

Introduction

The aim of this book is to explore the products and practices of Islamic finance against the background of its ideology and to shed light on the tensions that inevitably 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 and a half decades later there are hundreds of Islamic financial institutions and specialized Islamic subsidiaries. At the end of 2017 total Islamic assets were estimated at US\$2438 billion, with banks accounting for US\$1721 billion and sukuk (Islamic certificates, see Chapter 4) for US\$426 billion, while Islamic funds held US\$110 billion and Islamic insurers (takaful) US\$46 billion (Thomson Reuters 2018, p. 6). Though Islamic finance generally shows impressive growth rates – total assets were estimated at only US\$1746 in 2012 – it still occupies no more than a modest segment of global financial markets. The biggest banks in the world each individually have a similar size as all Islamic financial institutions together. Total assets of Bank of America for instance amounted to US\$2354.5 billion at the end of 2017. Even in many Muslim-majority countries Islamic finance is often overshadowed by conventional finance, as shown in Table 0.1. Two countries are said to have fully Islamized banking systems: Iran since 1986 (M.S. Khan and Mirakhor 1990) and Sudan since 2002 (State Bank of Pakistan 2011c, pp. 17–18). After the peace agreement between North Sudan and South Sudan in 2005, the banking laws were amended with the South shifting to conventional banking. Of course, when South Sudan became independent in 2011 Sudanese banking law no longer applied. Libya also intended to Islamize its banking industry in 2015 when a law prohibiting *riba*, interest, in all civil and commercial transactions was implemented (Metcalf and Weir 2017; Belal and Hassan 2018). It is not clear whether the banks fully comply. Furthermore, the Indonesian province of Aceh strives to ban conventional banking.

Although the Islamic financial system is still very small compared with the conventional financial industry, its share of the market has been steadily

Table 0.1 Market share Islamic banks, end of first quarter 2017, assets in per cent of total assets

Country	
Bahrain	14.1
Bangladesh	19.8
Bosnia and Herzegovina	3.6
Brunei	61.8
Egypt	~4.5
Indonesia	~4
Iran	100
Jordan	15.5
Kuwait	39.3
Malaysia	24.9
Pakistan	11.7
Qatar	25.7
Saudi Arabia	51.5
Sudan	100
Turkey	~4
United Arab Emirates	20

Source: Compiled from figures and chart 1.1.2 in *Islamic Finance Services Industry Stability Report 2018*, Kuala Lumpur: Islamic Financial Services Board, 2018, pp. 10–11. Figure for Pakistan from *Islamic Banking Bulletin*, State Bank of Pakistan, June 2017, www.sbp.org.pk/ibd/Bulletin

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, but it is also present in Europe and has footholds in Australia, the Americas (Canada, the United States, Surinam) and non-Muslim Asian countries.

Islamic finance is based upon the prohibition of *riba* and a number of additional injunctions, but it is much more than just a severe case of ‘thou shalt not’. The advocates 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 to what extent the texts and traditions from the early centuries of Islam, which, often as interpreted by medieval religious jurists, 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 is changing all the time and that the old texts and traditions have to be reinterpreted before they can be applied to situations and financial instruments that were unknown in earlier times.

The Medieval Christian Church wrestled with similar problems as present-day Muslims about what to accept and what to reject. 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, dominant in Iran, holds that their last imam, the twelfth one, went into occultation (in 873). The Sevener sect, the Ismailis, maintains it was the seventh imam, the last in their line of imams, that did so. The third branch of Shiism are the Zaydis, concentrated in Yemen, who consider the fifth imam the last one (and differ from other Shiites in not completely rejecting the first three caliphs as legitimate successors of Muhammad, nor do they ascribe supernatural powers to their 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; note that Zaydis differ). 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 being. This system cannot be understood without some knowledge of Islamic thought on ethics and law. It must be emphasized that there is no such thing as *the* Islam and it is the Islamic ethics and religious law corpus behind Islamic finance that is covered in this volume. This corpus falls within the confines of what may loosely be called mainstream Islam, made up of the main Sunnite groups and the largest Shiite group (see Chapter 2 Section 2.3).

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 and the religious foundations that Islamic finance builds upon. Chapter 3 analyses the rules for an Islamic economy, and thus for Islamic finance, originating from the Islamic ethics and religious law corpus; Chapter 4 gives an overview of Islamic financial instruments; Chapter 5 discusses the characteristics of Islamic banking; Chapter 6 does the same for Islamic insurance, home finance, investment and the activities of charitable foundations (waqfs), among other things; Chapter 7 goes into the problems confronting the monetary and fiscal authorities if they decide to follow Islamic principles and Chapter 8 finally assesses Islamic finance from the point of view of conventional economics and confronts the practice of Islamic finance with the claims made for it. The Appendices contain relevant texts from the Quran and the Bible.

NOTES

1. Notice that not only the infallible leaders of Shia Islam are called imams. The term also applies 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. The belief in the coming of the Mahdi is not restricted to Shiites and not all Shiites see him as identical with the returned last imam. Some Sunnites embrace the concept as well.
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).