Introduction

The aim of this book is to explore the products and practices of Islamic finance against the background of its ideology, including the tensions that may arise between the ideology and the practices. Islamic finance is an especially interesting phenomenon because it presents itself as an alternative to conventional finance not only in Muslim countries but throughout the rest of the world as well, at times broadening its appeal to non-Muslims. In the aftermath of the first oil crisis of 1973–74, which put large amounts of money into the hands of Middle Eastern investors, the first full-fledged Islamic bank, Dubai Islamic Bank, was founded in 1975. Four decades later there are hundreds of Islamic financial institutions and specialized Islamic subsidiaries. In mid-2011, a spokesman of the Securities Commission Malaysia said that the Islamic finance industry was estimated at about US$1 trillion, of which sukuk (Islamic certificates, see Chapter 4) made up some US$140 billion and Islamic funds US$48 billion (Sarif 2011). Though this is said to imply a 14 per cent annual growth rate over a period of 15 years, Islamic finance still covers no more than a modest segment of global financial markets. The biggest banks in the world each individually have a larger size than all Islamic financial institutions together. US$1 trillion was less than one half of the total assets of Citigroup, Bank of America or J.P. Morgan Chase. Even in what may be called the heartlands of Islamic finance, Malaysia and the member countries of the Gulf Cooperation Council (GCC), it is smaller than the conventional financial system. In Malaysia, Islamic banking assets comprised 18.9 per cent of all banking assets in 2011. In the United Arab Emirates (UAE), the share was smaller at 16.7 per cent, far below Saudi Arabia with 49 per cent and also below Kuwait at 33 per cent, Bahrain at 26.9 per cent and Qatar at 23 per cent, whereas in Turkey it made up no more than 4.9 per cent and in Egypt only 3.8 per cent of total commercial bank assets (Ernst & Young 2012a). In Oman there were no Islamic banks at all before January 2013. In Pakistan, at the end of September 2012, 8.1 per cent of all bank assets and 9.3 per cent of bank deposits were Islamic (State Bank of Pakistan 2012b, p. 9). Islamic banking was introduced in Indonesia in 1992 and nearly 20 years later, at the end of 2011, Islamic banking assets represented just 4.2 per cent of total banking assets (*New Horizon* 2012a; Ernst & Young 2012a). Two countries are said to have fully Islamized banking systems: Iran since 1986 (M.S. Khan and Mirakhor 1990) and (Northern) Sudan since 2002 (State Bank of Pakistan 2011, pp. 17–18). Confusingly, however, the Annual Reports of the central bank of Sudan mention conventional banks, and a market share of Islamic banks of no more than 33.84 per cent in 2007 (Beck et al. 2013, p. 437) suggests that conventional banks were not confined to the non-Muslim South.

Although the Islamic financial system, which not only comprises the banking industry, but also insurance firms and investment and pension funds, is still very small compared with the conventional financial industry, its share of the market has been steadily increasing ever since it started in the 1970s. Islamic finance is highly likely to continue growing in the countries where it is already an established factor and to capture new markets, first of all in Africa and Central Asia.

It is well known that Islamic finance is based upon the prohibition of interest, among other things, but we will see that it is much more than just a severe case of 'thou shalt not'. The proponents of Islamic finance emphasize that it provides an alternative to conventional finance, based on the ethical precepts of Islam. These translate into norms for all fields of human activity, including economic life, and are claimed to be aimed at the wellbeing of the human race. 'Islamic finance', says Mahmoud El-Gamal, an expert on the foundations of Islamic finance, 'is a prohibition-driven industry', but 'Islamic jurists and legal theorists have maintained that God never forbids anything that is good' (El-Gamal 2006, p. 46).

One would be mistaken to assume that it is always unambiguously clear what is admissible and what is forbidden for a devout Muslim. First of all, it is a moot point as to what extent the texts and traditions from the early centuries of Islam, which provide the foundation of Islamic finance, have to be adapted to the modern world. Muslims are deeply divided over this question, but even those who want to fully hold on to the traditions have to grapple with the fact that the world has changed since the seventh century and that the old texts and traditions have to be reinterpreted before they can be applied to situations and financial instruments that were unknown at the time.

The Medieval Christian Church wrestled with similar problems, about what to accept and what to reject, as present-day Muslims. Discussions in the Medieval Church went on and on, even if there was an ultimate authority, the Church Councils that assembled irregularly (the dogma of papal infallibility only dates from the First Vatican Council of 1870). If Medieval Church Council resolutions did not provide final answers to economic questions, it is hardly surprising that there is no end to the discussion among Muslims about what is admissible and what is forbidden, from a religious point of view. After all, the Sunni community, to which between 85 and 90 per cent of Muslims belong, knows no church-like hierarchy and, like Protestantism, no final authority. With Shiite Islam it is different. Shiites distinguish themselves by holding that the religious and political leader of the Muslim community, the *imam*, is divinely appointed and can only be a direct descendant of the Prophet Muhammad, starting with his cousin and son-in-law Ali (Shia means Party, that is, Party of Ali). Ali was also the fourth Caliph, or successor of Muhammad as ruler of the Islamic world, for the Sunnites. The most numerous Shiite group, the Twelvers, or Ithna Asharis, holds that their last imam, the twelfth one, went into occultation. The Sevener sect maintains it was the seventh imam, the last one in their line of imams. In the fullness of time, many Shiites believe, their last imam will return as the Mahdi (Guided One), who will bring justice to the world for a period just before the end of the world, or the Day of Judgement (Madelung 2006).[1] The Shiite imam was as infallible as post-1870 popes of the Roman Catholic Church when proclaiming dogmas *ex cathedra*, and during the time of the last imam's occultation other religious leaders borrow at least some of his authority (Douwes 2004; Slomp 2005, pp. 114–17; Mavani 2011). Unlike Sunni Islam, Shia Islam does have clerical hierarchies, in the case of the Twelvers headed by *ayatollahs* (ayatollah is an honorific title for an outstanding legal scholar). These ayatollahs in their turn may accept guidance by *grand ayatollahs*, of which there may be one, as in Iraq, or more than one, as in Iran. In the latter case, Shiites decide for themselves which ayatollah to follow as their source of authority. Shiites differ on whether the religious leaders should keep some distance from politics during the time of occultation (de Bruijn 2008).[2]

Even if acceptance of the need for an Islamic financial system is by no means universal among Muslims and its advocates disagree on a number of points, a distinctly Islamic financial system has come into existence. This system cannot be understood without some knowledge of Islamic thought on ethics and law. Therefore, this is dealt with first. The structure of the book is as follows: Chapter 1 traces the motives for setting up a separate Islamic financial system; Chapter 2 describes the legal reasoning behind Islamic precepts and their religious foundations; Chapter 3 analyses what Islamic finance is all about, put against the backdrop of an Islamic economy; Chapter 4 gives an overview of Islamic financial instruments; Chapter 5 discusses the peculiarities of Islamic banking; Chapter 6 does the same for Islamic investment, insurance and other special activities; Chapter 7 goes into the problems confronting the Central Bank and the Treasury if they decide to follow Islamic principles and Chapter 8 finally assesses Islamic finance from the point of view of conventional economics and gives the judgements of some prominent Muslim scholars. Appendices contain relevant texts from the Quran and the Bible. The reader will become acquainted with quite a number of latinized Arab words. In the latinization of these words, macrons and diacritics have been left out.

NOTES

1. The belief in the coming of the Mahdi is not restricted to Shiites. Some Sunnites embrace the concept as well. The messianic role of the Mahdi will be fulfilled by someone with the stature of a caliph or an imam. The idea of a Mahdi resembles the Christian notion of the second coming of Christ. Notice that the word 'imam' not only refers to the infallible leaders of Shia Islam, but also to the founders of the Sunnite law schools (see Chapter 2, Section 2.3) and to the *caliphs*, the successors to the prophet Muhammad as political and military leaders of the Muslim community. The leader of prayers in the mosque is also called imam.
2. The arrogation of far-reaching political power by ayatollah Khomeini after the 1979 Islamic revolution in Iran was, consequently, highly contentious. Numerous other religious scholars rejected Khomeini's concept of a cleric as the supreme leader who, thanks to his divine mandate, would be above the law and could overrule all decisions made by Parliament, the government or any other institution (Mavani 2011).