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SOCIAL JUSTICE AND POVERTY IN MUSLIM WORLD PROCEEDINGS

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Philosophy of Economic Justice in Islam and its Implications on Islamic Banking and Finance Industry

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Abstract: Justice ('Adl) is the most essential component of the economic philosophy envisaged under the principles of Islamic Shari'ah (Islamic Law). Islam has laid certain fundamental principles and restrictions for the economic endeavors so that the entire structure of production, consumption, distribution and exchange of the wealth is in concordance to the Islamic standards of justice and equality. Since the conception of justice is normative and socio-political in nature; therefore the analysis of theoretical and institutional framework of Islamic banks and financial institutions from the principle of Islamic conception of justice would be significant to reveal the compatibility of Islamic banking and finance industry with the just economic philosophy of Islam on practical grounds. The present study would be a humble attempt to evaluate the institutional framework of Islamic banks and financial institutions against Islamic conception of economic justice. It would also provide a basis for further discussion and research regarding the need of such a framework which would enable the Islamic banking and finance industry to serve the ethos of Islamic political economy and justice and the potential consequences which the industry would have to bear in its absence.

Keywords: Economic Justice, Foundations, Implications, Islamic Banking and Finance.

Introduction

Creeping out of Muslim niche, the Islamic banking and finance industry is constantly gaining momentum among the leading financial service providers in the world like HSBC (London), Deutsche Bank (Germany), BNP (France), Citi Group (U.S), USB (Switzerland), Merrill Lynch and Barclay's (United Kingdom). Presently, Islamic banking and finance industry has more than 500 working outlets in near about 80 countries of the world (Martin & Heiko, 2008). Many developed countries like Germany, UK, USA, France, Hong Kong and Singapore have opened up Islamic banking and financial institutions to satisfy the growing customer demand. In spite of *Shari'ah* compliant claim, there remains still few controversies over various underlying concepts and practices of Islamic banking and finance. Some scholars are of the view that Islamic

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banking and financial institutions are imitating mainstream banking structures which are primarily designed to generate higher interest rates as a result of this fundamental objectives of *Shari'ah* (Islamic Law¹) and ethos of Islamic economic justice are belittled. Subsequently, it leads to piling-up of individual & collective debt, unequal distribution of wealth and spread of materialistic values in the society.

As a matter of fact, Islamic banking and finance does provide an alternative framework of financial intermediation which conceptually and theoretically has its own determining principles which are much closer to the normative premise of Islamic Justice. This study would be an attempt to analyze the compatibility of Islamic banking and finance industry with objectives of *Shari'ah* more holistically, while keeping Islamic conception of justice in view.

An Overview of Economic Justice in Islam

Justice ('*Adl*') is the first and foremost principle of socio-economic philosophy of Islam. It is purely extracted from the sources of *Shari'ah* without any human blend which may often involve bias and prejudice.²³ It is the foundation upon which whole structure of Islamic culture and civilization is built (Ahmad, 2010; Adebayo, 2012; Chapra, 2008, Siddiqi, 1990). Apart from its practical side, the conceptualization of justice has been strongly incorporated with religious dogma. As a result justice doesn't remain a principle of system only rather it finds its roots in transcendental composition of faith and belief. The principle of justice has been thoroughly discussed in *Quran* and there are about 160 direct or indirect expressions with regard to practice of justice and near about 200 verses which admonish against injustice (Hussain, 1977; Zaheer, 2011; Al-Qardawi, 1981). Leading a practical model, Prophet (s.a.w) perfectly practiced justice, in letter and spirit, throughout his life as God has Himself entailed justice as one of the core aspects of prophetic mission.⁴ It directly implies that a Muslim society must observe justice in all aspects of life be it social, economic, political or spiritual. Among all reflection of justice, economic justice is one of the most critical elements of an Islamic social order. Rendering the importance of justice in economic life; a Muslim

1 The term *Shari'ah* means "way" or "path"; it is the legal framework within which the public and private aspects of life are regulated for those living in a legal system based on Islam. *Shari'ah* deals with all aspects of day-to-day life, including politics, economics, banking, business law, contract law, sexuality, and social issues.

2 Islam doesn't refute the involvement of human intellect on absolute terms rather it fixes some parameters and within those parameters human intellect is endorsed to work out. The development of *Fiqh-ul-Ma'amalat* (commercial Jurisprudence) itself is a major example of involvement of human reasoning in the light of set parameters.

3

4 Al-Quran, 57:25

buyer or seller, creditor or debtor or individual entrepreneur or a firm is supposed to abide by the laws concerning justice and take notice of any possible unjust act before signing up a financial contract (Siddiqi, 1990; Mohammad & Syahidawati, 2013; Javaid, 2012). Thus economic justice essentially refers to application of Islamic ethics and moral standards in business relationships.

The main concern of economic justice according to Islam is socio-economic stability and establishment of a welfare society wherein the principle of “No-Injury”⁵ could flourish up to its maximum (Siddiqi, 1990; Chapra, 2008; Khudduri, 1984). The principle of “No-Injury” can’t materialize unless the overall structure of production, consumption, distribution and exchange follow the scheme of justice envisaged by Islam. In the context of economic phraseology, it would be right to claim that justice (*‘Adl*) is the pendulum upon which the rules pertaining to prohibition and permission of financial transactions revolve. The characteristic feature of Islamic economic justice is that it doesn’t only concentrate on the objectives of justice but it also propounds the just ‘means’ to achieve these objectives. The purposefulness behind setting up even the ‘means’ is to safeguard an economic institution or an individual against the dilemma of choices (Siddiqi, 1990; Muslehuddin, 2009; Mawdudi, 2009). It must be borne in mind that mere consideration of arithmetical equality in application of economic justice may not necessarily make a business transaction a just one unless balance and proportion is maintained between people with respect to their rights and due share (Kuran, 1989; Hassan, 2014).

Foundations of Economic Justice in Islam

The theoretical and conceptual framework of economic justice in Islam is engrossed in certain fundamentals. The espousal and development of these fundamentals is a prerequisite in the establishment of welfare society where every individual can meet his or her economic needs, and have a decent standard of living. These fundamentals can be summarized as follows:

Principle of Tawhid (Oneness of God)

The belief in one God (*Tawhid*) is the principal dogma of Islam’s ideological and practical system. It is a coin with two faces: one implies that Allah is the Creator and the other that all human beings are equal partners (Mawdudi, 2004). The belief in one God contains at least five important beliefs which have direct implications on socio-economic structure of Islam and Islamic conception of economic justice thereof.

5 Prophet (s.a.w) is reported to have said, “No injury, and no inflicting of injury” (*Ibn Majjah, Abwab al-Ahkam*) and “Whosoever injures, Allah will injure him and whosoever tyrannies, Allah shall tyrannies over him”. (*Tirmidhi, Abwab al-bir wa Sila*)

These five beliefs are as:

- i. Belief in the common origin of whole humanity.
- ii. Belief in the organic unity in the existence of the immanent (life) and the transcendent (life after death).
- iii. Belief in the human being as God's vicegerent or trustee.
- iv. Belief in certain universal moral standards and principles.
- v. Belief in that all human beings possess universal rights and responsibilities.

Principle of Brotherhood and Mutual Cooperation

The concept of brotherhood and mutual cooperation is basically natural output of *Tawhidi* world view where God (Creator) occupies the centrality and whole servanthship (creation) is directed towards the same centre (Mawdudi, 2009). Since God has created whole human race from the first couple, Adam and Eve, this implies that all human beings are accepted as brothers and sisters irrespective of their color, language, country, or any other distinction. This genealogical commonality outlines the basis of universal brotherhood and mutual cooperation in Islam (Mawdudi, 2009). This principal has following implications:

- i. It categorically refutes the concept of cut-throat competition in society and denounces thrive of one group of people on the expense of others.
- ii. It promotes co-existence and guaranties equal economic rights and responsibilities.
- iii. It creates a strong feeling of mutual respect and honour.
- iv. It negates absolutely justification for any type of discrimination.

Principle of Freedom

Human dignity and protection of human intellect is among the prime objectives of *Shari'ah*. In order to save the dignity of human beings, the *Quran* insists that the individual be freed from any kind of fear which disturbs human beings such as the fear of death or injury in general or the fear of poverty and destitution in economic perspective in particular (Dusuki& Abdullah, 2012; Mawdudi, 2009). Islamic principle of economic freedom means that an individual has been allowed liberty by God to earn wealth, own it, enjoy it and spend it as he or she likes. Thus Islam recognizes free enterprise, human initiative, and individual's potential. It also recognizes role of organization, capital, labour and market forces in economic field (Sa'addudin, 2001; Chapra, 2008). Some fundamental implications of this with principle with regard to Islamic economic justice are as:

- i. All legal (*Hala*) business ventures are encouraged.
- ii. All unnecessary curbs placed on the individual or the organization regarding earning or owning of wealth are shun down.
- iii. Innovation and entrepreneurship with regard to economic prosperity is encouraged.

Implications of Economic Justice on Islamic Banking and Finance Model

The economic philosophy persuaded under *Shari'ah* regulations ensures the preservation and protection of fundamental objectives of *Shari'ah*. The establishment of such system is not possible if the entrepreneurial behaviour of an individual, institution or a business firm is not in line with conception of economic justice. The incorporation of economic justice in the development of Islamic banking and finance model would refine the nature and structure of financial transactions as per the required standards. As a result these financial transactions would serve the broader objective of *Shari'ah* instead of remaining mere money generating structures.

Conceptual Model of Islamic Banking and Finance

Islamic banking and finance system ascertains its underpinnings in the economic philosophy of Islam. It is based on four main factors explicitly mentioned in the text of *Quran*, *Hadith*, and *Fiqh* (Islamic jurisprudence): *La-riba* (no-interest), *La-gharar* (no-uncertainty), *La-maisir* (no-speculation), and *La-Haram* (no-unlawful) (Malik & Khaki, 2013; Warde, 2000; El-Gamal, 2006; Muslehuddin, 2009).

Interest (*Riba*)

Interest or *riba* is considered as a major sin under Islamic law and even those hired to write the contract or who witness and then confirm the contract are party to the sin as it goes against the Islamic conception of economic justice. There are several passages in the *Quran* which clearly condemn the practice of usury or *riba*:

"Those who devour *riba* will not stand except as he stands who has been driven to madness by the touch of Satan....Allah has permitted the trade and forbidden *riba*....Allah will deprive *riba* of all blessing"⁶

"O! You, who believe fear Allah and give up what remains of your demand for *riba*, if you are indeed believers, if you don't, take notice of war from Allah"⁷

The absolute prohibition of interest in the *Quran* envisages establishing an economic system free from all forms of economic exploitations. In an interest-based economy the banks charge high rate of interest on loans which make it almost inaccessible to the deprived class of the society and maximizes the wealth of industrialists. On contrary, Islamic economy promotes circulation of wealth so that it contributes to the welfare of the community as a whole. Allah says in the *Quran*:

6 Al-Quran, 2:275-6.

7 Al-Quran, 2: 278-9.

"...that it (wealth) become not a commodity between solely the rich among you"⁸

In other verse *Quran* mentions:

"The interest that you give in order to increase the wealth of the people, does not increase in the sight of Allah; and the Zakat that you pay in order to win Allah's approval, its payers do indeed increase their wealth".⁹

Uncertainty (*Gharar*) and Speculation (*Maysir*)

One of the core elements of Islamic economics is that it has categorically forbidden all business transactions which may involve any mistreatment and unfairness. It seeks protecting the all parties from deceit, ignorance and gains at the cost of others by forbidding *gharar* and *maysir* in all commercial exchange contracts and ensures transparency, accuracy, and disclosure of all necessary information related to financial contract. The prohibition of *gharar* (uncertainty) protects business parties against unexpected losses and the possible disagreements regarding qualities or incompleteness of information and prohibition of *maysir* checks out the big investors and industrialists who may turn the economic financial system toward their personal benefits (Siddiqi, 1990; Mansoori, 2008; Jobst et al., 2012).

Avoidance of Unethical Businesses

The another important component of Islamic economic system is that any financial transaction that involves investment in prohibited products or activities such as alcohol, illicit drugs, pornography and tobacco is invalid. Since Islam wants to develop an ethical and friendly environment in the society therefore it prohibits all activities leading to ethical and moral degradation (Hassan, 2009).

Money as a "Potential" Capital

In the Western capitalist theory both money and commodity are treated at par and can be sold at whatever price parties agree upon. For example, the selling of US\$100 for US\$110 is the same as selling a bag of rice costing US\$100 for US\$110. On contrary to the conventional monetary theories, in Islamic economics money is considered as "potential capital". Consequently, Islamic economics does not negate the time value

8 Al-Quran, 59:7.

9 Al-Quran, 30: 39.

of money rather it recognizes its importance but only when it acts as capital, not when it is “potential” capital (Iqbal, 1997, Usmani, 2010). Thus, increment in the price of a commodity in any sale contract to be paid at a future date is not prohibited in *Shari’ah* (Siddiqi, 1983, Ausaf, 2010, Usmani, 2010, Ahmad, 2010). This implies that *Shari’ah* only prohibits making money’s time value an element of a lending relationship where it is claimed as a predetermined value (Farooq and Hassan, 2007, El-Gamal, 2006).

Legal Modes of Financing

Profit sharing (Mudarabah): *Mudarabah* is a financial contract in which one partner (*rabb al-mal*) finances the project, while the other party (*mudarib*) manages it. Under *Mudarabah* principle Islamic banks offer savings and time deposits in the form of investment accounts. The profit rose through this business venture is shared as per pre-agreed ratio and in case of genuine failure the financier has to bear the loss (Mirkhor et. al. 1987, Usmani, 2010, Warde, 2000).

Non-interest bearing demand deposits (Wadiah Yad Dhamanah): *Al-Wadiah* is basically a contract (*a’qad*) between the owner of goods (depositor) and the custodian of the goods (Islamic bank). In banking perspective, the Islamic bank takes responsibility to safeguard the goods or money from being damaged, destroyed, stolen etc. (Ayub, 2007, Qaed and Qaed, 2014).

Joint Venture (Musharakah): It is a partnership agreement entered by at least two parties (Islamic bank and depositor) or best to be described as partners, for a particular business venture. Here the bank not only participates in the supply of capital to the venture, but also in its management thus, it plays the role of an entrepreneur as well as that of a financier. The profit is shared as per the agreement set between parties while the loss is shared in proportion to their shares of capital in the enterprise. (Usmani, 2010, Ausaf, 2010, El-Gamal, 2006).

Cost Plus (Murabaha): *Murabaha* is defined as a cost-plus sale, where the seller (Islamic bank) expressly mentions the cost he has incurred on the commodities to be sold and sells it to another person (customer) by adding some profit or mark-up thereon which is known to the buyer (Ausaf, 2010, El-Gamal, 2006, Usmani, 2010, Wilson, 1997).

Leasing (Ijarah): An agreement whereby the Islamic bank (lessor) purchases or constructs an asset for lease (customer) according to his/her request (lessee), based on his/her promise to lease the asset for a specific period and against certain rent installments. *Ijarah* could end by transferring the ownership of the asset to the lessee known as *Ijarah wa Iqtina* (Usmani, 2010; Ausaf, 2010; Warde, 2000)

Securities and Bonds (Sukuk): *Sukuk* is a financial certificate an Islamic equivalent of conventional bond. These are securities that comply with the Islamic law (*Shari'ah*) and its investment principles, which prohibit the charging or paying of interest. Financial assets that comply with the Islamic law can be classified in accordance with their tradability and non-tradability in the secondary markets (Jobst, et al. 2008, Hassan, 2009, Godlewski et al, 2013).

Conclusion

Islamic banking and finance is an interesting phenomenon in view of its current status. It presents itself as a viable alternative to conventional banking and financial intermediation not only in Muslim countries but in the rest of the world as well. The present study is an appraisal of Islamic banking and finance model with respect to *Maqasid-ul-Shari'ah* or Islamic conception of Justice. It critically analyzed that Islamic economic structure as whole have been able to abolish financial structures prohibited in *Shari'ah* while developing financial intermediation between depositors and clients. However, it has not been able to realize all possibilities what it is supposed to due to overall dynamics of the conventional financial industry and its momentum which it gained in last 4 centuries. The conception of economic justice has set distinguished goals for Islamic banking and financial institutions so that ratio of profit, capital and wealth generated for all stakeholders is in line with objectives of *Shari'ah*. In the view of conception of economic justice, it sometimes comes as a surprise that Islamic banks also measure their success, evaluate their operating risks and compete with other banks (Islamic or conventional) in the same way how conventional banks usually do. To avoid criticism that overwhelms Islamic finance for its mimicry of conventional products, Islamic financial institutions have to maintain the product uniqueness and authenticity. Therefore, all new ventures as well as existing institutions must revise Islamic finance underlying principles, its mission and goals.

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