

***Ribā* and Islamic Banking Put on Retrial**

“O, believers, fear Allah, and give up what is still due to you from ribā if you are true believers.” (Q; 2:278) “If you do not do so, then take notice of war from Allah and His Messenger. But, if you repent, you can have your principal. Neither should you commit injustice nor should you be subjected to it.” (Q; 2:279)

Whereas at the global level, Islamic finance is being accepted increasingly as an alternative to the conventional system, in Pakistan a discussion has been re-initiated whether or not the commercial interest is *ribā* and therefore, prohibited. It is pertinent to observe in this regard that Pakistan had served as a pioneer of the current Islamic finance movement, a lot of fundamental work had been done there that played a role in promoting Islamic finance around the globe. Pakistan emerged as a global leader in the 1970s and early 1980s; it may even now contribute to the promotion of *sharī‘ah* compliant businesses and finance by working in association with other Islamic countries like Saudi Arabia, Malaysia, Indonesia and Turkey, etc. Formation of “I-5 Group” has already been suggested by the academic circles for leadership of which Pakistan has been considered as the most suitable country. These I-5 countries “can be knitted together strategically to form a bloc that may be used for developing Islamic banking and finance as a tool for integration of financial sectors in these countries”.¹

Islamic finance has become a significant global force involving almost all international structural, regulatory and commercial financial institutions.² They are increasingly considering taking the safeguarding measures similar, to some extent, to the core principles of Islamic law of contracts. The main principle is that no one should profit purely from creating and exchanging money or from the games of chance. The authorities in the West and the non-Muslim communities are realising that a truly Islamic finance institution cannot finance terrorism, as some sections of the public there mistakenly perceives. “Islamic finance is a legitimate expression of an economic philosophy of the use of money.

¹ Humayon Dar, <http://www.islamiceconomist.com/?p=1095#comments> (24th August, 2013).

² Timothy Spangler; The Guardian; 8 October 2013;

<http://www.theguardian.com/sustainable-business/islamic-finance-sustainable-economic-system>

This shouldn't be stigmatised or criminalised – especially in light of the excesses and abuses that preceded the recent global financial crisis”, says Timothy Spangler of ‘*The Guardian*’.

In the scenario where value based and responsible investing has ground to gain in the financial markets, ignoring the developments of Islamic finance could be harmful for the global economy and finance. It implies that we have to come out of the trivial discussion about the interpretation of *ribā* in the earliest possible time to play an effective role in resolving the current socio-economic problems. Time and efforts have to be exerted for promoting risk-based financing system as every single day is making the transformation job more and more difficult, which could have been much easier if accomplished in the 1980s. The piling up of domestic and external debt is making the case increasingly difficult.

The Questions Circulated by the Federal *Sharī‘at* Court

The Federal *Sharī‘at* Court (FSC) in its judgment of 1991 had declared interest as also the non-interest based (NIB) banking system implemented in Pakistan in 1980s as un-Islamic, although the petitions filed pertained only to interest. The questions circulated this time by the FSC pertain mainly to three areas: i) The meaning of the term *ribā* – whether or not it includes the present day commercial interest; ii) Banking and financial services for non-Muslims, treatment of the past loans and debts, and the commitments with the foreign interest based institutions and the governments; and iii) The status of Islamic banking as currently being practiced.

As regards the interpretation of *ribā*, the FSC, in its judgment dated 14th November, 1991 and the *Sharī‘at* Appellate Bench (SAB) of the Supreme Court of Pakistan, in its decision dated 23rd December, 1999 have already sufficiently explained the connotation of the term *ribā*. [For salient features of the both judgments, see SBP History, Vol. IV]. Prior to that, the Advisory Council of Islamic Ideology declared in 1969 that under the present banking system any increase received or paid in addition to the principal sum is *ribā* irrespective of the fact whether the transactions were between individuals, organizations or the governments. The Council, that was renamed in the Constitution of 1973 as the Council of Islamic Ideology (CII) dealt with in detail for elimination of interest (taking it *ribā* and so prohibited) in ‘*The Report on the Elimination of Interest from the Economy*’, (June, 1980). Eminent scholars of all schools of thought in Pakistan and personalities like Mr. A. K. Brohi, Maulana Mohammad Yousuf Binnouri, Mufti Sayyid Siahuddin Kakakhel, Mufti Jafar Husain

Mujtahid, Maulana Mohammad Haneef Nadvi, Maulana Zafar Ahmad Ansari, Maulana Mohammad Taqi Usmani, Mufti Mohammad Husain Naeemi, Pir Qamaruddin Sialvi, Dr. Ziauddin Ahmad and others participated in the Council's deliberations for that Report.

The proponents of commercial interest depend ultimately on the alleged view of Egyptian scholars like Muhammad Abduh and Rashid Reza, and among the later scholars, that of Iqbal Ahmad Khan Suhail (1884-1955), an Advocate, and a politician from India who authored a book in Urdu in 1936;³ Dr. Fazlur Rahman (1919-1988)⁴ and Abdullah Saeed whose book was published from New York in 1996.⁵ It is important to note that even Dr. Fazlur Rahman and Abdullah Saeed relied directly or indirectly on the book by Iqbal Ahmad Khan Suhail and to some extent on the alleged view of Abduh and Rashid Reza.

However, views of the Mufti Abduh are being interpreted wrongly. Nomani (2003) has indicated in his extensive research that the views of the Egyptian scholars have not been taken in true sense. Mufti Abduh believed that any increase over the amount of loans and debts was *ribā*. He identified the interest paid by the Postal Fund as *ribā*, and argued against the use of money, not as a means of exchange, but as a means to an unfair increase of wealth by *ribā*. He also asserted that the Postal Fund was not borrowing money from the depositors out of necessity, and, therefore, the prohibition of the payment of interest could not be lifted. In order to facilitate economic activities, Abduh proposed the replacement of the savings accounts by *muḍārabah* contracts in order to avoid *ribā*. Nomani opines, "Besides, it is important to note that the views of Muslim scholars concerning Abduh's position on *ribā* are not unanimous. Some, like Rashid Reza—who narrates the view of Abduh, and Saleh, insist that Abduh considered only the pre-Islamic *ribā* and, therefore, compound interest as the absolutely forbidden *ribā* (Saleh 1992: 35–36). Others, such as Homoud and Mallat, consider this View an uncritical acceptance of Rashid Reza's interpretation of Abduh's position and assert that the Grand Mufti identified the interest received by the Postal Fund depositors as *ribā*."⁶

³ Dr. Tahir Mansuri reviewed that book and observed that Suhail's views were personal and not based on any *sharī'ah* tenets. (*Islamic Studies*, IRI, Islamabad; Vol 40, No.1.

⁴ Fazlur Rahman; *Riba and Interest*; *Islamic Studies* (Karachi) 3(1), Mar. 1964:1-43.

⁵ Abdullah Saeed is a Maldivian scholar who holds PhD in Islamic Studies from the University of Melbourne, Australia.

⁶ Farhad Nomani (2003), "*The Problem of Interest and Islamic Banking in a Comparative Perspective: The Case of Egypt, Iran and Pakistan*"; *Review of Middle East Economics and Finance*; Volume 1, Issue 1, 2003.

Prohibition of Interest and Inflation

Some people question the prohibition of interest on account of inflation. As per the tenets of the *sharī'ah*, granting a loan or a debt is a virtuous act, and if value of a loan decreases due to inflation, it is as if the lender has rendered a greater virtue or given a larger charity. This is why, granting *qard al-ḥasan* is considered more virtuous than *ṣadaqah* even.

Sharī'ah does not make loaning a compulsion; it only encourages helping others in case of dire needs, any kind of reward for which cannot be claimed in this world.⁷ Giving a loan as help to the needy followed by reminders of generosity (*mann*) or injury (*azā*) makes a charity a sin as provided in the holy Qur'an (2: 262⁸, 264). Another point needed to be mentioned is that commercial banking business is not feasible even with indexation because there has to be some return for the shareholders as also the depositors. Further, the fall in prices of gold over the last 2 years or so, which occurred due to speculative trend of the big market players, also implies that indexation cannot be a feasible option for repayment of the liabilities.⁹ It will not be fair and rational to expect that the lenders / creditors will accept the amounts lower than what they had advanced only because the gold prices have decreased.

Invoking the Principle of *Maṣlahah*

Abu Zahra, also a leading jurist from Egypt argued that reliance of the advocates of interest on the principles of necessity and *maṣlahah* as a justification for the payment of interest is wrong. He added that the two principles cannot be used in the case of *ribā* because 'necessity' applies only at the level of individuals and, in the case of loans with interest; it is relevant for a single borrower and not lenders of money. In addition, in his view, since the Islamic principle of necessity is applicable to individual cases and not to the society in general, the principle of the public interest cannot be invoked in defence of interest rate for the whole society (Kamali1991:273–280; Cf: Nomani, 2003).

⁷ Zulfiqar Ali; "*Daure Hazir Kay Mali Muamalaat ka Sharie Hukm*" 2008, Pp. 237-239.

⁸ 'Those who spend their wealth in the way of Allah, then after spending neither boast of favours conferred nor injure, their reward is with their Lord, and they shall have no fear, nor any grief'. (2: 262).

⁹ Thomson Reuters, GFMS; an update to its Gold Survey 2013. Gold prices have fallen by around a fifth during 2013, hitting a three-year low in June of \$1,180.71 an ounce, (from the highest of about \$ 1,850 an ounce in October, 2011)

(<http://profit.ndtv.com/news/commodities/article-gold-prices-set-to-fall-in-2014-as-india-demand-weakens-survey-327046>).

See the 10 years' gold price at: <http://www.kitco.com/charts/popup/au3650nyb.html>

‘*Illah* and *Ḥikmah* of the Prohibition of *Ribā*

Another argument in favour of interest is that *‘illah* for prohibition of *ribā* is *ẓulm* and taking interest from the well-off business community is not a *ẓulm*. But it does not make real sense. Both the FSC (Paras 83 - 95) as well as the SAB (1999: pp. 242, 279-292, 557-564) have already discussed and discarded this argument. According to the principle given by the Holy Qur’an, claiming anything in excess of *ra’as ul-māl* is *ẓulm*. (*ra’as ul-māl* in a loan or debt refers to the nominal amount of principal advanced). Similarly, borrower's failure in paying back the *ra’as ul-māl* is equally unjust and *ẓulm* (2: 279). The FSC quoted from *Kitāb al-Fiqh* by Al-Jaziri: "Among the points relating to loan or debt is the requirement that the transaction should involve equality. In this way if a measurable thing is lent, for example, wheat; it is necessary to return the same quantity irrespective of increase or decrease in its price" (Para: 187).

This issue basically pertains to the *ḥikmah* or rationale of the prohibition of *ribā*. *‘Illah* as legal reasoning could be different from the *ḥikmah*. Human beings may or may not be able to understand the real meaning, rationale or objective of any tenet given in Qur’an fully and at all the times. "There are many areas of human life," Taqi ‘Uthmani opines, "where ‘reason’ is often confused with ‘desires’.... It is these areas where human reason needs the guidance of divine revelation...which finally decides as to which human attitude actually falls within the limits of *ẓulm* or injustice, even though it appears to be just in the eyes of some secular rationalists".¹⁰ "There has to be a relationship and "interplay" among the *‘illah*, the *ḥikām* [sing., *ḥikmah*), and the *maqāṣid al-sharī‘ah* so as to promote certainty and accuracy in determining the *‘illah*, the law, and its applicability" (‘Umar F. Moghul, 1999).¹¹ "The *‘illah* is important to Muslim jurists and to Muslim society because Muslims want to conform to their religion and religious law as circumstances and realities in society change", ‘Umar adds.

While combining both *‘illah* (legal cause) and *ḥikmah* (*ratio decidendi*) for ascertaining the prohibition of *ribā*, the contemporary jurists have reached the consensus that potential injustice with any of the parties to a contract is the major element that may be legally determined

¹⁰ The Text of the Historic Judgment on *ribā* (Interest), Supreme Court; Taqi ‘Usmani, 23rd December 1999; also see at <http://remmm.revues.org/5343> : Muhammad Qasim Zaman.

¹¹ "Approximating certainty in ratiocination: How to ascertain the *‘illah* (effective cause) In the Islamic legal system; And how to determine the *ratio decidendi* in the Anglo-American Common Law"; *The Journal of Islamic Law*, Fall/ Winter 1999.

keeping in view any benefit sought by the lender / debtor, or the feature(s) of edibility and being a monetary unit (*thamaniyah*) in a contract of exchange of fungible goods. The collective wisdom reflecting *ijmā'* has led to the removal of injustice being ultimate *ḥikmah* for prohibition of *ribā*. Keeping in view all relevant texts and principles of Islamic law, the convincing rationale is that of (distributive) justice because the prohibition of *ribā* is intended to prevent the accumulation of wealth in a few hands, that is, it is not to be allowed to “circulate among the rich” (Q: 59:7).

The Government’s Position with Regard to Interpretation of *Ribā*

It also needs to be mentioned that the Government of Pakistan has expressed commitment time to time to transform the system from interest based to interest free bases and /or to introduce Islamic banking in the country. The present Government has also expressed its resolve to introduce Islamic banking and constituted a high-level committee in this regard. Similarly, SBP has recently renewed its commitment in the second strategic plan (2013-17) to promote Islamic banking to increase its market share up to 15 percent of overall banking industry by 2017. (B /R, Dec. 15, 2013). The same is the case of all major banks operating in the country; they have their Islamic banking divisions with segregated accounts and have shown their commitment to develop Islamic banking services remaining within the framework introduced by the Islamic Banking Department of the SBP. (The question is, if five full-fledged Islamic banks, as of now, can work to provide almost all necessary financial intermediation services, why not the other commercial banks.) Hence, they cannot argue rationally that the commercial interest is not *ribā* and therefore should be declared as valid as per the principles of Islamic law of contracts.

Banking for Non-Muslims and the Foreign Liabilities

In any Muslim jurisdiction, both Muslims and non-Muslims have to be the clientele of Islamic banks and financial institutions (IFIs). According to the SAB (1999), prohibition of *ribā* is applicable to non-Muslims citizens of Islamic State as well (P. 110). ***“The Judgment that could not be Delivered - in Reference to International Loan Agreements under the Sharī‘at Act, 1991”*** by the IDB Laureate, Justice (R) Dr. Tanzilur Rehman has amply discussed these issues. The author has concluded the following:

“The prohibition also applies to a non-Muslim living in a Muslim territory as its citizen, or coming with permission and staying in Muslim territory on a visa or a permit. The prohibition as to *ribā*-based transaction or agreement, in

the circumstance, equally applies to Muslim State and its functionaries who act on its behalf. The State functionaries in Pakistan are bound by the principles of policy laid down in the Constitution and the principles and provisions of the Objectives Resolution as made substantive part of the Constitution under Article 2-A. The members of the Parliament and the Provincial Assemblies hold their offices as a sacred trust from Almighty Allah and exercise their authority as representatives of the people within the limits prescribed by Allah the Almighty". [Para 140; Pp. 133,134]

The open-ended exclusion of the interest based foreign loans is not a solution at all. The point to ponder is: "for how long the application of *ribā* prohibition for interest based borrowing by the Government, a statutory corporation, company, institution, body, enterprise or any person in Pakistan from any "foreign agency be allowed and kept away from the jurisdiction of the *sharī'ah* courts". Borrowing from foreign sources is the worst form of resource inflow in any country, the other being direct investment for fixed capital formation and the portfolio investment in securities and stocks. With regard to fulfilling the obligations Dr. Tanzilur Rehman concluded, "...We have been asked to fulfil our promises and at the same time we have been warned that *ribā* is unlawful. Now, our obligation to an individual, or the State is subservient to the Commandment of Allah. If it is sinful to perform an act or fulfil a promise, no duty is cast on a Muslim to perform it as it involves defiance to the Commandment of Allah. So the prohibition will override the fulfilment of such an obligation. Covenant to Allah rules supreme". [Para 106; p. 109]

Islamic Banking Put on Trial

The NIB system was declared un-Islamic by the FSC (1991) as it was based on 'buy-back' and sale of bills and securities for discounting. While *murābaha* was disallowed by the FSC (1991), the SAB (1999) had declared it permissible provided the *sharī'ah* essentials, as advised by *sharī'ah* board of the SBP, are taken care of. This time, some practices / products of Islamic banking institutions (IBIs) are expected to come under discussion with regards to the questions on the objectives of Islamic finance, alternative to the discounting of bills as being used by the IBIs, priority banking services and the fixed return modes like *murābaha*, *ijārah* and diminishing *mushārakah*. A number of groups and individuals have become party to the case to argue that the current Islamic banking has failed in observing the *sharī'ah* principles in letter and spirit; they have prayed the Court to declare it as un-Islamic. The IBIs have to be extremely careful, and ready to face the challenge. With regard to the categories of modes, it needs to be emphasized that the issue is that of preference /

priority, and not of the permissibility. If all *sharī'ah* essentials are taken care of, trading and lease based modes can be validly used for financing.

The so-called priority banking, with regard to both current and investment deposits, is an undesirable practice of Islamic banks which may lead to non-*sharī'ah* compliance, and could be against the objective of equitable distribution of income and wealth in the economy. As current accounts represent a loan to the bank, all return on investment of such deposits goes to the banks' shareholders. It harms the cause of Islamic banking as it implicitly conveys a message to the public that Islamic bankers themselves may not be confident with regard to Islamicity as they still persuade the depositors for current accounts. The other harm is that return that should go to the depositors, making thereby income distribution pattern more and more equitable, goes to the banks owners.

For investment deposits, priority banking may involve a fixed rate to big depositors, higher than the profit rate on smaller deposits of the same tenure(s) and may have no relevance to the rates actually earned by the respective pools of deposits. Islamic banks have been resorting to this practice in competitive environment where they have to compete with conventional banks offering priority rates to attract deposits from the corporate sector. Hence, one reason of the problem is the dual banking system for operation of interest based and Islamic banks. As required by Qur'an and Sunnah and also by the Constitution of Pakistan, the whole system, particularly the banking system, has to be transformed to conform to the tenets of the *sharī'ah*, and the Honorable *Sharī'at* Court may like to ordain it by giving suitable time for transformation.

The Objectives of Islamic Finance

Islamic finance is to provide financial intermediation facility to bridge the surplus and the deficit units and groups in an economy in such a way that the *sharī'ah* related prohibitions are observed on the one hand and the real sector is provided with the sufficient finance for growth and development, on the other hand. It is pertinent to observe in this regard that both the *shirkah* based and the trade based modes can play positive role provided they are used in line with the *sharī'ah* principles in letter and spirit. With regard to social welfare function, Islamic banks need to be a part of the overall socio-economic plan to be implemented by the State. Banking is one part of an economy and finance; the government's fiscal and monetary policies have also to be re-aligned to conform to the *sharī'ah* principles and to achieve *maqāsid al-sharī'ah*. For achieving the objectives, IFIs need to ensure that they do their business on precise and pertinent

principles of Islamic finance.¹² Benes and Kumhof in a recent IMF Working Paper have come to the conclusion that the conventional finance and economics would tend to fare better under 100% reserves banking.¹³ Islamic finance has to be a model to move in that direction.

The current practices and performance of the IFIs / IBIs, however, are much divergent from the principles. They have started using complex derivatives, short-selling and all other products the modern financial engineers innovate to make excessive amounts of money from money, without reference to real sector economy or to valid asset. It is important to note, however, that such objectionable structures are generally avoided by IBIs in Pakistan except for 'commodity *murābaha* / *ṣukūk murābaha*, and in some cases, bills discounting under one pretext or the other, which also need to be discontinued. An important requisite measure is removing the conflict of interests with regard to *sharī'ah* advisory, and hence to strengthen the *sharī'ah* compliance framework, details of which have been given separately in an article being published in the current Issue of the JIBM. More importantly, *sharī'ah* scholars should not be at payrolls of the banks, the products and operations of which they have to certify as *sharī'ah* compliant. Further, the products / contracts have to be standardized at national as also international levels, and this standardization may base on the AAOIFI's *Sharī'ah* Standards.

Government's Recent Steps

The Government recently constituted a 10-member steering committee to formulate a comprehensive policy framework for the Islamic Financial System (IFS), and sought its recommendations by December 31, 2014. The committee would review the reports prepared by the committees / commissions so far, formulate comprehensive policy framework for IFS and suggest practical steps needed to be taken to implement *sharī'ah*-based system and to maximise equity-based financing. It would also propose solutions for Islamic secondary market/ money markets and propose a time plan for progression of different phases of Islamic banking and study international implications of converting conventional banking into *sharī'ah*-compliant banking. The committee would conduct an analysis of the possible legal obstacles in converting conventional banking into *sharī'ah*-compliant banking, and the changes required to remove these obstacles. It would review existing research and training facilities for Islamic finance and suggest measures for reinforcement and new initiatives in this regard.

¹² See for these principles; JIBM; *Editorial*, Vol. 2, No. 1, June, 2012.

¹³ Jaromir Benes and Michael Kumhof; *The Chicago Plan Revisited*; IMF WP/12/202.

We may take an optimistic view of it on the basis that its ToR is comprehensive. But the relevant circles in the country are deeming it an effort to preclude any possible verdict by the FSC in re-hearing the *ribā* case. The most serious issue is the time given – one full year with the main function to review the earlier reports. Almost all aspects included in the ToR have already been discussed in detail in reports of various commissions established time to time on Islamization of economy or elimination of *ribā* from the banking and financial system. The State Bank has also prepared summary of recommendations of eleven such commissions / committees.¹⁴

Prime Minister's Business Loan Scheme

The youth business loans scheme recently announced by the PM has been decided to be implemented through IBIs. But practically, not only the scheme as a whole seems to be economically unviable, but also the *sharī'ah* compliance is at stake *ab initio*. It has to be re-named as a financing, and not a loans scheme. For *sharī'ah* compliance, Islamic banks would have to provide goods, assets or vehicles on the basis of sale or lease fulfilling the relevant *sharī'ah* rules which may not be feasible for the most of the youth starting a new business. Financing on the basis of *mushārahah* / *muḍārahah* seems to be simple impossible due to faulty income tax and disclosure and financial reporting systems. The culture of not paying the loans /liabilities payable to the public sector institution or even the private sector banks is the main reason behind this. The most of the loan seekers are the potential defaulters; some have been reported to be offering up to Rs. (50,000) to anyone who arranges a guarantor; even the attesting Government officials (17 scale and above) are being offered money. All this implies that the most of the applicants may be expecting loot money that could be taken mainly by kith and kin of the influential Politicians or those who are already in good economic condition. Financing schemes linked to any specific areas / projects like small scale solar / wind / hydel energy plants, poultry, dairy, fish or cattle farming or micro level agro based industries could, however, be considered with additional requirements of removing the red-tape, bureaucratic or corruption related hurdles. The minimum that IBIs must keep in view, both for *sharī'ah* compliance as well as for solid risk management, is that applicants are not made agents for purchase of the materials and the funds are not given to the applicants, to ensure that payments with regard to *murābaha* or *ijārah* are made directly to the vendors / suppliers.

¹⁴ See: Appendix-D to the SBP's Strategic Plan for Islamic Banking in Pakistan.