

# 1. Why Islamic finance?

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## 1.1 INTRODUCTION

This chapter is about the motives for Muslims to advocate the use of financial instruments that obey specific Islamic requirements. The movement for an Islamic economy, and an Islamic financial system in particular, is rooted in the experience of Muslims in what they, or at least some of them, felt in the past was an unfriendly non-Muslim environment. A new impetus was given with the rise in oil wealth in a number of Muslim countries after the 1973–74 oil crisis and the success of Malaysia as a fast grower, both of which may have contributed to a formerly unknown level of self-confidence that made it possible for Muslim governments and firms to develop new financial instruments in close cooperation with Western firms, without the feelings of resentment that underlay the first attempts to Islamize the economy. The history of the movement for Islamic finance, and Islamic economics in general, is sketched and the chapter ends with highlighting the diversity of views among Muslims on this matter.

## 1.2 THE ORIGINS: MAULANA MAUDUDI

Islamic finance is a way to put Islamic principles about the economy into practice. Attempts to develop a specific Islamic type of economy, based upon the precepts of the holy book of Muslims, the *Quran*, and on Islamic religious law, the *sharia*, can be seen as a manifestation of the wish harboured by Muslims to retain, or regain, their own identity vis-à-vis the capitalist West and, until the fall of communism, the socialist East. There is a deep-rooted idea among large parts of the Muslim intelligentsia, in particular in the Middle East, that the forces of the globalizing world, in their view characterized by materialism and sex, are incompatible with the values cherished by Muslims (Najjar 2005). Thus, Islamic economics can also be seen as an attempt to prevent Muslims from assimilating in this globalizing world dominated by Western culture (Kuran 1996, 2006, ch. 4).

The idea of Islamic economics was introduced around the time of the Partition of India by a number of people, first of all maulana or

mawlana Sayyid Abu'l-A'la Maududi (1903–79).<sup>1</sup> Maududi (also spelled Mawdudi or Maudoodi) had already delivered an address on the subject in 1941 (Maududi 1941). An economy based on Islamic principles was also advocated by Anwar Iqbal Qureshi in 1946 (Qureshi 1991), who was influenced by Maududi, Naiem Siddiqhi in 1948 and Sheikh Mahmud Ahmad in 1952 (see Gafoor 1996, p. 37; Mahmud Ahmad 1999). It should not come as a surprise that pre-Partition India and later Pakistan provided a fertile environment for developing ideas on an Islamic economy, as Pakistan was founded expressly to be a homeland for Muslims. Maududi is the main figure behind the movement to organize society along orthodox, fundamentalist lines (Slomp 2003, p. 239). Sayyid Qutb (1906–66), a prominent leader of Egypt's Muslim Brotherhood, and Muhammad Baqir al-Sadr (1931–80) from Iraq were also in the forefront of the development of Islamic economics.

One important motivation for developing specific Islamic views on the economy was the conviction that Islam was seen as backward by the dominant European civilization, which had little time for the tenets of Islam in the economic sphere. From the nineteenth century on, Islam was not taken seriously and was regarded as rather benighted and incompatible with modern scientific views, people such as Maududi, Qutb and al-Sadr felt; and not without some justification (see the Introductions by Syed Sulaiman Nadvi and Manazir Ahsan Gilani to Qureshi 1991; Kuran 2006, pp. 86–7). Maududi, as editor of a journal he founded in 1932, wrote about its objective:

The plan of action I had in mind was that I should first break the hold which Western culture and ideas had come to acquire over the Muslim intelligentsia, and to instill in them the fact that Islam has a code of life of its own, its own culture, its own political and economic systems and a philosophy and an educational system which are all superior to anything that Western civilization could offer. I wanted to rid them of the wrong notion that they needed to borrow from others in the matter of culture and civilization. (Quoted from Slomp 2003, p. 240)

They said farewell to the defensive attitude and went on the offensive, in their discussion on economics in particular impugning existing interest theories and justifications of interest (extensively in Qureshi 1991, ch. I). Mahmud Ahmad even states that intellectual bankruptcy is the hallmark of every theory of interest (Mahmud Ahmad 1999, p. 30).

Communism could not find favour with Maududi, as, in his words, Islam does not approve of any political or economic organization that seeks to submerge the individual in the society, and stultify the flowering of his personality (Maududi 1999, p. 5). Nationalization of all means of production

would lead to social regimentation, read: dictatorship (Maududi 1999, pp. 5, 27). Fascism and national-socialism are as bad as communism in this respect (Maududi 1999, pp. 28–9, this is still from his 1941 address). On the other hand, Islam, according to Maududi, also abhors *laissez faire*, because that would open the way for individuals to pursue their own ends at the cost of society as a whole. Capitalism is associated, in his view, with the French revolution, which propagated individual liberty, liberalism, capitalism and the system of secular democracy (Maududi 1999, p. 107). For French revolution we may probably read Enlightenment.

Maududi was the most outspoken advocate of an Islamic economy. He was born in 1903 in Aurangabad, in the Muslim state of Hyderabad in the Deccan. His family belonged to the upper crust of Indian Muslims and claimed to descend from the relatives of the Prophet. His father was strongly under the influence of a movement that, in reaction to the European values that had come to India with the British, strove to purify Islam from syncretistic practices and revive the strength of the Muslim community. Maududi himself, as editor-in-chief of a variety of Muslim journals, was opposed to Muhammad Ali Jinnah's All-India Muslim League and its ideal to found an independent Muslim state, because Islam pretends to express universal values and should not be used as an ideological foundation for a nation state. Rather, he would bolster the Islamic community in order to prepare for life in an independent India dominated by Hindus often hostile to the Muslim minority (Kuran 2006, pp. 83–4). Some people suspect a personal antipathy vis-à-vis Jinnah (Mazari 1998). Nonetheless, after the Partition he moved to Lahore and propagated the view that the moral and ethical principles of Islam can only be put into practice if the state imposes them.

Maududi founded a political party, the *Jamaat-e-Islami* (Islamic Society or Party) in 1941. This party, which is still active in Pakistan, is based on the idea that all present-day problems can be solved with the help of the Quran and the *sunna* (from *sunnat al-nabi* or practices of the Prophet, see Chapter 2), as delivered in the *ahadith*, or traditions. Maududi distinguished himself by combining a strictly literal interpretation of the Quran with modern political terminology in order to show the relevance of the Quran and the sunna for twentieth-century society. Maududi's ideal society was the supposedly pure one under the Prophet and his four successors before the Umayyad dynasty took over, Abu Bakr, Umar, Uthman and the Prophet's cousin and son-in-law Ali, collectively known as the rightly-guided caliphs. Remember that the first three are not acknowledged by Shiites, as they were no relatives of Muhammad.

It was all fine and well to have a Muslim state, or a state for Muslims, but that was still far removed from an Islamic state. What Maududi was after

was a fundamentalist theocracy, which he dubbed a ‘theo-democracy’, a form of government that should not only be forced upon Pakistan or the Muslim world, but on the whole human race. The Muslim population should freely choose a leader, but with the choice restricted to people, or rather males, with an impeccable sunna-respecting track record. He only differed from traditionalist *ulama*, or religious scholars, in that he still left a small place for the modernization of Islamic law, as traditional Islamic law does not have the answer to each and every problem confronting present-day Muslims. His views did not go down too well with the modernists in the Pakistani government and the army, nor were these enamoured of the well-organized Jamaat-e-Islami machinery that spread his message. Maududi was several times imprisoned and in 1953 he was even sentenced to death by a court martial, but under public pressure the sentence was commuted to two years imprisonment. He died in 1979 in New York, where he had gone for heart surgery. In the same year his follower Kurshid Ahmad became a cabinet minister (1979–80) under President Muhammad Zia ul-Haq (1977–88), who declared Pakistan an Islamic state and began to enforce sharia law (see on Maududi Adams 1966; Aziz Ahmad 1967; Otto 2001; Slomp 2003).

Maududi held strong views on the way society should be run. He advocated strict gender separation and was strongly in favour of the death sentence for apostates, even if prominent Muslim scholars argue that in the early times of Islam the death sentence was only issued for soldiers that converted to Judaism or Christianity, in order to evade military service (Slomp 2002). He was very strict as regards expenditure on leisure and even culture. Muslims, in his eyes, should not only stay away from such things as wine and gambling, but also from ‘music and dances and other means of self-indulgence’ and are furthermore forbidden to wear silken dresses, to use golden ornaments and jewels (except in the case of women, parentheses Maududi’s), or to decorate their house with pictures and jewels (Maududi 1999, p. 31). This rejection of culture sounds not too different from the views of some of the more puritan currents within Protestantism, and, like there, cannot be seen as representative of the views of the whole community of believers.

### 1.3. DIGRESSION: THE ISLAMIZATION OF THE FINANCIAL SYSTEM IN PAKISTAN; A CHEQUERED HISTORY

The ideas about what an Islamic economy should look like took some time to develop. For the founding fathers in British India and later Pakistan

it was a process of trial and error; they did not start out with a detailed blueprint. Also harsh realities impeded a fast adoption of the principles of Islamic economics. Anwar Iqbal Qureshi notes that he, as Economic Advisor to the Government of Pakistan after Partition, actively tried to introduce interest-free banking, but did not pull it off because of practical difficulties (Qureshi 1991, p. 199). An important step in the process was that President Muhammad Zia ul-Haq, who had seized power in 1977, in February 1979 decided that interest-based transactions were to be phased out. Banks were ordered to offer interest-free alternatives to conventional savings accounts and to completely switch to interest-free banking within five years. Zia started in the same year by making three financial institutions interest free. Even if some specialized credit institutions were quick to shift to interest-free financial products, in the commercial banking field the process proved time-consuming and the government itself did not refrain from fixed-interest borrowing activities. In the mid-1980s the Islamization of the financial sector ran out of steam, but the Sharia Bench of Pakistan's Supreme Court became active with a verdict given in December 1991 under which a number of laws based on *riba* or interest were declared unlawful. The governments that followed upon Zia's death in an air accident that nobody believes was an accident, did all they could to stymie the efforts of the Court and its supporters.<sup>2</sup> The struggle has been dragging on since. The Sharia Bench had ordered the government to eliminate interest from the economy by 30 July 2002. An appeal by Pakistani banks for the court to review its earlier decision was backed by the government, which claimed that the initial ruling was flawed and that modern banking did not conflict with Islamic principles. The government also argued that interest-free banking would create financial anarchy in the country. The Supreme Court on 24 June 2002, a few weeks before its earlier deadline, duly reviewed the earlier judgement and remanded the case back to the Federal Sharia Court for a fresh decision (Supreme Court of Pakistan 2003, pp. 35–8).<sup>3</sup> So banking is to a great deal interest-free, but interest-based transactions are still possible.

#### 1.4 ISLAM AGAINST THE REST OF THE WORLD?

Maulana Maududi can be credited with launching the idea of an Islamic economy. In his approach, it is associated with an ideology where the state sees to it that Islamic rules are strictly observed. This idea of an Islamic economy not only proved attractive to Pakistanis, but also to non-Pakistanis in search of an Islamic answer or alternative to capitalism and communism. It was embraced by the Muslim Brotherhood in Egypt,

which, like Maududi, advocated Islamic forms of finance as part and parcel of a rather aggressive drive to Islamize society at large. Members of the Muslim Brotherhood also played a prominent role in the establishment in 1977 of the first Islamic bank in Sudan, Faisal Islamic Bank (rival groups set up their own Islamic banks, see Coutsoukis 2004). Indeed, *political Islam*, the ideology that seeks the establishment of an Islamic state based on the sharia, is commonly seen as having been born with the establishment of the Muslim Brotherhood in 1928. In the eyes of the leader of one of its more radical wings, Sayyid Qutb, who was executed by the Nasser regime in 1966, people have to choose between ‘God’s absolute rule’ and ‘total pagan ignorance’ (*jahiliyyah*). People who are deemed not to follow ‘God’s absolute rule’ have to be struck by *takfir*, that is, they are declared unbelievers, *kuffar*. Muslims that turn unbelievers are guilty of apostasy and deserve the death penalty. Sunnites are not allowed to rise against a Muslim ruler, but declaring him an unbeliever frees the way for insurgents. Through *takfir*, attempts on the life of Muslim rulers that stand in the way of the establishment of a fully Islamized society can be justified (Best et al. 2004). The Muslim Brotherhood and similar movements attacked, after their countries had gained independence, the ruling classes in their own societies, who they felt were guilty of social injustice and oppression. A return to what they preached to be the true Islamic way of life was seen as necessary to end these evils (Hoebink 2008). As a reaction, some argue, the ruling classes embraced the cause of Islamic finance in order to legitimize their rule and evade *takfir* (Barenberg 2004–05). Timur Kuran (2006, pp. xii, 73), for instance, suggests that in countries where the propagandists of political Islam or Islamists do not eschew violence, such as Pakistan, politicians and intellectuals have supported efforts to introduce Islamic economic institutions, including Islamic banks, not out of conviction, but for fear of being branded insufficiently Islamic. In countries such as Egypt and Turkey, where critics have been assassinated, intellectuals hesitate to speak out openly against the economic ideas of Islamists.

Advocates of a distinct Islamic way of life and Islamic institutions come in all shapes and sizes. Apparently, there is more than one way to read the holy scriptures. After the sources of Islamic law have been discussed in Chapter 2, we shall bring in a bit of nuance by presenting Tariq Ramadan’s classification of Muslims according to their way of reading and interpreting the sources.

Against the voices advocating an Islamic economic system totally different from and even isolated from the non-Muslim rest of the world, we have people such as the leading Muslim economist Mohammad Nejatullah Siddiqi, who takes his brethren (and sisters, but they are less vociferous) to task for what he sees as a ‘hostile-West syndrome’ that puts all the

Muslim countries' woes down to the pernicious influence of the West (Siddiqi 1994). He deems it futile to try and develop an Islamic economic system that is totally different from the West. To him, Islamic finance and Islamic economics are more a question of ethics and morality. He sees these as a step forward in the development of more equitable economic and financial arrangements which the whole world needs and in which Muslim individuals and countries should participate (Siddiqi 2002).

This shows that embracing Islamic finance can follow without any antagonism to non-Muslims. Many Muslims who take their religion seriously are eager to obey what they see as the precepts of the Quran and the sunna as much as possible, even if they are not inclined to impose their views on those who do not share their convictions or to shut themselves off from the non-Muslim world. The ideas on Islamic economics may have been developed as a reaction to colonialism and capitalist and communist economic systems and it may be true that Islamization of the financial sector in Iran was an instrument in the hands of the revolutionaries who had overthrown the Shah, but it still seems the case that these ideas can be adopted without necessarily accepting at the same time the political ideas of Maududi or Sayyid Qutb. No anti-Western feelings need be involved, as Siddiqi argued. Muslims have no compunction making use of the services of Islamic windows of American and European banks in predominantly Muslim countries. Western banks such as HSBC, Citigroup and Deutsche Bank have been in the forefront of developing Islamic financial instruments. Moreover, the International Monetary Fund has built up cordial relationships with the Islamic financial world and the Institute of Islamic Banking and Insurance, set up in London in 1991, calls it a good omen that major international financial organizations are involved in Islamic finance and that there is an active interaction between those organizations and Islamic bodies. Others find that it is only to be applauded if non-Muslim institutions accept sharia conditions and offer sharia-compliant products (Yaqubi 2000). They may be inclined to see this as a step forward on the way to a fully Islamized economy, however.

It seems that Islamic finance may fulfil different roles in different circumstances. In countries where it is the only form of finance allowed, it is clearly part of an Islamization drive that leaves little choice to their inhabitants. If, however, Islamic finance is offered alongside conventional finance, the range of products offered to the public is widened. Greater choice is in principle a good thing, provided there are no forces working behind the scenes to completely replace conventional finance in the end by Islamic finance. As so often in the Muslim world, opinions differ widely. One observer, the Turkish columnist Uğur Mumca, saw Islamic banking as part of, in the words of Timur Kuran (2006, p. 55) 'a sinister ploy to

advance Islamism, isolate Muslims from global civilization, and force Muslim nations into a despotic political union established on medieval principles'. Mr Mumca was murdered in 1993, and there are strong indications that this was on orders from Iran. The results apparently can be disastrous if the most extreme views clash, but generally the world of Islamic finance itself gives the impression that the interest in earning money in a sharia-compliant way is more prevalent than any hatred of critics. Still, some theorists of an Islamic economy may have more fundamentalist and antagonistic convictions than the practitioners.

In the case of Islamic finance offered in Western countries one may take the positive view that it is to be applauded if Muslim inhabitants have a choice and feel themselves taken seriously. From the viewpoint of Western financial institutions it is probably best to see the market for Islamic financial products as a potentially interesting niche. But there is more to it than that. Islamic finance is not only touted as the answer to Muslims who feel uncomfortable with conventional finance for religious reasons, but also as beneficial for others. It is claimed that Islamic finance is ethically superior and one observer states that 'Islamic Banking and Finance marketing strategies may be undergoing a subtle shift, toward the "ethical" and "socially responsible" labels and away from the "faithbased" and "Islamic" labels' (Maurer 2003, p. 198). Though the September 11 attacks in 2001 may have played a role in this strategy and the phenomenon is first of all an American one, it is a potentially attractive one for Islamic financial institutions, in particular Islamic funds, in other countries as well, as it might broaden the potential market.

## 1.5 CONCLUSIONS

It should be realized that, as just described, the Muslim world itself is divided on the desirability of Islamic economics. Islam harbours as divergent views as Christianity. Many Muslims do not agree that the Quran and the sunna forbid the financial instruments rejected by Islamic finance. One Pakistani writer, Izzud-Din Pal, sees the whole drive to introduce Islamic finance and an Islamic economy as a plot by traditionalist religious scholars, the ulama, and their political supporters, first of all president general Muhammad Zia-ul Haq, to revive the institutional framework of the Middle Ages (Pal 1999, p. 143). He deplores the fact that there is little place for 'Islamic modernism which embraces those Muslims who believe that the Qur'anic verses should be examined in the context of the social framework in which they were revealed and their message reconstructed in the light of modern times' (Pal 1999, p. ix). He does not hesitate

to label the brand of Islam which dominates the mainstream literature in Pakistan, that is, the literature inspired by the ideas of Maududi and Qureshi, as pharisaic (Pal 1999, p. xx). But if not all Muslims feel attracted to Islamic financial products, some non-Muslims may do. The most well-known characteristic of Islamic finance is the prohibition of interest and if Malaysia's former Prime Minister, Dr Mahathir Mohamad, claims that Islamic finance puts an end to the slavery of debt and makes for a fair distribution of risk between lenders and borrowers, that may ring a bell with those in the West who are sympathetic to the diatribes against interest from such people as the poet Ezra Pound in his Cantos 45 and 51 (Pound 1968, see Brooke-Rose 1971 on his economic views). Also they might feel that Islamic investment funds answer their needs for ethical ways of investing their money. Indeed Western banks such as Switzerland's UBS target both Muslim and non-Muslim investors with their Islamic investment products (Iley and Megalli 2002).

There is thus a wide variety of views concerning the desirability of Islamic forms of finance. Some of these views may be incompatible with each other, but a pluralistic society should at least be able to accommodate Islamic forms of finance, whatever the ideas of the theorists.

## NOTES

1. 'Maulana' or 'mawlana' is a title used for a scholar of Persian and Arabic in countries such as India and Pakistan.
2. See Maududi's disciple Khurshid Ahmad (1997) for an account from the point of view of Maulana Maududi's Jamaat-e-Islami party.
3. See Mehmood (2002) on the history of the attempts to Islamize Pakistan's economy.