

Challenges Facing Islamic Finance: Research Areas

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Islamic banking started in earnest in the 1970s with personal initiative of the concerned Muslims to address the problem for *riba*. The pioneers included committed and resourceful individuals, professional bankers, Islamic economists and religious scholars. There was no initial working model to act upon, except the belief that interest-based banking might be replaced by banking on the basis of profit-and-loss sharing. Situation has changed considerably since then both at the practical and the theoretical levels.

The difference in the working of the Islamic banks and the interest-based banks is becoming thin by the day. The existing Islamic banking model carries the risk of being called “banking under Shari’ah supervisory” or, perhaps, “banking for the Muslims by the Muslims (and some others too) with clearance by the Shari’ah scholars”.

“Islamic economics” is already facing an identity crisis, and is being seen as “economics with moral and ethical values”. Islamic banking is growing as “asset-backed” banking that is somewhat at variance with asset-based banking. If the trends continue, perhaps Islamic finance too may come to be viewed as “finance with emphasis on Islamic values”.

There is urgent need for serious research on several fronts.

1. The Need for a Common Fiqh

This is essential for two reasons:

1. In the global perspective, banking based on a particular school of thought is inconceivable.
2. Everything in Islamic banking and finance depends on clarity on the Shari’ah matters.

At present, an equivalent of Church and the State (*Ibadaat* versus *Mu’amalat*) separation exists in the Islamic scholarship: the Shari’ah matters are supposed to fall in the domain of the Shari’ah scholars, and the *dunya* matters for experts in the respective fields. The Shari’ah scholars, on their part, do base their conclusions on some principles, but those principles or reasons are seldom made explicit. Many a time, the Shari’ah solutions are no more than Shari’ah-fixes.


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The current state of the fiqh:

The Methodology:

- Committee Framework. Answers to the various issues are sought from amongst the options available in different fiqh streams
- No change in the methodology of the fiqh (usul al-fiqh) enunciated in the past

 The same old notion of ijtehad: The focus is on literal interpretation of the Divine Texts with the help of إجماع (Ijma'), قياس (Qiyas), إستحسان (Istehsan), مصلحة مرسلة (Maslahah Mursalah), إستصحاب (Isteshab), سد ذريعة (Sadde Dhari'ah), قول صحابي (Qaol-e-Sahabi) and شرع من قبلنا (Shar'a mann Qablona). Lately, there are some refinements in the form of مقاصد الشريعة (Maqasid Al-Shari'ah). But, by and large, there is no change in the methodology developed a thousand years ago.

 Problems have been further compounded in the modern age with the growing emphasis on Qawaed Al-Fiqhiyyah, notably Al-Abahato Aslunn, Al-Muslimoona 'Ala Shurutehimm, Al-Kharajo bid-Daman and Al-Ghunum bi Al-Ghurum.

On the Need for a New Methodology for Fiqh:

Rationale

- Need for recognition of Internal consistency in the Qur'an and the Sunnah
- Invitation of the Qur'an on the coverage of all conceivable cases in it
- The Hadith that calls upon the Muslims to always uphold the Qur'an and the Sunnah
- Formal compilation of the Hadith in the 3rd Century Hijrah
- Quest for unification of the fiqh and bringing all the Muslims to one platform

The Approach in Respect of the Qur'an

- A consolidated look at all the Ayat relevant for a given subject.
- Proper allowance for the nature of the Qur'an as Spoken Word of Allah SWT
- Role of the Sunnah
- Observance of balance in the emphasis placed on the Ahkam and their purpose
- Role for the Arabic language

The Approach in respect of the Sunnah

- Unconditional respect
- Authentication
- Separation of the goals of interpretation and those of derivation of the Ahkam

- Allowance for the link between the Qur'an and the Hadith
- Taking a consolidated look at the various Ahadith on a given subject
- Focus on message rather than the words in the texts
- Allowance for real life cases covered by the Ahadith

Going beyond the Qur'an and the Sunnah might hinder the process of unification of the Ummah.

The focus:

- Let the focus be on the identification of the principles and the search for admissible arrangements for (or, solutions to) the contemporary problems in the light of the said principles.
- Rather than the nays, the search should be for what the Shari'ah desires in the various instances.—For example, when Allah SWT expressed His Displeasure with *riba* or prohibited it, what is it He SWT desired the Muslims to do?

2. The Basic Theory of Islamic Banking and Finance

The rationale for Islamic banks, their nature, their instruments and their operations are to be explained by a unifying theory. Furthermore, this theory should also serve as a platform for further advances in Islamic finance.

Perhaps, it needs to be made clear that Islamic banking is not banking without interest. It is asset-based, not asset-backed, banking. It is not universal banking. Last but not least, it is not a dual-modarabah model.

3. Financial Instruments

There is dire need for comprehensive review of simple as well as divisible and tradable financial instruments for Islamic banking operations in the following areas:

- ◆ deposit mobilization
- ◆ financing
- ◆ liquidity management
- ◆ regulation and control of Islamic banks

Somewhere the following point has been missed. A financial instrument is not only a set of contracts and agreements but it also replicates the transaction process between banks and their clients. A few examples:

1. In principle, Murabahah financing means that the bank buys and sells. But do the existing instruments capture role of the Islamic banks as such, in both letter and spirit?
2. Auto financing is being offered under leasing (Car Ijarah) as well as Murabahah. In the Murabahah instrument, the purpose of leasing is served through hypothecation of the car sold to the customer. Everything else,

insurance, installments, etc., is more or less the same as under the leasing agreement. How, or why, is it so?

3. What is the difference between general savings accounts of interest-based banks and similar Musharakah-based financial products of Islamic banks if the same daily-product method is used and a minimum balance restriction enforced for the award of profits to the account-holders?

That Islamic banking is different from the conventional interest-based banking, ought to be reflected in the working as well—not just in vocabulary and documentation requirements.

4. Covers for Financing

This area is untouched at present. There is serious need for review of the introduction of penalty on defaulters of Islamic banks. And, Shari'ah-compliant solutions for Islamic banks' legitimate concerns need to be worked out.

5. Banking Manuals and Pricing Formulas

There is need for developing (1) the Shari'ah manuals, (2) regular Banking Manuals, and (3) the formulas for pricing the various Islamic financial products

6. Shari'ah-compliant Accounting

The accounting is about tracking claims: rights and obligations. There is need for a wholesale review of the existing accounting practices so that they truly reflect on the Shari'ah principles for mu'amalat.

7. Regulation and Control

The implications of the Islamic principles of contracts for Islamic banking are yet to be fully recognized.

The Basel protocols are with reference to the interest-based banking. In their present form, they are not directly applicable to Islamic banking that is essentially a different way of banking. Basel-compatible or Basel-compliant arrangements need to be worked out and got recognized at the appropriate level.

Additional considerations for keeping Islamic banks as banks, checks against misuse of Islamic financial instruments, the Shari'ah audit, etc., also call for the researchers' attention.

8. Legal Framework

At present, except for passing of some general laws (Malaysia, for example) and guidelines for Islamic banking (in Pakistan, for example), , no serious effort has been undertaken to bring about necessary changes in the banking laws and other laws that affect Islamic banking.

FURTHER READINGS

1. International Institute of Islamic Economics: *IIIE's Blueprint of Islamic Financial System* (Islamabad: International Inst. of Isl. Econ., 1999)
— The above reference identifies the necessary Shari'ah parameters, and takes a consolidated look at the various areas related to Islamic banking and finance.
2. Sayyid Tahir, "Current Issues in the Practice of Islamic Banking", 2003. (*Typescript*)
3. Sayyid Tahir, "Future of Islamic Banking", 2003. (*Typescript*)
