

# Islamic banking in South Africa: between the accumulation of wealth and the promotion of social prosperity

*Khaled Qasaymeh*\*

## **Abstract**

The banking sector is the cornerstone of modern economy. Muslims in South Africa have been utilising Islamic banking through Albarakah since 1989. In 2004 and 2006 successively First National Bank and Absa Bank started offering Islamic banking services through their Islamic windows. South African legislature has introduced the Draft Taxation Laws Amendment Bill introducing Islamic Banking instruments for the purposes of taxation. The Bill does not create a comprehensive legal landscape for Islamic banking. Nonetheless, the Bill indicates at the practices of South African Islamic banks. The investigation of the application of the *shari'ah*-compliance banking reveals that the mechanical application of Islamic rules does not necessarily achieve the goals of *shari'ah*. This is due to the major role of the institution of Islamic banking in promoting social prosperity. The matter requires Islamic banks to revisit their current practices in order to restore the origin of norms intended to justify profit by promoting social development.

---

## **INTRODUCTION**

Islamic banking is intended to offer efficient allocation of financial resources including fundamental tools for a modern Islamic economy.<sup>1</sup> The fundamental principles of Islamic economy require the Islamic banking industry to operate according to *shari'ah* (شريعة) (Islamic law principles).<sup>2</sup> This compels Islamic banks to operate within the central parameters of Islam, namely *halal* (حلال) (that which is permissible), and *haram* (حرام) (that which is prohibited). *Halal* and *haram* construct a regime permitting all *halal* activities and prohibiting all *haram* activities.

---

\* Senior Lecturer: Department of Public, Constitutional and International Law, Unisa.

<sup>1</sup> Dahlia El Hawary *et al* 'Regulating Islamic financial institutions: the nature of the regulated' (March 2004) Working Paper 3227 *World Bank Policy Research* 4.

<sup>2</sup> *Shari'ah* is an Islamic terminology which means Islamic law. For more reading about Islamic law see, Janine Hunt *et al* *Islamic law: the sharia from Muhammad's time to the present* (2007).

Reducing this to the Islamic financial environment imposes the *halal* and *haram* regime as the legal standard in the Islamic economy.<sup>3</sup> Sadr regards *halal* and *haram* as compelling factors in establishing the foundation of Islamic economics.<sup>4</sup> Ghazali does not separate the values of Islamic economics from righteous living, which link profit with various human activities.<sup>5</sup>

Generating profit in an Islamic financial environment does not deviate from the parameters of the *halal* and *haram* regime. This means that all human activities seeking profit in an Islamic financial environment should comply with *shari'ah* law, which requires justification for profit and guarantees the elimination of *riba* (ربا) (interest from financial operations) and dealing in *halal* products. In other words, the Islamic financial environment is controlled by layers of institutions, which include a profit-justifying institution, and a prohibitive institution.

The profit-justifying institution is a controlling mechanism enforcing ethical normative rules pertaining to faith and social purposes. This institution confers legitimacy on profit resulting from the conducting of *halal* businesses. The prohibitive institution is exclusive in nature and includes *riba*, and a group of financial operations involving, for example, *gharar* (غرر) (speculation), *zulm* (ظلم) (oppression), *ghish* (غش) (cheating), *ghubon* (غبن) (injustice) and trading in prohibited commodities, for example, gambling, prostitution, *etc.* This institution makes it *haram* to conduct businesses which fall within the notion of the general prohibition contemplated by Islamic normative rules. In other words, the *halal* and *haram* regime functions predominantly as a control system intended to give legitimacy and establish legal frameworks governing financial transactions in the Islamic financial environment.

South African banks, including Albaraka,<sup>6</sup> Absa Bank,<sup>7</sup> and First National Bank,<sup>8</sup> offer Islamic banking. These banks adhere to the *halal* and *haram*

<sup>3</sup> Muhammad Baqer As-Sadr *The renewal of Islamic law* (1993) 122.

<sup>4</sup> *Ibid.*

<sup>5</sup> Sheikh Ghazali Abod Syed Omar Syed Agil *An introduction to Islamic finance* (1992) 5.

<sup>6</sup> Al Baraka Bank Limited was established in 1989 and its activities are directed mainly at the two per cent of Muslims in the population of South Africa. <http://www.albaraka.com/default.asp?action=article&id=95> (last accessed 5 May 2011).

<sup>7</sup> Absa Islamic Banking was established in March 2006 as part of the Absa Group and Barclays. <http://www.absa.co.za/Absacoza/> (last accessed 5 May 2011).

regime and therefore, eliminate *riba* and do not trade in *shari'ah*-prohibited financial operations. They utilise Islamic financial instruments which are predominantly based upon contract including, *mudaraba* (مضاربة) (trust financing), *musharaka* (مشاركة) (partnership financing), and *murabaha* (مرابحة) (cost-plus financing).

South African Islamic financial institutions have advanced considerably in developing the Islamic financial sector in South Africa. For example, Absa Bank<sup>9</sup> has been 'ranked as the World's Best Islamic Financial Institution for the Non-Gulf Cooperative Council (GCC), Middle East/Africa region by *Global Finance* magazine,'<sup>10</sup> for three consecutive years.<sup>11</sup>

*Shari'ah*-adherence banking in South Africa has been legally recognised since 2010 through the incorporation of legal definitions for *musharaka*, *mudaraba*, and *murabaha* in the Draft Taxation Laws Amendment Bill.<sup>12</sup> Nevertheless, the main focus of the Bill is not the creation of comprehensive legal frameworks regulating Islamic finance. Instead, the Bill focuses on the introduction of the definition of *musharaka*, *mudaraba*, and *murabaha* for the purposes of taxation. The question arises as to whether the elimination of *riba* and the utilisation of Islamic contracts are sufficient for financial institutions to be regarded as compliant with *shari'ah* law.

This article focuses on the definitions of *musharaka*, *mudaraba*, and *murabaha* as incorporated in the Bill in comparison with the origin of norms of these contracts, which is intended to promote social prosperity by deploying capital in *shari'ah*-compliance enterprises. The investigation revolves around the compatibility of the technical application of these contracts by South Africa's Islamic banks with the aims of *shari'ah*.

---

<sup>8</sup> The First National Islamic bank was established on 5th of May 2004 [http://www.islamicfinance.co.za/about\\_us/history.html](http://www.islamicfinance.co.za/about_us/history.html) (last accessed 5 May 2011).

<sup>9</sup> Absa Islamic Banking was established in March 2006.

<sup>10</sup> Banking & Finance News at: <http://www.bizcommunity.com/Article.aspx?l=196&c=163&i=59528> (last accessed 5 May 2011). Moreover, the Professional Management Review-Africa (PMR-Africa) magazine has twice ranked Absa Bank as the best. <http://www.absa.co.za/absacoza/content.jsp?/Home/Personal/Our-Customers/Islamic-Banking>.

<sup>11</sup> *Ibid.*

<sup>12</sup> 10 May 2010. Hereafter referred to as the Bill.

### THE NOTION OF ISLAMIC BANKING

During the colonisation of Islamic countries the mode of finance was predominantly based upon conventional banking which did not satisfy the needs of an Islamic economy. Muslims sought a mode of finance which could be regarded as Islamic law-compliant in order to assist them in their micro finance. Decolonisation of Islamic countries created a new dispensation allowing for the development of Islamic banking.<sup>13</sup> The starting point for this trend can be traced back to the initiative 1963 initiative launched by Mit Ghamr in Egypt<sup>14</sup> which aimed at investors who wished to comply with Islamic law.<sup>15</sup>

The institution of Islamic banking forms a cornerstone required to create an Islamic financial environment. Islamic banking plays a vital role in the economic development of Islamic societies by facilitating the mobilisation and allocation of dormant savings,<sup>16</sup> which used to be intentionally kept out of interest-based financial channels. This has facilitated the development of capital markets and enabled Muslim savers and borrowers to choose financial instruments compatible with their business needs, social values, and Islamic principles.<sup>17</sup>

Islamic banks became the custodian of Muslims' money with enormous responsibility to deploy these resources in a manner which serves the banks' interests, the interests of clients, and society. Contrary to the notion of traditional banking, which is centered around an interest-based banking system and maximum profit, Islamic banks are interest free in rendering their financial services and the notion of Islamic banking links profit to social prosperity. An example can be found in article 50(a)(1) and 50(a)(3) of the Jordanian Banking Law.<sup>18</sup> The former prescribes the prohibition of *riba*, while the latter requires Islamic banks to seek 'reviving social solidarity organised on the basis of mutual benefit' when they provide their services.

---

<sup>13</sup> For example, 'the Idea of Islamic banking goes back to the early days of the independence.' See Amr Mohamed El Tiby *Islamic banking: how to manage risk and improve profitability* (2011) John & Wiley Inc 19.

<sup>14</sup> M Raquibuz Zaman *et al* 'Islamic banking: a performance analysis' (2001) 12/22 *The Journal of Global Business* 31.

<sup>15</sup> Mohammed El Qorchi 'Islamic finance gears up' (2005) 42/4 *Quarterly Magazine of the IMF* 2.

<sup>16</sup> *Ibid.*

<sup>17</sup> Zamir Iqbal 'Islamic financial systems' (1997) *Finance & Development* 43.

<sup>18</sup> The Jordanian Banking Law 28 of 2000.

Islamic banking has been legally accommodated by both Islamic and non-Islamic countries. This legal accommodation offered by countries around the world varies. Countries, such as Iran, Saudi Arabia, and Sudan<sup>19</sup> follow the total Islamic compliance banking system. Countries, such as Egypt, and Jordan<sup>20</sup> follow a dual approach system, in which Islamic banks operate under laws intended for conventional banking. Malaysia has created a parallel banking system by introducing separate regulatory frameworks accommodating both Islamic banking and conventional banking in an open economy.<sup>21</sup> In South Africa, Absa and First National Banks,<sup>22</sup> which are conventional banks, offer Islamic finance through their ‘Islamic windows.’<sup>23</sup>

Regardless of the nature of legal accommodation offered by countries to Islamic banks, these banks adhere to *shari’ah* principles, adapt profit-loss sharing principle, fee-based profit, interest free services, and ancillary principles.<sup>24</sup> These principles are intended to reflect the spirit of *shari’ah* in all the contracts that banks conclude.

### ISLAMIC FINANCIAL INSTRUMENTS

Islamic normative rules pertaining to financial instruments used by banks are based on *fiqhul muaamlat* (فقه المعاملات) (doctrine of transactions). *Fiqhul muaamlat* regulates contracts in the Islamic financial environment where performance is inextricably linked with faith. *Surah Al Maeda* (المائدة) 5:1 reads as follows: ‘...O you who have believed, fulfill [all] contracts...’<sup>25</sup> (...يا ايها الذين آمنوا اوفوا بالعقود...). Furthermore, *Surah Al-Isra* (الإسراء) 17:34 reads as follows: ‘...And fulfill [every] commitment. Indeed, the commitment is ever [that about which one will be]

<sup>19</sup> It is important to remember that the entire legal systems of Iran and Sudan are based on *shari’ah*.

<sup>20</sup> Although Jordan has the Law of Jordanian Islamic Banking for Finance and Investment of 1978, Islamic financial economic activities are regulated under laws for conventional banking, which is Banking Law 28 of 2000 as amended by Temporary Law 46 of 2003, published in the *Official Gazette* 4600 June 1, 2000.

<sup>21</sup> Farhad Nomani ‘The problem of interest and Islamic banking in a comparative perspective: the case of Egypt, Iran and Pakistan’ (2003) 1/1 *Review of Middle East Economics and Finance* 37–38.

<sup>22</sup> On 5 May 2004 the First Rand Group announced the birth of First National Bank Islamic Finance. [http://www.islamicfinance.co.za/about\\_us/history.html](http://www.islamicfinance.co.za/about_us/history.html) (last accessed 5 May 2011).

<sup>23</sup> Natalie Schoon *Islamic banking and finance* (2009) *Spiramus London* 9.

<sup>24</sup> Sudin Haron ‘A comparative study of Islamic banking practices’ (1998) 10 *J KAU Islamic Econ* 25.

<sup>25</sup> The Holy Quran.

questioned.<sup>26</sup> (...وافوا بالعهد ان العهد كان مفعولا...) This has created confidence in commerce and encouraged the development of legal frameworks governing commerce in the Islamic financial environment. These legal frameworks have paved the way for the development of two categories of contract namely, unilateral and bilateral contracts.

The unilateral contracts category comprises *isqatat* (اسقاطات) (waiver), *ibra'* (إبراء) (rebate), *muqasah* (مقاصة) (off-set of debt), *wasiyyat* (وصية) (will), *waqf* (وقف) (fund), *al-qardul hassan* (القرض الحسن) (the benevolent or good loan),<sup>27</sup> and *al-qard* (القرض) (loan).

The bilateral contracts category comprises *uqud ishtirak* (عقود مشاركة او عقود اشتراك) (contract of partnership) either *mudharabah*, or *musharakah*, *murabaha*, *bai'mua'jjal* (بيع مؤجل) (deferred delivery sales contract), *ba'salam* (بيع السلم) (post delivery sale contract), *ijara* (إجارة) (leasing), *ijara wa iqtina* (إجارة واقتناء) (lease/hire purchase), *musaqat* (مساقاة) (co-irrigation), *muzar'ah* (مزارعة) (co-cropping), *jo'lah* (جعلة) (fee/reward), *istisna* (استصناع) (co-manufacturing), *uqud tawsiqat* (عقود توثيقات) (contract of security) either *kafalah* (كفالة) (suretyship) or *rahnu* (الرهن) (pledge), *uqud itlaqat* (عقود اطلاقات) (contract pertaining to do a work) either *wakalah* (وكالة) (agency), or *hiwalah* (حوالة) (debt transfer), '*uqud taqiydat* (عقود تقييدات) (contract of restriction), and '*uqud hifz* (عقود حفظ) (contract of safe custody), or *wadiyah* (وديعة) (safekeeping).<sup>28</sup>

In the context of Islamic banking, Rahul Dhumale and Amela Sapcanin divide Islamic commercial instruments utilised by Islamic banks into two categories namely, concessionary and trade financing.<sup>29</sup> The concessionary institution involves profit and loss-sharing contracts such as *mudaraba*, *musharaka*, *musaqat*, *muzar'ah*, and direct investment. The trade financing institution involves non-profit and loss-sharing contracts

<sup>26</sup> *Ibid.*

<sup>27</sup> *Qardul hasan* is an Islamic financial instrument by which the lender does not expect any profit. Islamic banks are encouraged to deploy *qard hasan* within successful microfinance activities in order to benefit from its potential capacity 'in empowering the poor in Muslim societies.' See *Newhorizon: global perspective on Islamic banking & insurance* (2007) 164.

<sup>28</sup> For further reading around contracts refer to Abdul Nasir Musa Abu AlBasl *Al-Qanun Al-madani Al-Urduni Al-Nazriah Ala'mah Li Al-Aqd* (1999).

<sup>29</sup> Rahul Dhumale & Amel Sapcanin 'An application of Islamic banking principles to microfinance' *World Bank, A study by the Regional Bureau for Arab States, United Nations Development Programme, in cooperation with the Middle East and North Africa Region* (4 December 1999).

such as *qardul-hassan*, *bai'mua'jjal*, *bai'salam*, *Ijar wa iqtina*, *murabaha*, *jo'lah*.<sup>30</sup>

South Africa's Islamic banking sector operates under conventional banking law including the Banks Act,<sup>31</sup> the Mutual Banks Act,<sup>32</sup> and the Co-operative Banks Act.<sup>33</sup> None of these Acts refers directly to Islamic banking. However, Islamic banks are allowed to operate utilising *mudaraba*, *musharaka*, and *murabaha*, which are necessary to perform financial operations in accordance with Islamic standards. Recently, the Bill has introduced a technical definition for the diminishing *musharaka*, *mudarabah*, and *murabaha*, for the purposes of the Transfer Duty Act of 1949, by inserting section 3A; the Income Tax Act 58 of 1962 by inserting section 24JA;<sup>34</sup> and the Value-Added Tax Act 89 of 1991 by inserting section 8A.

#### ***Musharakah and Diminishing Musharaka***

*Musharakah* is an Arabic word which means sharing, and relates to the sharing of profits or losses resulting from joint ventures or partnerships.<sup>35</sup> In the business environment *musharakah* is a partnership contract based upon equity participation, by which partners provide capital under joint venture. The sharing of profits and losses resulting from such partnerships, is pre-determined and partners may co-manage the enterprise. Diminishing *musharaka* is 'a form of partnership in which one of the partners promises to buy the equity share of the other partner gradually until the title to the equity is completely transferred to the buying partner.' Section 24JA defines 'diminishing *musharaka*' as an arrangement concluded between a bank and a client of that bank complying with the precepts of *shari'ah* law.' Practically, both 'the bank and the client acquire joint ownership of an asset...the bank and the client conclude an agreement in terms of which the client will purchase the bank's ownership interest in the asset.'<sup>36</sup> 'The amount of consideration payable by the client for the acquisition from the bank of the banks' ownership interest in the asset is<sup>37</sup> equal to the amount of consideration

---

<sup>30</sup> *Ibid.*

<sup>31</sup> Act 94 of 1990.

<sup>32</sup> Act 124 of 1999.

<sup>33</sup> Act 40 of 2007.

<sup>34</sup> Hereafter referred to section 24JA.

<sup>35</sup> Geneva: International Trade Centre (ITC) *Islamic banking: a guide for small and medium-sized enterprises* (2009) 12.

<sup>36</sup> Section 24JA(b).

<sup>37</sup> *Id* at 24JA(c).

payable by the bank to acquire its ownership interest in the asset,<sup>38</sup> and is 'payable in installments over a period of time as agreed upon between the client and the bank.'<sup>39</sup> 'The client pays rent to the bank in respect of the bank's ownership interest in the asset until such time as the client becomes sole owner of the asset.'<sup>40</sup>

Islamic banks utilise *musharakah* as a financial instrument to finance certain projects which are likely to make a profit. This instrument was codified in the *Majalah Al ahkam Al adliyah*<sup>41</sup> (مجلة الاحكام العدلية) which required both the bank and the client to advance the capital and also to co-manage the enterprise and share profit according to the predetermined percentage and bear losses according to the ratio of their contribution to the capital.<sup>42</sup> Article 1336 of the *Mejelle* stipulated the identification of the modalities of dividing the profits. Article 1337 required a pre-determined percentage, for example twenty-five or fifty per cent, to be allocated as share of profits to the partners. The percentage of profit given to a partner can be negotiated and many factors may affect it such as the skills of one of the partners.<sup>43</sup> Damages and losses are borne by the partners according to the ratio of their contribution in the principal.<sup>44</sup>

### ***Mudarabah***

*Mudarabah* is a silent partnership based upon a profit-sharing agreement, by which the investor advances the capital and the entrepreneur provides time and has sole control of the enterprise. Section 24JA defines *mudarabah* as an arrangement concluded between a bank or portfolio of a collective investment scheme, and any other person complying with the precepts of *shari'ah*. In practical terms, the *mudarabah* arrangement requires 'funds to be deposited with the bank or contributed to the portfolio of a collective investment scheme by that person.'<sup>45</sup> 'The anticipated profit from the funds deposited or contributed is divided proportionally in terms of an agreement concluded when the arrangement is entered into between the bank or portfolio of a collective investment

<sup>38</sup> *Id* at 24JA(c)(I).

<sup>39</sup> *Id* at 24JA(c)(ii).

<sup>40</sup> *Id* at 24JA(d).

<sup>41</sup> *Majallah al-Ahkam-I-Adliya*, hereinafter referred to the *Mejelle* (المجلة) was introduced in 1882 to function as the civil code of the Ottoman Caliphate, and is considered to be the first attempt to codify Islamic law. See *The Mejelle (Majallah al-Ahkam-I-Adliya)* (2003).

<sup>42</sup> Note 35 above at 9.

<sup>43</sup> For example, article 1391 of the *Mejelle*.

<sup>44</sup> Article 1369 of the *Mejelle*.

<sup>45</sup> Section 24JA(a).



scheme and that person'.<sup>46</sup> 'The proportional division of the profits contemplated in paragraph (b) may not be altered over the lifetime of the arrangement.'<sup>47</sup> Finally, 'that person bears all the risk of loss in relation to the funds deposited or contributed in terms of that arrangement'.<sup>48</sup>

Article 1404 of the *Mejelle* defines *mudarabah* as a type of partnership in which an economic agent with capital (*rabbul mal*) (رب المال) proposes to another economic agent with expertise (*mudarib*) (مضارب) to deploy this capital into real economic activities<sup>49</sup> according to a pre-determined ratio of profit.<sup>50</sup> Losses are borne by *rabbul mal*<sup>51</sup> as long as the *mudarib* has not been guilty of misconduct, negligence<sup>52</sup> or has not contradicted the provisions of the restricted *mudarabah*.

### **Murabaha**

*Murabahah* is simply a resale contract based upon a cost-plus profit financing transaction. In this sale the Islamic financial institution purchases an asset from a supplier according to its client's instructions, then sells the purchased item to the client on a deferred sale basis with a mark-up reflecting its profit.<sup>53</sup> Section 24JA of the Bill defines *murabaha* as an arrangement concluded between a bank and a client of that bank. According to this agreement, the bank 'will purchase an asset from a third party (hereafter called the seller) for the benefit of the client on such terms and conditions as are agreed upon between the client and the seller.'<sup>54</sup> The bank 'retains a right to take possession of the asset after the asset is delivered to the client in the event that the client defaults on any payment in terms of the arrangement.'<sup>55</sup> 'The client will in terms of the agreement within 180 days after the acquisition of the asset by the bank take transfer

<sup>46</sup> *Id* at 24JA(b)

<sup>47</sup> *Id* at 24JA(c).

<sup>48</sup> *Id* at 24JA(d).

<sup>49</sup> The *Mejelle* article 1404.

<sup>50</sup> *Ibid* 1405.

<sup>51</sup> *Ibid* 1428.

<sup>52</sup> *Ibid* 1421.

<sup>53</sup> Tarek s Zaher & Kabir Hassan 'A comparative literature survey of Islamic finance and banking' (2001) 10/4 *Financial Markets, Institutions and Instruments* 160. *Mudaraba* which was the custom governing the trade of the pre-Islamic Arabs (Mohamed Ariff 'Research Report on Islamic Banking' (1988) 2/2 *Asian-Pacific Economic Literature*) became the cornerstone of Islamic financial intermediation which includes banking (note 1 above at 10). This financial institution creates viable alternatives for interest and does not diminish the capital value as a factor of production. It allows the owner of the capital to make legitimate profit sharing profits with the entrepreneur.

<sup>54</sup> Section 24JA(i).

<sup>55</sup> *Id* at 24JA(ii).

of the asset from the bank; and pay to the bank an amount, that exceeds the amount paid by the bank to the seller as consideration to acquire the asset on behalf of the client; and paid in equal instalments that will not vary over the lifetime of the arrangement.’

### **FREEDOM OF TRADE**

The origin of norms in Islam is intended to allow all Muslim activities in the financial environment to function freely, unless it is an activity prohibited by a rule. Article 64 of the *Mejelle* does not limit human activities, which are intended to function freely, unless there is clear evidence of limitations imposed by a law or a presumption. This means that restrictions and the interpretation of the limitations on economic freedom in Islam cannot be overstated to prohibit any permitted activities on the basis that it is in the form of banking. However, banking in its conventional form which is based upon interest and upon generating maximum profit, contravenes Islamic principles – in particular the elimination of *riba* and meeting *maqasidul Shari’ah* (مقاصد الشريعة) (goals of *Shari’ah*) and *masalih* (مصالح) (benefits). Prohibition of *riba*, meeting *maqasidul Shari’ah*, and the application of *masalih* doctrine form the foundation which permits banking activities in Islamic society for the purposes of developing an Islamic economy.

Islamic economy is based upon production norms and consumption norms. Consumption norms do not introduce any compulsory regulatory frameworks that may limit consumption. Restrictions on consumption are based upon ethical precepts that do not encourage waste or over consumption.<sup>56</sup> *Al-Araaf* (الاعراف) 7: 31 reads as follows: ‘O children of Adam! Take your adornment (by wearing your clean clothes), while praying...and eat and drink but waste not by extravagance, certainly he (Allah) likes not...(those who waste by extravagance).’<sup>57</sup> (يا بني آدم خذوا زينتكم عند كل مسجد وكلوا واشربوا ولا تسرفوا انه لا يحب المرففين)

Production norms are based upon *fiqhul mu’amlaat* which regulates the methods of generating wealth in an Islamic financial environment. *Fiqhul mu’amlaat* allows the development of modes of transaction as long as the

<sup>56</sup> Islamic ethics always preach ‘moderation and a balanced pattern of consumption’. See, Mohamed Ariff and Munawar Iqbal *et al Foundations of Islamic Banking: Theory, Practice and Education* (2011) Edward Elgar Publishing Inc 44.

<sup>57</sup> The Holy Quran. Moreover, Prophet Mohammad said that ‘no equivalent harm to the son of Adam as much as excessively filling a stomach...’ Produced by Ahmad: 4133, codified by Al-Albani in *Sahih Al-Jami’*: (صحيح الجامع) 5774.

development process is guided by *maqasid al-Shari'ah* and *masalih*. In other words, the adaptation of traditional contracts to contemporary transactions for the purposes of Islamic banking requires the adherence to the *halal* and *haram* regime and must pursue the welfare of the society. The Jordanian Banking Law requires Islamic banks to select and adhere to 'recognised jurisprudence opinions' selectively according to 'the rules laid down by various Islamic schools of jurisprudence as serving best the common interest, without exclusively deriving from a specific school...'<sup>58</sup> This can be reduced to the test which requires Islamic banking to be limited to the *halal* and *haram* regime coupled with the *maqasidul shari'ah* and *masalih* regimes. The dynamics of these regimes serve as a 'limitation clause' that should be interpreted as narrowly as possible. The *halal* and *haram* regime interplays with the *maqasidul shari'ah* and *masalih* regimes in order to relax an inflexible rule relating to unrestricted public interest because 'the God's purpose in the *shari'ah* is the promotion of human welfare.'<sup>59</sup> The application of this dynamic in Islamic banking is intended to allow certain contracts involving prohibited practice because they are indispensable. For example, although 'bai'salam) (forward buying of a commodity which does not yet exist)...is apparently illegal interest bearing dealing'<sup>60</sup> and the *takaful* borrows its norms from the risk-based capital RBC standards, the *Hanafis* have allowed them on the basis of *masaleh dharuryyah* (مصالح ضرورية) (necessary interest).<sup>61</sup>

### Limitations on trade

Limitations on trade ordained by *fiqhul mu'amalaat* have migrated to Islamic banking governing its transactions by the *halal* and *haram* regime.<sup>62</sup> This has narrowed the scope of legal framework of operation<sup>63</sup> and excluded certain economic transactions, which are the norm in

<sup>58</sup> Note 18 above article 53(a).

<sup>59</sup> John L. Esposito *Women in Muslim Family Law* (1 ed 1982) 9–10.

<sup>60</sup> Mohammed Obaidullah 'Islamic risk management: towards greater ethics and efficiency' (2002) 3/4 *International Journal of Islamic Financial Services*. See also Abu Umar Faruq Ahmad *Theory and practice of modern Islamic finance: the case analysis from Australia* (2010) 112.

<sup>61</sup> Azman Ismail 'Fiqh aulawiyatI in retakaful: between RBC (Risk-Based Capital) Standards and Islamic institutions' (11 November 2008) ISRA Islamic Finance Seminar (IFS) at:

[http://www.islamchest.com/uploads/5/0/2/9/5029153/fiqh\\_aulawiyat\\_in\\_retakaful-azman\\_ismail-www.islamchest.com.pdf](http://www.islamchest.com/uploads/5/0/2/9/5029153/fiqh_aulawiyat_in_retakaful-azman_ismail-www.islamchest.com.pdf) (last accessed 8 July 2011).

<sup>62</sup> Chika Umar Aliyu 'Fiqhul Mu'amalaat and the need for Islamic economics: a clarification of misconception' (1993) 5/1 *Journal of Objective Studies* 90–97.

<sup>63</sup> KM Akram 'Teaching Islamic economics at university level' in M Abdul Rashid M *et al* (eds) *Rafiqul Islam* (1988) 66.

traditional banking, for example, the financing of a successful brewery project for interest. Nonetheless, the *maqasid al-shari'ah* and *masalih* tests utilised by jurists tend to relax the *halal* and *haram* regime and narrow the limitations relating to Islamic banking to issues such as *gharar* (غرر) (speculative contracts)<sup>64</sup> and prohibition of *riba* interest.<sup>65</sup>

### **Gharar**

*Gharar* is an Arabic word expressing uncertainties and risky transactions. Shaik Al-jibreen links it to the definition of gambling and *ghrarar*.<sup>66</sup> Prohibition of *gharar* is derived from the institution prohibiting gambling<sup>67</sup> contemplated in *Surah Al Maeda* (المائدة) 5:90 which reads as follows: 'O you who have believed, indeed, intoxicants, gambling, [sacrificing on] stone alters [to other than Allah], and divining arrows are but defilement from the work of Satan, so avoid it that you may be successful.' يا ايها الذي امنوا انما الخمر والميسر والانصاب والازلام رجس من عمل) (الشيطان فاجتنبوه لعلكم تفلحون).<sup>68</sup> Examples of *gharar* contracts are as follows: a buyer tells a fisherman: 'I will pay you ten Rand for the fish that will be caught by your net today.' These kinds of contract are prohibited by Islamic norms because the validity of a contract depends on the specification of the item purchased, in its genre if it is fungibles,<sup>69</sup> or its type if it is countable.<sup>70</sup> Speculative contracts are prohibited because they create uncertainties about the nature of the item purchased.<sup>71</sup> This will likely disturb the balance based upon fair play which requires any exchange to be a value against an equivalent value.<sup>72</sup>

<sup>64</sup> *Gharar* (literally, hazard). See Farhad Nomani 'The problem of interest and Islamic banking in a comparative perspective: The case of Egypt, Iran and Pakistan' (2003) 1/1 *Review of Middle East Economics and Finance* 37.

<sup>65</sup> *Ibid.*

<sup>66</sup> Official website of Shaik Abdullah bin Abdual-rahaman Al-jibreen: <http://ibn-jebreen.com/ftawa.php?view=vmasal&subid=673&parent=786> (فتوى) (ruling) 673 (last accessed January 11 2011).

<sup>67</sup> Maha-Hanaan Balala *Islamic finance and law: theory and practice in a globalized world* (2011) I. B. Tauris Co Ltd 35.

<sup>68</sup> The Holy Quran.

<sup>69</sup> Article 383, 384, and 385 of the *Mejelle*.

<sup>70</sup> Article 151 and 152 of the *Mejelle*.

<sup>71</sup> Note 21 above at 22.

<sup>72</sup> For more reading about *qhara* see Saiful Azhar Rosly 'Ciwaa' as a requirement of lawful sale: a critical analysis' (2001) 9/2 *IJUM Journal of Economics and Management*.

**Riba**

In the corporate world *riba* simply means interest. *Riba* is a contractual instrument by which the lender collects a predetermined interest added to the principal amount it has lent out.<sup>73</sup> The principal amount can be money, gold, silver, or fungibles<sup>74</sup> including wheat, barley, dates, etc. The Pakistani Supreme Court's Appellate Bench in *Riba case* concluded that the following transactions involve *riba*:

- A transaction of money for money of the same denomination where the quality on both sides is not equal, either in a spot transaction or in a transaction based on deferred payment.
- A barter transaction between two weighable or measurable commodities of the same kind, where the quantity on both sides is not equal, or where the delivery from any one side is deferred.
- A barter transaction between two different weighable or measurable commodities where delivery from one side is deferred.<sup>75</sup>

**Prohibition of riba**

Islamic norms regulating commerce strictly prohibit the receiving or giving of interest. Quranic verses ban interest unequivocally. *Al-Imran* (آل عمران) 3:130 reads as follows: 'Believers! Do not consume *riba*, doubling and redoubling...' <sup>76</sup> (يا ايها الذين امنوا لا تاكلوا الربوا اضعافا مضاعفة...). The alternative institution intended to generate profit can be found in trade. *Al-Baqara* (البقرة) 2:274 states that: '...God has made buying and selling lawful, and *riba* unlawful...' <sup>77</sup> (...واحل الله البيع وحرم الربوا...). Prophet Mohammad condemned all persons who are involved in dealing with interest, including those who take it, those who give it, and those who record or witness it. All of these are regarded as peers in guilt.<sup>78</sup> Ottoman bin Abi Sheibah narrated that 'the Messenger of Allah condemned the one

<sup>73</sup> Note 21 above at 20.

<sup>74</sup> Fungible goods are those that can readily be estimated and replaced according to weight, measure, and amount. See West's encyclopaedia of American law (2ed 2008).

<sup>75</sup> Civil Shariat Review Petition No 1 of 2001 Muhammad Iqbal Zahid v M/S Farooq Brothers and others, on review from the order dated 14 June 2001 passed in CMA 1485/ 2001 in C Sh RP1 Of 2000 in Shariat Appeal 11-19 of 1992. [http://www.globalwebpost.com/farooqm/study\\_res/i\\_econ\\_fin/scp\\_appeal.pdf](http://www.globalwebpost.com/farooqm/study_res/i_econ_fin/scp_appeal.pdf) (last accessed 25 May 2011).

<sup>76</sup> The Holy Quran.

<sup>77</sup> *Ibid.*

<sup>78</sup> See Imam Muslim Book on co-irrigation and co-cropping كتاب المساقاة (الامام مسلم: كتاب المساقاة) chapter 19 par 105 1597 condemning eating usury and feeding it (باب لعن أكل (بالمزارعة) الربا وموكله) 798-799.

who eats interest and the one who feeds it.<sup>79</sup> Muhamad bin Al-Ssabah said the Prophet also condemned those who record interest and witness interest.<sup>80</sup> Prophet Mohammad prohibited selling gold for gold, unless they are treated as equals.<sup>81</sup> Omar bin Al-Khattab did not allow the unequal exchange that involved fungibles because the Prophet regarded the exchange of barley for barley, dates for dates, or salt for salt involving an increase as *riba*.<sup>82</sup> The Pakistani Supreme Court's Appellate Bench in *Riba case* ordered the government to repeal many laws inherited from the English system relating to commerce that sanctioned *riba*. The court stated that 'these laws, it was rightly observed, being alien to Islamic Injunctions and the concept of Islamic social justice, can have no place on the statute book of the land and these laws or the rules framed there under were rightly declared to be repugnant to the Injunctions of Islam.'<sup>83</sup>

***Rationalising the prohibition of riba***

Islamic financial norms do not allow any increase during the exchange of fungibles or money because it is unfair to the borrower, the lender, and the economy. Prohibition of interest is 'based upon values such as justice, efficiency, stability, and growth.'<sup>84</sup> Islamic economy rewards people according to their effort in order to achieve growth paralleled with equity principles, which is frustrated by the introduction of interest.<sup>85</sup> Natalie Schoon considers that a situation where the borrower makes less profit than that predetermined interest, is marked with unfairness and will result in bankruptcy and unemployment.<sup>86</sup> On the other hand, the lending process may result in fast enrichment of the borrower who makes high profit and will result in concentration of capital and unfairness.

In high inflation environments, unfairness occurs when the returns are below the rate of inflation, or when 'the net profit generated by the borrower is significantly higher than the return on capital provided to the

---

<sup>79</sup> *Ibid.*

<sup>80</sup> *Id* at 106 1598.

<sup>81</sup> *Id* at chapter 14 par 75 1584 usury (باب الربا) 743.

<sup>82</sup> *Ibid.*

<sup>83</sup> Order of the Pakistani Supreme Court's Appellate Bench in *Riba Case* (9 2000) 155–194 Review of Islamic Economics at: [http://www.financeinislam.com/article/1\\_11/1/435](http://www.financeinislam.com/article/1_11/1/435) (last accessed April 11 2011).

<sup>84</sup> Note 51 above at 156.

<sup>85</sup> Malik Mirza & Nabil Baydoun 'Accounting policy choice in an interest-free environment' Working Paper No 1999–014 at the Islamic Perspective International Conference III in Jakarta, Indonesia, 15–18 February, 1999.

<sup>86</sup> Note 23 above at 21.

lender.<sup>87</sup> Moreover, the economy may be affected because in an interest-based economy, interest, rather than profitability, will be the determining factor in allocations of capital.<sup>88</sup> This will contribute to instability of a system marked with inefficient allocation of available resources because of the limiting effects created by interest on allocation of resources, production, and distribution.

Prohibition of interest is not exclusive to Muslims.<sup>89</sup> The origin of norms in Christianity prohibits interest. It is said in the Bible ‘thou shalt not lend upon usury to thy brother, usury of money, usury of victuals, usury of anything that is lent upon usury’.<sup>90</sup> In Proverbs it is said that ‘he that by usury and unjust gain increase his substance, he shall gather it for him that will pity the poor’.<sup>91</sup> Thomas Aquinas and St Bonaventure did not accept the notion of reproductive money because ‘money does not re-produce itself,’ nor does it ‘bear fruit’. However, the industrial revolution and secularism which invaded Europe pushed towards a banking system based upon accepting deposits and lending out money for interest. This banking system allows for all financial operations, for example those involving interest, speculative contracts, gambling, short selling, and dealing in prohibited commodities, which are unappealing to the Islamic financial environment. Muslims have found alternative solutions offered by the introduction of the Islamic banking system tendering Islamic commercial principles to achieve the purposes of *shari’ah*.

### ***Purposive function of Islamic banking***

The functionality of Islamic banking in the corporate world is derived from conventional banking. Islamic banks offer services involving the accumulation of capital by creating facilities for savings to depositors which will be deployed in productive enterprises.<sup>92</sup> That is to say, the

---

<sup>87</sup> *Ibid.*

<sup>88</sup> *Ibid.*

<sup>89</sup> The prohibition of *riba* is known to the Greek and to the Jewish people. Aristotle regarded money as sterile and could not beget. For further reading about the history of usury, *riba* and interest, see Zamir Iqbal and Abbas Mirakhor *An introduction to Islamic finance theory and practice* (2ed 2011). See also, Abdulkader Thomas utilises the text in the Book of Ezekiel in order to trace the prohibition of *riba* by the Jewish teaching. See, Abdulkader Thomas *Interest in Islamic economics: understanding riba* (2006) 14–15.

<sup>90</sup> The Holy Bible (King James Version) Old Testament, Deuteronomy 23: 19 183.

<sup>91</sup> *Id* at Proverbs 28: 8 553.

<sup>92</sup> ‘Critics have likened Islamic banking operations “to contractum trinius” a method devised by European bankers in the Middle Ages to circumvent the church laws against charging interest on borrowed money.’ See, Nimrod Raphaeli ‘Islamic banking: reality and myth’ (9 October 2009) *MEMRI* at:

Islamic banking system has to create solutions for two technical problems, namely *riba* and accumulation of capital in order to comply with *shri'ah*

### ***Riba issue***

Islamic banks have overcome the issue of *riba* through the deployment of *halal* and *haram*-compliant commercial instruments. *Surah Al-Baqara* 2: 274 reads as follows: '...God has made buying and selling lawful, and *riba* unlawful ...' The wording of *Al-Baqarah* 2:276, which theorises the functionality of Islamic economy around fair trade that yields *halal* profit and prohibits interest that yields *haram* profit, provided Islamic banks with a way to justify profits yielded from Islamic financial products including Islamic cheque accounts, Islamic target save, Islamic savings accounts, Islamic vehicle and asset finance, Islamic wills, Islamic international banking, and *takafol* (تكافل) (motor vehicle and business insurance).<sup>93</sup> Presumably, these financial products comply with *shari'ah* utilising the definition of *mudaraba*, *musharaka*, and *murabaha* contemplated in the Bill. The focus of the Bill is on the definition of Islamic instruments for the purposes of taxation. The wording of section 24AJ is intended to mechanically comply with *shri'ah* standards.

### ***Accumulation of capital***

The accumulation of capital is, in essence, prohibited and Islamic banks have offered no practical justification for this practice. *Surah At-Tawbah* (التوبة) 9–34 reads as follows: '...And those who hoard gold and silver and spend it not in the way of Allah – give them tidings of a painful punishment.'<sup>94</sup> *والذين يكنزون الذهب والفضة ولا ينفقونها في سبيل الله فيشربهم بعداب (اليوم)* The focus of literature on Islamic banking does not include the norms prohibiting the accumulation of capital or the justification for the accumulation of capital. Probably, this is due to the wording of *At-Tawbah* 34, which may fall within the parameters of the ethical obligations. Nevertheless, *At-Tawbah* 34 also tenders a relaxation of the prohibition of accumulating capital as long as a legitimate spending process is in place. This argues for a purposive approach intended to achieve *maqasidial shari'ah* by promoting socio-economic development.<sup>95</sup>

---

<http://docstalk.blogspot.com/2009/10/islamic-banking-reality-and-myth.html> (last accessed 3 May 2011).

<sup>93</sup> <http://www.absa.co.za/Absacoza/Individual/Banking/Exclusive-Banking/Islamic-Banking> (last accessed 5 May 2011).

<sup>94</sup> The Holy Quran.

<sup>95</sup> A Saeed 'Islamic banking and finance: in search of a pragmatic model' in V Hooker & A Saikal (eds) *Islamic perspectives on the new millennium* (2004).



Islamic normative rules always intertwine ethical obligations with the compulsory obligations in order to achieve the objectives of the norms. The commencement of Islamic banking in the 1970s was based upon an ideal approach intended to promote the uniqueness of the Islamic financial environment, which is intended to achieve both compliance with the technical requirements of *shari'ah* by eliminating *riba* and by meeting *maqasidul shari'ah* which promotes social prosperity.<sup>96</sup> However, a pragmatic shift in Islamic banking and finances has changed the mode of finance to *shari'ah* mechanical adherence. For example, the concept of profit and loss-sharing (PLS) banking which favours public interest, has moved to a sales-based and debt-based system.<sup>97</sup> This shift derails Islamic banks from their social purposes and renders their functions questionable because Islamic normative rules construct regulatory frameworks revolving around *masalih*, which eliminate a positivist culture. Dusuki and Abozaid do not accept the *shari'ah* mechanical compliance by Islamic banks but focus rather on the economic substance in order to achieve social justice, economic growth, efficiency and stability.<sup>98</sup> They rely on many Muslim economists, including Sadr, Siddiqi,<sup>99</sup> Chapra,<sup>100</sup> Naqvi<sup>101</sup> etc<sup>102</sup> in order to prove that the Islamic banking reality has departed from the true spirit of the Islamic banking system.<sup>103</sup>

### Conclusion

Islamic normative rules do not prohibit Muslims from acquiring profits and accumulating the premier capital required for enterprises. This implies a tension between the norms prohibiting the treasuring of gold and silver, and the norms promoting social prosperity. The test applied is to examine

<sup>96</sup> Sadr, Muḥammad Bāqir (*Iqtisādunā*) *Our economics: An objective study consisting of the examination and criticism of the economic doctrines of Marxism, capitalism and Islam as concerns the fundamentals and details of their ideas* (1982) WOFIS Tehran.

<sup>97</sup> Abdul Rahim Abdul Rahman 'Islamic banking and finance: between ideals and realities' (2007) 15/2 *IIUM Journal of Economics and Management* 123–141.

<sup>98</sup> Dusuki & Abozaid 'A critical appraisal on the challenges of realizing maqasid al-shariaah in Islamic banking and finance' (2007) 15/2 *IIUM Journal of Economics and Management* 145.

<sup>99</sup> MN Siddiqi *Issues in Islamic banking* (1982). Also MN Siddiqi *Partnership and profit-sharing in Islamic law* (1985).

<sup>100</sup> MU Chapra *The future of economics: an Islamic perspective* (2000). Also MU Chapra 'Why has Islam prohibited interest: rationale behind the prohibition of interest' (2000) 9 *Review of Islamic Economics* 5–20.

<sup>101</sup> SNH Naqvi *Perspective on morality and human well-being: a contribution to Islamic economics* (2003).

<sup>102</sup> Note 85 above.

<sup>103</sup> *Ibid*

the *modus operandi* of Islamic banks relating to achieving *maqasdul shari'ah*. That is to say, if Islamic banks do not achieve *maqasdul shari'ah* by substantial involvement in socio-economic development, they *de facto* do not comply with Islamic normative rules. The introduction of section 24AJ does not promote the involvement of Islamic banking, but rather regulates issues relating to taxation without catering for the concept of PLS. It seems that section 24AJ has been moulded according to South African Islamic banking methods which provide for *shari'ah*-technical compliance without sufficient attention to *maqasdul shari'ah*.

The challenge that the Islamic banking sector in South Africa could face is a loss of confidence in Islamic financial products. This may push depositors and lenders to deal with Islamic banks which are not South African, so depriving the South African economy of Islamic capital and financial transactions. In order to overcome these issues, Islamic banks should offer two categories of services. The first category comprises business enterprises that are useful in making profits influenced by the capitalist economic values. The second category comprises business and enterprises reflecting other stakeholders, such as employees, creditors, government and society pointing to *shari'ah* compliance. This requires a new approach, by which Islamic banks include certain regimes intended to introduce financial products such as *qardul hasan*, charity, substantial involvement in microfinance activities, etc. These regimes are intended to justify profits and maintain *maqasidul shari'ah* and *masalih* by which Islamic banks are required to involve themselves in the general upliftment of the people, the redistribution of wealth and the eradication of poverty, as well as social development and prosperity.