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WORLD OF ISLAM TO-DAY: TOWARDS INTEREST-LESS BANKING: GROWTH PROBLEMS

In spite of several set-backs, Pakistan has not, in any way, slackened in its commitment to Islamise the socio-economic structure of the country. In the first constitution passed by the independent Pakistan Assembly on February 29, 1956, the text referred to the rapid elimination of Riba as one of the aims towards which the state shall strive, along with the welfare of the people. Since then, abolition of interest rates remained a subject of academic debate and discussion in various forums, on the ground that they violate the law of Quran. But commercial considerations have so far carried the day. Even in Saudi Arabia where prohibition of interest has been introduced in the text of its laws, the commercial code of the kingdom is silent on the matter of interest.

The facts of history are that ideology shows itself to be a great deal less powerful in the long run than the requirement of a social situation. However, the tide seems to have turned and it is a matter of pride for us that Pakistan is going to introduce Shariat in its rules and laws. The Council of Islamic Ideology is seriously seeking to evolve an interest free banking system to be introduced in the country at various stages. But it has certain prerequisites. A switch over to interest-less banking would inevitably require certain basic changes and adjustments.

Commercial Banking under Islamic Framework

Each institution of the present day, specially of long standing like commercial banks has evolved its own traditions of management. It has taken centuries to develop to the stage it exists now. The commercial banking of today with their world-wide extensions, complexities and functions performed and diversity of staff utilised have evolved traditions and techniques that have generally stood the test of time. But this does not mean that we should adopt the present interest-based banking which is the blood stream of modern capitalism; they have grown together to give and help each other.

Riba and Interest

Islam categorically prohibits interest that comes within the definition of Riba. The interpretations given to the word Riba and to the precepts have been extremely varied. According to Dr. Fazlur Rehmam, Riba is usually translated in Urdu by the word *Sud* (Interest), which is of Persian origin and literally means profit. *Sud* (interest) in his opinion is not synonymous with the Quranic term Riba, but is synonymous with the Arabic word Ribah, the literal meaning of which according to Quranic usage is to grow, to prosper. Dr. Rehman and before him, a number of prominent Muslims found themselves inclined to sanction bank interest as permissible in Islam, while some other advocated a change in the name by calling "interest" as service charges. The consensus is that any income which a person makes by trading in money as opposed to trading in commodities is Riba and is totally prohibited in Islam.

Present System needs a Change

As developed banking was not needed in the days of the Holy Prophet and the pious Caliphs as it is needed these days, we have to revert for guidance to the Islamic Economic System for providing sound foundations and right atmosphere for its development. In contra-distinction to the present interest rate system on which commercial banking rates, Islamic economists and bankers will not find it impossible to base their banking upon some other basis which will establish a direct link between capitalists and producers in a joint and direct enterprise—excluding the interest media. All transactions which lent themselves to gains or losses and in which there is no fixed profit are non-usury enterprises approved by Islam.

In the course of establishing this sound and interest free economy, Islam does not object to the necessary transition period for readjustment and consolidation. Islam does not favour destruction of one evil if result is to bring forth a more serious one.

Broad Structure for Interest-less Banking

Interest free banking can be run on the basis of Mudaribah or profit sharing arrangements between suppliers of capital and its users. This will be a two tier arrangement of profit sharing between the entrepreneurs or ultimate users of investible funds and bank; at the same time there will be a profit sharing arrangement between bank and depositors who are savers or suppliers of funds. The percentage ratio of profit sharing can be $\frac{2}{3}$ for users and $\frac{1}{3}$ for suppliers of funds. The bank will thus

get share $\frac{1}{3}$ from profits earned by actual investors. Similarly the depositor will get $\frac{1}{3}$ from share received by bank.

The salient features of interest free commercial bank can be visualised as under :—

(1) All depositors, savers and investors—small or big, will deposit their income and savings in interest free bank. Most of industrial, commercial and agricultural enterprises will be financed by the bank and overall profits earned by this enterprise will be shared by all participants. All commercial and personal credit requirements of members will be met by the bank.

(2) The bank will accept current deposits, withdrawable on demand and will pay no profit on such funds. The objective or motive of depositors of current account is primarily the transaction motive i.e. keeping excess liquidity readily available and not to earn any profit or income. The bank will also accept fixed deposits for certain periods and will pay profit on them as agreed upon between the bank and the depositors. The motive of the fixed account deposits or the time deposits is “investment” or “finance” i.e. to earn on idle funds some income during the period that they themselves do not utilise these funds in their normal business operations. These deposits under interest-free banking will be invested by the bank. The profit or dividends earned on these funds can be utilised by the bank for distribution among “investment depositors”. Income or dividend earned on these funds can be credited on a pro-rata basis to depositors in this category of deposits.

The services that the bank will render to the constituents or account holders in the current account are : (a) chequeing facilities, (b) transfer facilities i.e. collection of amounts of cheques on banks other than the one of which the person is an account holder, (c) Overdrawing facilities i.e. withdrawing an amount not covered by the deposits that he has in the bank. For this privilege of over-drawing the amount a sufficient security ought to be furnished to satisfy the bank about the possibility of repayment and that the amount overdrawn has to be deposited again within 30 days and that the amount overdrawn shall not be more than five times of the total balance deposit of that account, (d) Facilities of remittance. The bank will render this facility to current account holders. The remittance may be within the country through bank draft or T. T. as well as remittances to foreign countries through the bank. For remittance service there will be some specific commission to cover the cost of postal and telecommunication involved in remitting the amount and also to cover the cost of forms and papers used therein.

Though savings account depositors are also motivated by a desire to save and to earn some income on it, the main difference between the fixed depositors and savings account depositors is in the nature and kind of depositions.

Fixed deposits are deposits of business community and other sections of the population who are well off and having idle funds. Their primary motive is investment motive or finance motive, while secondary motive may be "precautionary" motive. Depositors in the savings accounts, on the other hand, are mostly people in the middle class. Motive of depositors in this category is saving for primarily "precautionary" motive while secondary motive may be "investment" or "finance". In the interest-less banking, bank can invest these funds as they do now and to credit the income thus earned in the accounts of depositors on pro-rata basis.

As regards very short-term loans required by the clients of the bank, they can be made available out of the funds available in the current account category. No interest will be charged from short term loans for periods not exceeding one month. However, bank can recover a service charge from borrower to cover cost of operations and appropriate portions of overhead expenses. For periods between one month and one year, there are two possibilities : either actual profitability of funds used by actual investors can be worked out to serve as a basis of profit sharing or alternatively an average annual rate applicable to overall business of the entrepreneur can be applied.

As for the question of consumer credit, this should be discouraged and the people should be asked to live within their means. Genuine demand for consumer credits can be met by other source of borrowing such as specialised agencies sponsored by the government.

The Individual saver/investor when he intends to make deposit in an interest-free bank will gather information about previous financing and profit earned by the same through the printed prospectus and the previous reports and balance sheets of the bank. He will also enquire as to what new industries or projects or even the business the bank proposes to finance at a particular time. After obtaining this information and satisfying himself the individual saver/investor will make a deposit.

Then the necessary papers will be signed and the contract made. This is a contract of Mudaribah, the depositor being the stock owner and the bank being the investor or Mudarib. This finishes the procedure on the one side, i.e. opening of investment account by depositors.

As for the relationship between the bank and the entrepreneur of

different projects, the latter have to submit a plan and the blue-print of projects they want to finance with bank deposits. The analyst and experts of the bank will then examine the same. When convinced of the two facts, *i.e.* its profitability with some definiteness and its social utility that can ultimately inspire savers, that the bank will enter into a Mudaribah contract with the party concerned.

The shareholders of the bank will get dividends as they do anywhere else and depositors will get profits. The principle of determining of both will be, of course, the same *i.e.* Mudaribah.

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The brief sketch of the procedure of an interest-free banking as visualised above is, however, a hypothetical one and cannot be conceived in isolation. After all it will constitute a small part of a larger system that will precede while introducing an Islamic economy which in itself will come into effect gradually. Further-more such measures can be introduced concomittantly with a mental and intellectual change infusing in the people faith and determination to act upon the requisite of Shariah.

Pre-Conditions for Introduction of Interest-Free Banking

In this context it is important to emphasise that the salient features of the Islamic economic system are its concepts of private property, institution of Zakat, Usher, Kharij, Khums, Inheritance, Infaq, Sadaqat, Shirakat and Mudaribah prohibition of interest etc. These institutions are interrelated coherently knit with each other and none of them can be conceived in isolation. As conceived in Islam, institutions of Zakat, Infaq, Sadaqat, Usher, Inheritance are connected with the institution of private property. Similarly, prohibition of interest is inter-related with business organised on the pattern of Shirakat and Mudaribah, which in turn are connected with the trade norms of Islam. Prohibition of interest and the introduction of interest-free banking can be conceived only in the presence of other institutions of the Islamic economy. In fact most of these institutions are inter-woven and dovetailed. For this very reason most of the Muslim writers have not been able to delineate them as independent parts of the system. At the same time one cannot ignore the fact that these institutions on the face of it are operational in a primitive society.

Some Basic Questions

The basic question is what should be the kind of society that we visualise now today under the Nizam-e-Mustafa. The injunctions of

Holy Quran and the guiding law of Sunnah are clear but we have yet to examine whether the practices in social, political, economic and cultural spheres that prevailed in a small pastoral and trading community fourteen centuries ago are practicable in the larger state of Pakistan now when we are in the industrial society.

Can an Islamic Society uphold all these institutions with their modernistic outlook? Commercial culture of a modern society and inexorable demand of an industrial economy are far different from the austere provisions of an Islamic Society. A Society that is based on swift selling cannot be moralistic according to old traditions. So how to find a balance between traditional practices and modern commercial concepts and new social urges.

Our Experience Since Independence

Our approach to an Islamic Society hitherto has been a negative one. It was primarily concerned with the negative legislation banning prostitution, liquor, gambling, night clubs, nudity etc. The positive aspects of an Islamic Society based on authentic Islamic Justice, deep humanitarianism and true dedication to the welfare of the state and the masses from our leaders, public servants alike, never figured prominently.

Now it is a happy augury that the stress is on positive aspect and on creation of an egalitarian society based on liberal concepts of Islam. But we cannot be unmindful of the fact that if an Islamic Society is ushered in by an ordinance, the question of administering Islamic laws can present serious problems. A moral society cannot be sustained and strengthened by an immoral bureaucratic machinery or improper political system. The kind of judicial system, executive departments, police, excise and customs officials we have cannot engineer an Islamic Society immediately.

Commercial Morality

It follows that interest is not an isolated economic phenomenon. Quran has taught commercial morality of the highest order. All transactions are to be carried out as in the presence of God. Mudaribah is of limited scope and risky for banking. It cannot work unless people are properly trained and their moral fibre is strengthened. In view of the difficulties involved in the abrupt switch over to the system of interest-free banking, it would be advisable to plan for its introduction gradually. To switch over to an interest-free economy will require an overhaul of the entire economic system. It need no emphasis that no economic system could be introduced without accepting all its

ingredients. We want a renaissance of the past Muslim glory but this is not possible unless we find among our midst a category of pious living examples—a galaxy of righteous Muslims who practice *Amar-bil-Marooif* and *Nahi-Anil-Munkar*. What we need just now is that our top echelons must be exhorted to give up living in luxury and comfort by setting an example of a simple and austere life. Meanwhile, serious efforts should be made to reduce corruption, immorality, injustice, hunger and pain among our midst. We need precise statement of principle of Islam as applied to our daily conduct or the governance of state duly translated in the lives of our rulers, a symbol in terms whereof we are to shape our individual and social life and make Pakistan a progressive nation in the world. That task is yet to be done and until that is done can there be no Muslim renaissance or the flowering of our national character.

One important reason for our trying to make do with a patch-work on the existing economic system is our difficulty in identifying the Islamic Economic System. Our long involvement with the western mode of life and institutions has made it inevitable for us to think in terms of making some change in the existing institutions to conform to the Islamic teachings. As we lack Taqwa of the early Muslims, the difference between the divine and human dispensation is naturally lost to us. It is, therefore, necessary that we should once again recollect what is an ideal economic system.

Islamic Economic System

The search for economic systems was reflected in the pages of history. Whereas socialistic societies frown upon and discourage individual initiative, it is left unbridled in western capitalistic societies. On the contrary, it is valued and encouraged in Islam. Moreover, as an individual, a Muslim is impressed with the consciousness of his multiple responsibilities to the society. These responsibilities in the economic sphere, are embodied in the six Quranic precepts that assure free, unobstructed and constant circulation of wealth. These are : prohibition of interest, prohibition of hoarding, prohibition of squandor, law of inheritance, obligation to spend for good, paying of Zakat dues etc.

Islam is the most rational of all religions. It is the only religion, the spirit of which is social. It has never enjoined upon its votaries individual worship of Allah and has never prescribed individual salvation. It has exhorted upon them to strive for salvation by serving the humanity. The service to humanity is the highest act of devotion which is best exemplified

in the life of the Holy Prophet and his companions. Islamic economic system is that way of dealing with social problems in the direct explanation of Quran and the tradition of Holy Prophet. It is a complete and equitable system, for which it holds human spirit in an exalted position and preserves ideal ethical principles; it does not deny importance of "material" aspect of human life; its legislation is a balanced admixture of spiritual and the material, the mundane and the moral. To become Muslims, it is necessary to submit to all embracing teachings of Islam, leaving no room for any other concept to erode their ideological aspirations.

Social Cohesion

This social cohesion which is a must in Islam is not limited to private conscience of individual in practising Zakat, charity and philanthropy. These are only some aspects of manifold ramifications of the principles of social cohesion. The Islamic social system is designed to train the spirit and conscience of individual, cultivation of his personal endowments and capabilities for useful and productive endeavours for the greater good of humanity.

Islam thus is not a mere religion in its real meaning as commonly understood. It is a comprehensive way of life, spiritually and materially believing in the conscience of the individual as well as the matrix of the group, while at the same time, binding the individual and the society integrally and indissolubly. The Muslim performs his prayers in the mosque sell his commodities in the market, decide between litigants in the court of law, manages affairs of state, concludes treaties and covenants with other states, fights in the name of justice and right on the battlefield. He does all these things motivated by one spirit and in accordance with one shariah and in the inspiration of one creed and system—the system of Islam.

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Islam builds this imposing edifice on the basis of a belief in God, upon the conscious awareness of God in both private and public behaviour and places God fearing conscience as a guarantee over all this. It depends upon these two sets of guarantees more than it depends upon punishment. Islam makes the link between this conscience and God the pillar of this system, for it is always possible to evade and cheat the law, but eternally vigilant eye of God is always on the watch for those who violate upright conduct.

Distribution of Income

Under various economic system practiced in the past or prevalent at

present, different methods of management and distribution of national wealth were practiced. Some of the systems favoured capital while in some others labour got preference over capital. The Islamic economic system which is yet to take practical shape, suggest a cooperation of labour and capital *i. e.* a partnership under the Mudharibah Theory. The income resulting out of such enterprise would have to be shared proportionately between units of labour and capital. But a guarantee of minimum level of subsistence for every persons is the first and most important characteristic of this system and assumes responsibility of government for that. This minimum level, to begin with, could be realised through an ownership system, system of Mudaribah and a financial system.

With respect of ownership, according to Islam, full equality of ownership is impossible and is undesirable. The ownership is a social function and should be limited within this function. Quran did not give any limit to ownership, but Allah left that to the judgment of government which depends on the overall conditions.

System of Mudharibah is the cornerstone of Islamic economic system. Mudharibah is a second name for duality of capital and enterprise. Shariah recognises reward for capital also in the form of the share for the capitalist, in a Mudarba contract. There is no interest on capital and instead for those who have capital Mudarbat (silent partnership by providing capital to one who needs capital for business) and Shirakat (active partnership by two or more entrepreneurs) is encouraged. These two concepts are well enunciated by number of earlier jurists and there is no fixed return on capital except a predetermined percentage in both profits and losses. In an Islamic state, entrepreneur, the manager and worker are equal partners in business and in seeking bounties of God. What they produce must be shared among them through an equitable and just method of distribution. What they collectively save, *i. e.* surplus value of capital, belongs to them equally and may be used by them for individual or collective gains.

With respect to financial system, Islam prohibits dealing with interest. The system of interest is inconsistent with the concept of social cohesion upon which Islam is based. The banker under Islamic economic system will be no more than a middleman between investor and entrepreneur. Islam stipulates that investment should be direct and that investor should share all risks and profits of an entrepreneur venture. This would lead to promotion of Joint Stock Companies which would give dividend and profit and no fixed interest. Money may be

invested in production either individually or through stock holding companies. This is compatible with the concept of social cohesion.

Importance of Ijtehad.

We Muslims in Pakistan are living in a capitalistic world and are accustomed to the norms, traditions and laws of the western oriented economic system. Some ultra modern among us having born, brought up, educated and following western life style are astonished when told that laws which were applicable 1400 years ago by Islam could still be applied. While there are some others who are not so ignorant but are wary of Shariah presented before them as rigid and unresponsive to change. These western educated Muslims whose understanding of religion is certainly not upto the mark, in retaliation, want a place of change (Ijtehad) in Islam and the right to question, refusing to accept blindly what is handed down to them in the name of Islam by those who refuse even to tolerate freedom of thought or expression for various reasons.

The Muslim intelligensia endorses their right of free enquiry. The spirit of free enquiry is a must. It must remain the hallmark intellectual life. Islam requires strict observance of certain major principles since fundamental values are perpetual but it still leaves a wide margin of freedom to meet social conditions. Rigidity of our theologians and their blind adherence to past opinions in the belief that door of Ijtehad is finally closed is certainly not understandable.

By Ijtehad is meant reorientation by interpretation to seprate "vital" from "lifeless". By Ijtehad is not meant an alteration in the fundamental concept of Islam so that Islamic laws should conform to new situation. While in matters of religious principles, we have nothing to ponder but as regards mundane affairs of the world, the Sunnah permits independence of judgement and freedom of action.

In the process of introducing Shariah, a system of interest less banking, we cannot remain unmindfull of the fact that societies are in the process of constant change and are never static. The society of AD 622, when Holy Prophet migrated to Medina, where he laid the foundation of Islamic state, was a feudal society. We are separated from his revelation and sunnah by about 13 centuries and a half and during this long period of the world has passed through feudalism and entered the sophisticated society of atomic age. As Islam is a dynamic religion, Muslim society cannot remain static and mechanism of its dynamics being Ijtehad. Islam as a religion in order to survive cannot keep its dynamic force shut otherwise it will remain a derelict religion in a fast moving world.