

Comments of

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on

Islamic Law, Adaptability and Financial Development

by Habib Ahmed

Introduction

In order for Islamic economics, banking and finance to continue to develop and be practised, many inputs are needed. Besides the body of theory itself, the related environment in which they are practised are also important. This paper by Habib Ahmed discusses an area that sees the interface between law and economics/finance that is very important in determining the implementational success of financial development. The author points out an almost self-evident truth that financial system success is greatly enhanced in legal environments that are more flexible and adaptable to its requirements. The author is right to point out (p. 2) that relatively little has been written regarding Islamic commercial law (comprising both the law itself and the organizational and administrative institutions) vis-à-vis its relationship to financial development.

General Overview of Paper

As a whole, the paper succeeds in its objectives of demonstrating the main features of Islamic commercial law that have ‘adaptability potential’ while at the same time highlighting some possible legal infrastructure/institutional problems that need to be addressed. The author discusses briefly the sources and evolution of Islamic law (pp.7-9) before focussing on the main issue of adaptability of Islamic commercial law as it relates to financial development (pp.9-18). He points to the examples of using analogy to adapt traditional contracts to contemporary situations, the use of multiple traditional contracts to create new financial contracts that can serve in the contemporary scenario and adopting/adapting conventional financial products that are in line with the Sharī‘ah criteria, as ways in which the adaptability of Islamic commercial law is harnessed. The role of scholars is central in this adaptability process. Islamic law is seen as the law of the ‘Islamic scholars’ (p. 14). These scholars perform *ijtihad* based among others, to the concept of *maṣlahah*, hence adapting Islamic law to contemporary needs, *but always remaining faithful to the objectives of the Sharī‘ah*. i.e. *maṣlahah and justice*.

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While the body of Islamic commercial law itself, *if treated in the above manner*, is not seen as an obstacle to adapt to contemporary requirements, some Islamic legal infrastructure deficiencies could be stumbling blocs. The author points to some institutional issues that must be addressed (pp.18-23): ‘harmonizing Islamic law and standardization of Sharī‘ah rules’, working on Islamic financial law/statutes and the establishment of dispute settlement/conflict resolution institutions. While adapting the body of Islamic commercial law is the prerogative of the jurists, this effort involving the Islamic legal infrastructure is one that requires the cooperation of political leaders, the legal fraternity as well as the law making and administration bodies of Muslim countries. The author also provides many cases in different Muslim countries throughout his paper that depict the reform efforts being made to facilitate the growing Islamic finance industry. As a whole the paper is coherent, well referenced, quotes authoritative sources, gives contemporary country examples and does contribute to an important area in contemporary Islamic financial development.

The following paragraphs will discuss two issues that arise from the paper, aspects that are not widely discussed today, in the hope that it would lead to further deliberation by participants of the Conference and after. The two issues are firstly, the approach of the paper and secondly, some methodological issues taken in the paper. These two issues are not new and were raised as early as 2 decades ago by scholars who were pioneers of contemporary Islamic economics and who were concerned about ‘starting off on the right foot’. We raise it up now not to take us ‘backward’ but because after almost 30 years of contemporary Islamic economics and finance, the discipline and its scholars have matured. We are more confident with ourselves and our discipline and are able to address these issues with greater openness, self-criticism and objectivity, something that may have been more difficult to do then. It must also be made very clear that these issues are not ‘writer specific’, i.e. they are not directed at the author alone. Although reference is made to his paper, the comments are directed at the general trend that has dominated contemporary Islamic economics and finance literature, at least since the early 1990s.

Issue 1: Do We Need/Can We Handle Plurality of Approaches?

As far as the approach is concerned, the paper adopts the approach of working within the existing financial and legal systems.¹ For example, the entire section 4 that discusses the adaptability features and process in Islamic law (pp.9-18) is said to work within the boundaries of the Sharī‘ah (p.11). However, the examples given in subsections 4.2.1 –4.2.2 all depict the acceptance of the existing financial and

¹ In the last five years or so, the term ‘harmonization’ has been put forward. See Kamali. H. (2005), ‘Harmonisation of Sharī‘ah and Civil Law: Proposing a New Scheme for *Uṣūl al-Fiqh*’, paper presented at the International Conference on Harmonization of Sharī‘ah and Civil Law 2, Kuala Lumpur, 29th –30th June, 2005 organised by the Ahmad Ibrahim Kulliyah of Laws, IIUM.

legal systems while adapting Islamic law and finance to suit the needs of these systems. Should contemporary Islamic economics, banking and finance (and in this case Islamic law) always need to adapt to existing realities? It is equally possible-maybe even necessary- for Islamic alternatives to thrive, for us to question and even reject existing realities. Islamic scholarship and practise must be able to distinguish the fact-truth distinction, as not all factual realities are desirable, are our concern or 'real problems' for Muslims, Islamic economics and finance. What is the role of 'ideals' in our scheme and model/theory building?

While the author does mention this other option in section 4.2.3, where conventional products/contracts that meet Sharī'ah criteria can be adopted/adapted (p.14), I think this option and approach needs greater elaboration and debate. While the first approach may be considered a valid one based on the criteria of pragmatism, practicality and gradualism, there have been some critics of this approach who claim that this does not 'Islamize' economics and finance (i.e. Making modern economics and finance fall in-line with Islam) but rather one that compromises the Sharī'ah and ends up justifying current realities and practises since it follows the reference point of modern systems and its institutions that have developed out of a western epistemology and experience. Islamic economics and finance become entrenched in the conventional neoclassical framework. Very rarely, if at all, are the foundations of neoclassical economics questioned or critically evaluated by contemporary Islamic economists.

Among contemporary Islamic economists, M.N. Siddiqi and M. Anas Zarqa were among a small group of pioneer Islamic economists who in the early 1980s², talked about these foundations and related philosophical/methodological concerns. However, due to various reasons, the practical demands of economics and banking/finance soon took precedence and talk of 'indigenous frameworks' were abandoned by the majority of contemporary Islamic economists. Among the exceptions to this trend were and are, writers such as Z. Sardar, S. N. H. Naqvi, M.A. Choudhury and Z. Hassan (all except the first are economists).³

² Muhammad Nejatullah Siddiqi (1989): "Islamizing Economics" and Muhammad Anas Zarqa (1989): *Tahqīq Islamiyyat 'Ilm Al-Iqtisād: Al-Mafhūm Wa Al-Manhaj* (Islamization of Economic: Concept and Methodology), in *Towards Islamization of Disciplines*, International Institute of Islamic Thought, Herndon. Both papers were written either before or for a conference in 1984 held in Kuala Lumpur.

³ See for example Ziauddin Sardar. (1984). "Islamization of Knowledge or Westernization of Islam", *Afkār Inquiry*, London: 40-44; Syed Haider Nawab Naqvi. (1981), *Ethics and Economics: An Islamic Synthesis*, Leicester: Islamic Foundation; Masudul Alam Choudhury (1986), "Microeconomic Foundation of Islamic Economics: A Survey in Social Economics", *The American Journal of Islamic Social Sciences (AJISS)*, 3(2); Zubair Hasan (1998), "Islamization of Economics: Issues and Agenda", *IIUM Journal of Economics and Management*, 6(2).

In the case of banking and finance, the main criticism of Islamic banking has been that it is modelled after the interest based (especially commercial) banking system. Hence, the role and function of conventional banks has primarily been retained while focus has been on creating 'Sharī'ah compliant instruments' to replace interest-based instruments of conventional banks. What has been attempted, according to some, is to mould conventional banks into Islamic shape by 'purging them of interest and basing their actions on the principle of *muḍārabah* or profit-loss sharing'.⁴ In practise however, we now know that Islamic banks have actually not focused on equity but almost exclusively on debt instruments. Hence, in certain fundamental ways, the approach of accepting the existing system, the commercial bank models and generally their practises (albeit modified) has become 'standard' Islamic banking and finance.⁵

Whether we agree with those who have been critical of the dominating approach and put forward other options, the point made is that these efforts, *if not inclusive of foundational concerns relevant to economics*, can end up making Islamic economics a branch of modern neoclassical economics. Some of us may not see the problem in this, while others see it as a betrayal of the Sharī'ah. The question is, do we want to, and are we ready to, allow and discuss approaches other than the one adopted for the last 2 decades?

Issue 2: The Foundations of Contemporary Islamic Economics: What Does It Mean?

The second aspect of the paper that is of concern is its overly 'legal' emphasis. For example, the author sees *ijtihād* as 'a process of independent reasoning by qualified scholars to obtain legal rules from the Sharī'ah using analogical reasoning and induction' (p.7). Later when talking of the role of scholars in interpreting the Sharī'ah to produce *fiqh mu'āmalāt* and to perform *ijtihād* (pp.10-11), he almost exclusively refers to jurists. Since the author is discussing the adaptability of Islamic law, it is natural that he focuses on the legal aspects. What is of concern is a more widespread practise among many contemporary writers in Islamic banking and finance of 'narrowing' and 'limiting' very profound concepts in our heritage such as Sharī'ah, *fiqh*, '*ulamā*' and *ijtihād* to the domain of law, lawyers and the legal dimension of life and society. There seems to be another kind of rigidity (p.8) that has set in the minds of many who commit this 'narrowing' of concepts, forgetting for example, about the ethical and moral dimensions that are part and parcel of economic and financial decision making. Life is not law and law is not life.

⁴ See Z. Sardar (1988), 'Rediscovering Islamic Epistemology' and 'Islamic Economics: From Partial to Axiomatic Approach', in *Islamic Futures*, Pelanduk Publications, Kuala Lumpur.

⁵ More recently, Z. Hasan (2005) has brought up these issues again in his 'Islamic Banking at the Crossroads' paper in a conference on Islamic Perspectives on Wealth Creation, held at the University of Durham.

As far as the heritage is concerned, only *fiqh mu'āmalāt* and to a lesser extent, *uṣūl al-fiqh* is stressed. Even in the case of the latter, the methodology referred to is for the law and not necessarily for economics and finance that must be seen as a human/social science. By adopting this legal emphasis, the inputs in developing Islamic banking products are almost exclusively under the 'jurisdiction' of 'Sharī'ah advisory boards' that are actually 'Islamic law boards' consisting almost exclusively of legal scholars, whose training is in Islamic law and whose main purpose is to try and give opinions on the development of new financial instruments. While no one is questioning the jurists' authority in Islamic law, unfortunately, the approach adopted would be a juristic one. The process of product development then is as follows. On the one hand, banking products are designed by bankers who may have 'mastered' conventional banking and finance, but are not well versed in the Islamic heritage. On the other hand, many of the Islamic scholars who are involved in the IBF industry as 'Sharī'ah' consultants and advisors, are trained in *fiqh* and to a lesser extent in *uṣūl al-fiqh*/jurisprudence. These scholars are still in 'legal' mode, i.e. Focused exclusively on legal reasoning.

Therefore, when the author discusses the various ways in which contemporary Islamic finance can be developed and how the Sharī'ah and Islamic law can be adapted (pp.11-18), he naturally focuses on the law and the role of the jurists. Should Islamic principles continue to be judged purely on juristic grounds? For example, when the author discusses the concept of *maṣlaḥah* (pp. 17-18), who decides the criteria of *maṣlaḥah*? By this, I mean who is actually involved in the elaboration of the Sharī'ah as it deals with *maṣlaḥah in the economic and financial spheres*? According to the paper, this role is almost the exclusive domain of the jurists. Should we continue to narrow important concepts to the legal sphere? This may prove to be counter-productive for the development of Islamic economics, banking and finance in the long-run.⁶

Our position is that the 'adaptability' process must be facilitated by scholars who are more than only legal/*fiqh* and *uṣūl al-fiqh* scholars. In the case of economics, banking and finance, we are talking about a social science that tries to understand, analyse and describe human interaction and choices made in areas of allocation of resources, distribution, exchange and finance (among others).⁷ Naturally this would include financial instrument development, but now seen in a wider social/human context. Maybe for economics, banking and finance, one has to focus more on *uṣūl al-iqtiṣād*. I do not know of any work that has tried to talk of this. *Uṣūl al-iqtiṣād* can be defined as a much broader area of 'foundations of (Islamic) economics', including the Islamic worldview, *uṣūl al-ilm* (sources or foundations of knowledge), *fiqh* and *uṣūl al-fiqh*, *uṣūl al-dīn*, history, analytical techniques and at least the 'equivalent' of what Schumpeter called the '*sociology of*

⁶ See Mahmoud Gamal 'The Limits and Dangers of Sharī'ah Arbitrage' on his website.

⁷ In this category, one could discuss the development and creation of financial instruments.

economics' in our heritage.⁸ Hence the knowledge of the heritage required to develop contemporary Islamic economics banking and finance must be more than just the narrowly 'mis-defined' *fiqh* (legal) sciences. While the *maqāṣidī* approach put forward by the author (p.18) is a step in the right direction, there is still much more that can be done to include ethical dimensions in the development of these instruments.⁹

No creative or meaningful 'adaptation' can take place unless this 'knowledge/qualification gap' is bridged. This can only be done if our economics curriculum is radically modified. Unfortunately, most economics programs in our universities are modelled after mainstream neoclassical-Keynesian programmes of western universities. They hardly discuss philosophical and methodological issues in economics. The underlying assumptions of mainstream economics are accepted as 'truth', while most if not all attention is placed on mastering the latest quantitative techniques (now available in software packages) and applying these to 'analyse data'.¹⁰ Critically evaluating the foundations of economics is needed and more resources should be allocated here, both financial and human. If nothing more, we should at least learn from the developments in the west where an increasing number of economists and philosophers of science are questioning the entire framework on which conventional neoclassical economics rests.

For example, it is very interesting to note that there has been a credible reaction to this in France, the UK and the US with the establishment of a 'post-autistic economics' (PAE) movement. Beginning as a *graduate student protest* towards the 'narrow' scope and approach to the teaching of economics, this movement has gained momentum and now has a credible following worldwide calling for a pluralist approach to teaching and learning economics. The movement has a quarterly on-line journal (now in its 30th issue) from economists and other scholars who have taken the very challenging task of critically analysing the philosophical and methodological issues of the discipline. The reason that the scholarship in this journal is worthy of reading is its common critique of 'modern disciplines' (in this case neoclassical economics). Scholars keen on discussing contemporary Islamic economics, banking and finance would certainly benefit from reading the material coming out from these scholars and graduate students in western universities, who in many respects are much more advanced and profound in their critique of

⁸ Another well-known writer in Islamic economists refers to Ibn Khaldun's *ʿilm al-ʿumrān* as a possible body of knowledge found in our heritage. See Monzer Kahf (2003), 'Islamic Economics: Notes on Definition and Methodology', *Review of Islamic Economics*, No. 13. This paper was also originally written in the 1980s.

⁹ From my limited discussions with scholars who sit on some of these boards, there is a reluctance to go beyond legal considerations. In this, Islamic banks may also gain from understanding the operations of 'ethical funds' operated by some conventional banks/funds whereby their criteria are in many ways more 'advanced' than the more legalistic criteria in Islamic banks.

¹⁰ See www.paecon.net

mainstream neoclassical economics. They seem to be doing in the last decade what some of our writers were doing in the 1980s. Sadly, we have lost that dimension of our scholarship.

Conclusion

While the paper presented by the author is 'intact' as an academic work, the approach adopted and the underlying assumptions and ideas taken in the paper- that has come to be seen as 'mainstream Islamic banking and finance- is the subject of debate. The author, like many others, talks of harmonization and standardization (pp.18-20) and due to their financial benefits, these efforts are taking place at both the national and international levels. The author also calls for the need to have a 'global Shari'ah body' (p.19) that will be entrusted to harmonize 'diverse bodies of knowledge to one standard version'. If the understanding of the Shari'ah continues to be limited to the law/legal rules governing contracts, and the standardized 'bodies of knowledge' continue to be mere legal compendiums, this may continue to perpetuate the 'narrowing' disease that plagues Islamic banking and finance, despite greater financial rewards being reaped by the industry players. What we need is greater plurality of approaches to widen the scope of knowledge and the type of scholars taking part in this discussion so that it encompasses the full scope of intellectual depth that one finds in Islamic scholarship. As shown by the author, if Muslims scholars can accept divergent views within the *fiqh* debates, surely having dispute settlement/conflict resolution institutions that go beyond the legal sphere is possible and viable.

May be next year we can organize a 30 year- anniversary conference as was held in Makkah in 1976 to rekindle that early spirit, to re-evaluate our successes and shortcomings and to plan for the future.

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