In the name of Allah, the Most- Merciful, the Very-Merciful

Looking for New Steps in Islamic Finance

Mufti Muhammad Taqi Usmani

Islamic banking industry has grown rapidly during the past three decades spreading its operations in many parts of the globe. Making its first debut in the small Savings Association of Mitghamr (Egypt) in 1963, its strength has now reached over 250 financial institutions operating in more than 40 countries with assets valuing USD 750 billions, and an annual growth rate of 15 per cent. Almost all the giant conventional banks are in queue to establish their Islamic units to capture the new emerging market. This rapid growth of Islamic financial industry is, no doubt, encouraging for those who wished to relieve themselves from the prohibition of interest on the one hand and to remain a part of the modern market economy on the other. Now that a substantial period of more than three decades has passed on the experience of Islamic Banks and Financial Institutions, it is imperative to review what they have achieved so far and what they have missed.

It is, no doubt, a great achievement of these institutions that they relieved the Muslims from clear prohibition of *riba*, and came up with some alternatives that might be adopted in financial market without indulging in interest. In an atmosphere entirely dominated by interest-based transactions, it was really a formidable task. I do not agree with those who criticize them on the basis of utopian idealism, and claim that they should have brought an immediate revolution in the entire pattern of the financial market and should, at the very outset, have achieved the basic objectives of a true Islamic economy. This idealism that accepts no breathing space between 0% and 100% always tends to support 0% and to maintain *status quo* in practical terms. Looking from practical aspect, it is always a wise policy to start something that can be done in a given situation, even though it is less preferable from an idealistic approach. It was in this background that some instruments of lesser risk like *murabahah*, *ijarah* and diminishing *musharakah* etc. were allowed by the Shariah scholars. It is also wrong to say that these instruments have an element of camouflaged interest. In fact, if implemented with all their necessary conditions that have always been stressed upon by the Shariah scholars, they are substantially different from an interest based financing. At the first place, all these instruments are based on real assets, and do not amount to trading in money and financial papers, which is the case in an interest-based financing. Secondly, unlike an interest-based transaction, the financier, in each one of these instruments, assumes the risk of real commodities, properties or equipments without which the transactions cannot be valid in Shariah. Thirdly, these modes can be used only to finance a commercial activity that is permissible according to Islamic rules and principles. These basic distinguishing features are enough to draw a line of difference between the two techniques of financing. Therefore, the notion that they are another form of interest is not correct.

Having said this, one must not forget that these instruments are not modes of financing in their origin. They are in fact some forms of trade that have been modified to serve the purpose of financing at initial stage as secondary and transitory measures. Since they are modified versions of certain forms of trade, they are subject to strict conditions and cannot be used as alternatives for interest-based transactions in all respects. And since they are secondary and transitory measures, they cannot be taken as final goal of Islamic Finance on which Islamic Financial Institutions should sit content for all times to come. It is a matter of concern for a student of Islamic finance, like me, that both these points are increasingly neglected by the players in the field, and especially by the new-comers in the industry.

One should always differentiate between the transactions based on the original philosophy of a particular system and the transactions resorted to in exceptional situations on the basis of need. The former ones represent the real concept of the system, while the latter ones do not. The original concept of Islamic financing is undoubtedly in favor of equity participation rather than creation of debts, because it is only equity participation that brings an equitable and balanced distribution of wealth in the society. Debt-ridden economy, on the other hand, tends to concentrate wealth in the hands of the rich, and creates a bubble economy which fuels inflation and brings many other social and economic evils.[1] That is why Islam has discouraged creation of debts, which should be resorted to in exceptional situations only, and encouraged equity participation, which is the best way to a just and balanced distribution of the benefits of commercial activities. Out of innumerable instructions given by Islamic resources to that effect, I would like to quote only two examples. It is reported by Sayyidah ‘Aisha رضي الله عنها, the blessed wife of the Holy Prophet ﷺ that, during his prayer the Holy Prophet ﷺ used to seek refuge from indebtedness.[2] On the other hand, the Holy Prophet has declared that ‘Allah Almighty remains with trade- partners (to help and support them) unless one of them becomes dishonest to the other.’[3] These two comments made by the Holy Prophet ﷺ are more than sufficient to show Islamic attitude towards debts as opposed to the equity participation.

In the light of the above, Islamic financial institutions have much to do before they achieve the desired objectives of a true Islamic economy. Although the trade-related instruments like *murabahah, ijarah* etc. used by them in their operations, are not loans in strict terms, yet they create debts on the basis of deferred sales or renting. As explained above, debt-based instruments are not preferred ones, but they were suggested to be used as modes of financing to start the wheel of interest-free financing, and to bring an instant relief from interest in an atmosphere that was not fully prepared for immediate switch over to an equity-based system. It was a sort of first aid provided to a patient before he may have access to full medical treatment. No one can deny the importance of measures taken as first aid, but who can claim that they are the final cure of the disease, or that no further treatment is needed after them? Pain-killers are necessary to give immediate relief, but they are not enough to cure the deep-rooted ailments. The idea was that after starting their operations on the basis

[1] I have explained this aspect of debt-based economy in my book *The Historical Judgment On Interest.*
[2] *Sahih-ul-Bukhari*, Chapter10:149, Hadith no.832
[3] *Abu Dawood*, Chapter 22:26, Hadith no. 3383

of these instruments, they should gradually proceed towards the ideal forms of Islamic finance.

Failure to abide by this idea has caused many problems resulting in total neglect of equity-based financing. Despite the differences we have explained above between interest and these instruments, they have many similarities in the net result, especially because of the benchmark used for their pricing. This has prompted Islamic Financial Institutions to compete with their conventional counterparts in all respects, and restrict themselves to the debt-based products. In their zeal to compete conventional banks, they are trying to invent 'Shariah compliant' counterparts for each and every financial product available in conventional capitalist market, regardless of whether or not they are in consonance with the ethos of Islamic economy. Instead of gradual progress towards equity, the tendency is to make maximum compromises to accommodate debt- related products matching with practices of the conventional market. Even derivatives are being designed on the basis of 'Shariah compliant' methods. If some products had to be equity based, they too were equated in some way or the other with a fixed return debt. 'Sukuk' was the best way to proceed towards equity, but in order to restrict the return of sukuk holders, a threshold based on Libor is applied after which the whole profit is given to a particular party in the name of incentive for good management. In many cases, it is not even mentioned that after the fixed rate the rest is incentive.

This situation needs serious consideration of the players in the field and of the Shariah scholars who oversee the new products for Islamic financial Institution. Many conferences and seminars are being held frequently to consider various aspects of Islamic finance. I think it is high time now to find out ways and means to make our products not only compliant with, but also founded on Shariah. Our research should now focus on how we can move from debt-based to equity-based instruments in their true spirit, so that they may demonstrate the beauty of Islamic finance based on its economic ethos. No doubt, there are still some hurdles in their implementation, but they are not insurmountable for an industry that is growing so fast, if serious importance is attached to this vital issue, which must be the next topic of our discussion in a workshop devoted for this purpose. May Allah guide us all.