

# TOWARDS A GRASS-ROOTS BASED ISLAMIC FINANCE FOR ALL

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The modern Islamic Finance movement has been around for more than quarter of a century. It has steadily progressed along two parallel paths; in the private sector, where it was launched in the first instance, and in the public sector, in which the theoreticians had dreamed it and postulated that it would shine and become effective. In this morning's presentation at this forum, which is organized by a major private sector initiative in the west, I am going to do some loud thinking about the growing chances and potential of Islamic Finance in the private sector as compared to the public/ government sector.

## FOCUS ON THE PRIVATE SECTOR

It is individuals who create wealth in the first instance. They have the money. They are the ones who save and look for avenues for profitable investment. Individuals are the decision makers. Cases where the decisions to save and invest are taken by the state are substantial but in decline.

Individuals have the conscience. Islamic finance's appeal is two-pronged. It is based on ethics as well as on efficiency (profitability). In the current situation it is easier to find individuals who are motivated by ethical considerations as compared to state governments that are guided by ethics.

Islamic financial institutions are presently capable of meeting some of the needs of the individual, e.g. home financing or facilitating the acquisition of a car and other durables like computers and refrigerators. Islamic Financial Institutions in their current format can hardly meet the huge demands of nation states because of the meager resources at their command. Islamic Finance can and does cater, however, to the financial needs of small business enterprises, using the newly refined instruments of *Murabaha* (cost plus), leasing, *Salam* and *Istisna* (prepaid orders). Therein lies an area of aggressive salesmanship and innovative cooperation in order to be able to tap the capital markets. Big businesses generally take care of themselves. Anyway, not much can be done about them until Islamic finance finds its feet on the public financial markets.

Last but not the least, individuals are more flexible and innovative. Islamic financial management currently needs these qualities. Historically, it has been the individual, the private sector, which has been in the vanguard of the Islamic financial movement since the middle of the twentieth century. As a matter of fact involvement of the state has been a mixed blessing, at best. Nation states tend to use everything, including religion in general and Islamic finance in particular, as instruments of national policy for promoting their strategic interests and hidden agendas. In case of authoritarian regimes, Islamic Finance has often been used as a tool for consolidation of authority and for ensuring political legitimacy. Priorities dictated by economics have been forsaken in favor of those dictated by political expediency. This happened in Pakistan in the late

seventies when Islamization of the liability side was done first while the asset side of the commercial banks was yet to change. Sudan was no different as sweeping legislations were introduced in early eighties without doing much homework or preparing the ground properly.

### BE CAUTIOUS ABOUT GOVERNMENTS

It is interesting to note that in the early periods of Islamic history, finance was largely left to the individual. The state exercised *hisba* (???) functions to ensure fair dealings, preventing fraud and deception and monitoring weights and measures and other standards. It did not take over the positive function of managing the community's savings and investments.

One of the lessons of recent history has been that governments tend to over-regulate. There are reasons to believe that a modern Islamic state will be over-zealous to do so. It may even overstep from regulation to full-scale management of the financial sector. One can already discern such a tendency in Sudan, Pakistan and the Islamic Republic of Iran. But neither the Law of Islam nor the *Maqasid* (goals) of *Shariah* or its *Masalih* (interests) require such a policy or even condone it. Such policies can only lead to disastrous results as the history of the socialist states has shown. Moreover, collective management does not and cannot have the flexibility and innovativeness that Islamic finance requires in a fast changing world.

The moral, especially relevant for the Islamic financial movement in the west in general and in the United States of America in particular, is to focus on the private sector and on the individual at the grassroots. For them specially not much good will come out of focusing on the Muslim countries coaxing them to adopt Islamic Finance or divert some of their resources toward it by simply issuing a government decree to do so.

Islamic financial movement before 1975 grew on the dedicated efforts of individual initiatives at the grassroots, in the private sector. The three notable developments, interest free savings and loan societies in the Indian subcontinent dating back to the 1940s (as reported by Dr. Mohammad Hameedullah), the City of Mit Ghamr experiment in Egypt, pioneered and documented by the late Dr. Ahmad Al Naggar, and Tabung Haji in Malaysia, which won an Islamic Development Bank (IDB) award for its innovative role, both dating back to the early 1960s, all resulted from individual initiatives at the grassroots. During the quarter century that followed 1975 there were several other initiatives resulting in the establishment of over 100 Islamic financial institutions including "Dar al Mal al Islami" and the "Al Barakah" group in Saudi Arabia. The same period saw a parallel stream of official initiatives resulting in the establishment of the Islamic Development Bank (IDB) in 1975 followed by attempts at Islamization of banking in Pakistan (1979), Iran (1983) and Sudan (1984). The Malaysian partial official government patronage to Islamic finance and a modest step towards Islamic Finance in the form of Bank Muamalat in Indonesia were the next significant developments in the late eighties/early nineties.

### DEMOCRATIC PROCEDURES MATTER

A great blessing indeed, more than anything else, government patronage put Islamic finance visible and loud on the scene of world finance. But unfortunately, most of these official initiatives lacked a solid basis in a democratic polity. The beauty of

democratic decision-making is that it is not hypocritical. Islamization of banking in the framework of democratic governance would have had the benefit of wide scale participation of those involved – bankers, businessmen, accountants, auditors and the common man (male & female) as depositor or borrower. The fact that they had a say in deciding where to begin, how to proceed, where to compromise and where to stay firm, etc. would have gone a long way in ensuring compliance. Decisions taken in this manner, and open to revision through dialogue and debate in the light of experience, would have been implemented at least as seriously and as sincerely as the other laws of the land and policies. But what we actually had was entirely different. The results are there for all to see.

Those gathered here today can hardly affect the policies of the rulers in Muslim countries, though the way these rulers handle the idea of Islamic finance does affect us all as it impacts the future of the idea. Let us hope and pray the idea survives the deficiencies of its practitioners. Meanwhile we can gainfully focus on those within our reach – individuals anywhere and everywhere, savers, investors, bankers, economists and business people in all walks of life regardless of their ethnic background, religious beliefs, skin color, gender or national origin.

" It is heartening to note that a number of indigenous Islamic financial institutions have emerged in North America over the last decade or so. Though very small their strength lies in being community based. Meanwhile the entry of conventional players into the field and the rapid growth of mutual funds have provided a new source of strength to Islamic finance in the private sector. This coincides with the greater interaction between Islamic scholars and conventional financial experts at various forums--a task for which the unencumbered intellectual environment of North America is best suited. This has heightened the realization that a search for ethical investment and cleaner, greener finance is not confined to any one community. Islamic financial movement can now be placed in the broader perspective of disenchantment with the excesses of capitalism and the uncaring financial system ensuing from it. The quest for socially responsible financial management that yields a fairer distribution of benefits tends to become a universal human endeavor. It is hoped the nascent Islamic financial movement in this country will seize the opportunity."

#### OPENNESS BRINGS CREDIBILITY

Exactly what needs to be done to bring people around to Islamic banking and finance? In the first instance we need to reinforce credibility which has suffered in the recent past, both on account of politicians exploiting the idea for promoting their hidden agendas and unscrupulous profit seekers preying on people's gullibility and using religion as a tool to do so. Credibility requires visible operation within a framework of rules everyone can know and understand. Islamic finance has to be transparent, open to inspection by anyone and everyone. It should not be perceived to be operating in the framework of rules largely unavailable in writing, understandable only to the select who can make sense of archaic terminology subject to varying interpretations. It should not be projected as something above the layman's scrutiny, tolerating no dissent, leaving room for no debate, immune to learning by doing and allowing no flexibility in application. We

should never lose sight of the reality that the divine part of modern Islamic finance, though crucial, is very small. The rest is man-made, resulting from *Ijtihad* (efforts in understanding and application). More than in any other walk of life, *Muamalat* (worldly transactions) in general and finance in particular require continuous interaction between scholars and practitioners for arriving at laws that really ensure the goals of *Shariah* in a particular time and place and rules of the game that are fair and perceived to be so by all concerned. It was so in the heyday of Islamic jurisprudence. It requires a similar environment today. But that environment does not exist at the present. We have to work for it. I hope and pray that meetings like the one we are having today are designed to create such an environment.