole business of banking was never a serious proposal.

Such importance did not discourage that the majority of scholars then to judge bank borrowing and lending on the basis of interest as violating of the rules of Shari'ah. By the 1940's it was obvious that a consensus was being formed amongst scholars that bank interest is the riba that is mentioned in the Quran. Hence, the establishment of a truly Islamic financial system was on the top of post-colonialism reform agenda. The place of the institution of banking is quite prominent in that broad financial sector. However, it is a far cry from commercial banks as were know then or new.

An Islamic bank was thought to be a socially responsible institution, more concerned with the good of the community than profiting the shareholders. It is an institution deep rooted in the notion of “Istiklaf”. To many Islamic Economists Istiklaf is the foundation of Islamic economy. The principle emanates from the Quranic assertion that all wealth is owned by Allah SWT and humans only have possession of items of wealth as vicegerent. To be a pious Muslim, you must internalize the interest of the rest of the community as you utilize your income and create new wealth and as you take decision in the utilization of such earthly possessions. For a bank, this means the cornerstone of the business model equal opportunity in allocation of credit and adopting policies to create fairer distribution of income. Extending credit by such Islamic bank will no longer be based on the conventional criterion of credit worthiness and ability to pay back a loan but on the feasibility of the project to be financed. Prime amongst the points to be looked at is the impact of the project on social welfare, rate of employment and the

environment. In the process it is social good at the heart of the Islamic financial system. None of this was realistic or doable. This is because such grand objectives constitute a major shift in the very concept of banking and require the restructuring of the whole economy in terms of laws and institutions. This may not even be enough. The moral standard of the society then (and now) leaves a lot to be desired and may not support such a puritan reference in the financial system.

One may say it was a mere dream that didn't come true. But it took few decades for reformist to realize this fact. Therefore, in the 1970's onward people were resigned to reality and to the fact that it is better to make the best out of the existing system than to wait for dreams to come true. It was thought that it would be a step forward, nevertheless, if we reduce the dream to merely *halal banks*". If a bank can render the function of financial intermediation in a "halal way" but within the already existing legal and institutional framework then this should be welcomed Halal meaning simply interest free. The first test of this concept came in 1975

when Dubai Islamic bank was established with a banking license from a conventional central bank and with a by laws that committed it to all standard regulatory and statutory requirements of banks.

That was a milestone. Several banks were to follow suite in many Muslim countries and governments in some Muslim countries were willing to issue amendments to the banking law to address the special nature of the novel concept of *halal banks*. It was this step was considered modest compared to the original vision, however, it is a change in the right direction. Nevertheless, in the late 1980's it was obvious that while quite significant the progress it is not enough. Most Muslim countries already have a mature banking sector with conventional banks controlling the entire market share. No matter how many new *halal banks* you establish, they will be merely a niche and the core will remain conventional. The strategy of ridding the society of *riba* requires a major shift. Hence, in the 1990's it was thought if the already existing conventional banks are

encouraged to transform gradually to Islamic and adopt a process that includes remising a “hybrid” for a longtime.

This last stage of development opened the world to Islamic banking and made Islamic banking a truly global phenomenon. Are we closer to the original vision? Though we can't underestimate the great achievement so far the answer is obviously not. But it appears that we are no longer chasing that dream. Rather, we seem to be following a route which appear to lead to a convergence between our most despised nemesis, i.e. *riba* based banks and the *halal banks*, and this is exactly what is Islamic banking is destined to be.

### What does this convergence look like?

A convergence means the two systems will be coming together and closer to each other, collaborate and cooperate. Left to its means, the convergence may become complete and may end up creating what may be termed “Shari'ah conventional banking”. “Shari'ah” because from a

mechanical point of view, everything is “halal”, “conventional” because the dynamics, the priorities and the objectives are a facsimile of the conventional as we know it today. In other words, the process of innovation in Islamic banking would have exhausted all possible Shari'ah means to emulate and create alternative banking products that deliver the same economic outcome, but failed to change the face of the financial industry.

Without being sarcastic Islamic banking would simply make those who are comfortable feel comfortable. I am referring here to equitable distribution of wealth and income.

If we look at the bigger picture, we can easily see that riba was prohibited because it is “zolm”. This is stated in the Quran. While charging interest on money for money is “zolm”<sup>1</sup>, zolm is a much wider a concept.

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<sup>1</sup> This is because surplus can only be produced by mixing capital with labor and taking risk of production. For a lender who decides his profit prior to surplus being realized is zolm.



A system that concentrates wealth in a smaller and small number of hands can't be said to be Islamic no matter what modus operandi it adopts. This is too harsh coming from someone who may be considered a contributor to the current state of Islamic banking.

### What is to be done?

This is the gathering of Shari'ah scholars. Had we been executives measuring their power by how many billion they have under their management, I would see we would be a trillion dollar powerful. We do not have executive power, thank God, but we are not exactly powerless. We have the moral power and the fact that we will get more respect when we listen more to the ordinary people. Those who, because of their trust in our names they are keeping bank mangers sleep well at night. We need to set "Islamic parameters" and adopt general statements that will then trickle down to becomes part of the strategy of the future for every Islamic. Good ideas will always find their place in the hearts and minds. We have a precedent. The whole concept of social responsibility and

corporate citizenship which is now part and parcel of corporate governance came as conventional initiative. It is now doing “good deeds” that are supported by the Shari'ah boards. It is high time that we have our own initiative that, though finds its origin in Islam it will be universal because it makes a lot of sense.

For example, we all know that debt burden on households could be a real problem that have both family and social implications. A banking system that is based on debt can't shoot itself in the foot by initiating an awareness program about the ills of debt overburden. But Shari'ah boards can develop a sort of self test which individuals can use to check their debt capacity and make this part of the obligation of banks to advise customers about debt.

Another possible program is one directed against poverty. Poor people are always outside the radar of bank, but they should be in the eyes of Shari'ah boards. While one will not fail to see the commercial advantages

of a micro finance program based on exorbitant interest rate, it is essential that we push for an Islamic alternative of microfinance with a “human face”. One that takes us clear to the original dream.