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A CRITICAL APPRAISAL ON THE CHALLENGES OF REALIZING *MAQAêID AL-SHARi¦CAH* IN ISLAMIC BANKING AND FINANCE

Asyraf Wajdi Dusuki[a]
Abdulazeem Abozaid[b]

[a]*Head Research Affairs, International Shariah Research Academy for Islamic Finance (ISRA), 2nd Floor Annexe Block, Menara Tun Razak, Jalan Raja Laut, 50350 Kuala Lumpur, Malaysia (email: asyraf@incief.org)*
[b]*Lecturer, Damascus University, Damascus, Syria (abozaid.abdulazeem@gmail.com)*

ABSTRACT

Islam harbours an economic vision that holds the key to a social order capable of providing social justice along with economic prosperity. This vision is deeply inscribed in the objectives of *shar¥¢ah*, also known as *maqŒ§id al-shar¥¢ah*. Consequently the doctrine of Islamic economics entered debates over the social-welfare role of Islam. It has somehow pursued the goal of restructuring economies according to perceived Islamic teachings and principles. Its most visible practical achievement is the establishment of Islamic banks meant to avoid interest and promote Islamic norms of economic behaviour and ultimately realizing the noble objectives of *shar¥¢ah*. This paper examines the challenges of the proper realization of *maqŒ§id al-shar¥¢ah* in Islamic banking and finance. These challenges cover various issues: the proper understanding of *maqŒ§id al-shar¥¢ah* in Islamic economics; the methods of implementing *maqŒ§id al-shar¥¢ah* in Islamic banking and finance; the potential conflicts between macro *maqŒ§id* and micro *maqŒ§id*; and the possible abuse of *maqŒ§id al-shar¥¢ah* to justify certain financial contracts which in fact contradict the *shar¥¢ah* texts. The paper analyses these challenges and provides examples from the current practices of Islamic banks and financial institutions.

JEL Classification: Z12, G10, K00

Keywords: Islamic economics, Islamic banking, *MaqŒ§id al-Shar¥¢ah*

1. INTRODUCTION

The 20th century spawned a movement committed to developing an Islamic variant of economics. After a long period of colonial domination of Muslim countries by Western imperialists, the movement for Islamisation in all spheres of life started to gain momentum and acceptance. These movements started in the Middle East and had influenced neighbouring continents to promote what was claimed as a turning back to the actual and complete practice of the Islamic way of life. The economic Islamisation campaign enjoyed at least tacit support of politicians and intellectuals of many Muslim countries like Malaysia, Iran, Pakistan and Sudan (Henry and Wilson, 2004).

Consequently, Islamic banking and finance emerged as one of the fastest growing industries. It spread to all corners of the globe and received wide acceptance by both Muslims and non-Muslims alike (Iqbal and Molyneux, 2005). Extensive literature proclaims that Islamic banking differs significantly from conventional banking, not only in the ways they practice their businesses, but above all, the values which guide Islamic banking operations and outlook. The values which prevail within the ambit of the *shar¥ªah*, are expressed not only in the details of its transactions, but also in the breadth of its role in realizing the *maqŒ§id al-shar¥ªah* (objectives of *shar¥ªah*).

Indeed, *maqŒ§id al-shar¥ªah* reflects the holistic view of Islam, as Islam is a complete and integrated code of life encompassing the individual and society, in this world and the hereafter. Hence, a deep understanding of the *maqŒ§id al-shar¥ªah* entails intense commitment of every individual and organisation to realise justice, brotherhood and social welfare. This will inevitably lead to a society whereby every member cooperates with each other and even competes constructively, as success in life is to obtain *falŒú* (ultimate happiness). Thus, mere maximisation of profits cannot be a sufficient goal for a Muslim society. Maximisation of profit must be accompanied by efforts directed to ensure spiritual health and consciousness, as well as justice and fair play at all levels of human interaction. Only development of this kind would be in conformity with the *maqŒ§id al-shar¥ªah* (Chapra, 2000a).

Hence, the restricted view of understanding the *shar¥ªah* by only focusing on the legal forms of a contract needs to be changed. Instead, the 'substance' of the *shar¥ªah*, that has greater implications for the realisation of *maqŒ§id al-shar¥ªah*, should be equally looked into especially in structuring a financial product. Otherwise, Islamic banks

are just an exercise in semantics; their functions and operations are no different from conventional banks, except in their use of euphemisms to disguise interest and circumvent the many *shar¥ᶜah* prohibitions.

This paper aims at analysing the challenges in realising the *maqœ§id al-shar¥ᶜah* in contemporary economic transactions, particularly with respect to the development and operation of Islamic banking and finance. These challenges stem from the improper handling and sometimes misleading application of various tools of Islamic jurisprudence including *maqœ§id shar¥ᶜah* and *ma§laúah*. The concept of *maqœ§id al-shar¥ᶜah* will be delineated in detail so as to shed light on its application in modern day practices of *muᶜœmalœt*. The examples of various forms of controversial products implemented will be discussed to illustrate the problems of misunderstood application of the *maqœ§id* and *ma§laúah* in legitimising contracts that substantially go against the spirit of the *maqœ§id al-shar¥ᶜah*.

Following this brief introduction, the next sections will illustrate the divergence of Islamic banking and finance practice from its idealised version proposed by many Muslim economists; this is followed by a discussion of the fundamental principles of *shar¥ᶜah;* the next section evaluates the application of the *maqœ§id al-shar¥ᶜah* and *ma§laúah* in Islamic banking and finance; and the final section provides a summary and conclusion.

2. OLD SKELETON IN A MODERN DRESS

Islamic banks made their first appearance in the 1970s. Since their inception, massive efforts have been made to portray them as analogous to an ancient financial organization based on profit-loss-sharing (PLS) mechanism, particularly *mushœrakah* and *muèœrabah*. Muslim economists including Sadr (1982); Siddiqi (1983, 1985); Chapra (2000a, 2000b) Ziauddin Ahmad (1984); Ahmad (2000); Siddiqui (2001); Haron (1995, 2000); Rosly and Bakar (2003); Haron and Hisham (2003); Naqvi (2003) and many others favour equity-based instruments and place greater social welfare responsibilities and religious commitment upon Islamic banks in order to realize the *maqœ§id al-shar¥ᶜah* with respect to economic and financial transactions, including social justice, equitable distribution of income and wealth and promoting economic development and growth. These writers even go further to argue that equity-based financing is the only principle representing the true spirit of the Islamic banking system which departs significantly from the interest-based

system. Although they do not fully negate the use of other *shar¥¢ah* permissible debt-based contracts alongside the equity-based contracts, they assert that the socio-economic objectives including social justice, economic growth, efficiency and stability that Islamic economics seeks to achieve, is better served by resorting to primarily equity-based contracts. They almost consistently affirm that the Islamic banking model should predominantly be based on equity to be congruent with the spirit of *shar¥¢ah* and overall Islamic worldview. In their opinion, for Islamic banks to be different from conventional banks, they must aim at promoting Islamic norms and values as well as protecting the needs of Islamic society as a whole without undermining its commercial viability. For example, the replacement of interest-based financial intermediation by PLS modes of financing would inevitably promote small and medium entrepreneurship or micro-entrepreneurs. Unlike conventional banks with their collateral-based lending and creditworthiness paradigm that favours more established businesses and corporate clients, Islamic banks, with their emphasis on PLS instruments are compatible with the needs of micro-entrepreneurs. Hence, small entrepreneurs with viable projects that are normally shunned by conventional banks due to insufficient collateral might be financed by Islamic banks[1]. Therefore, according to Haron (1996), the Islamic banking system will become an efficient model in mobilising and allocating resources in the economy as a result of interest elimination and the introduction of profit-sharing concepts. Entrepreneurs, for example, by associating themselves with Islamic banks will become more ethical in conducting their businesses in such a way that funds will be used properly and the sense of selfishness is reduced considerably (Haron, 1996).

2.1 IDEAL VERSUS REALITY

Despite the strong tendency in the literature to emphasise the theoretical superiority of Islamic banking based on PLS over conventional banking, the practices of Islamic banks are found to diverge in significant ways from the intellectual doctrines underpinning their role in the economy. Almost all Islamic banks across the globe today resort to the second line fixed return techniques or debt-based instruments. Observers point out that the use of PLS instruments, namely *muèŒrabah* and *mushŒrakah* financing have declined to almost negligible proportions (Iqbal and Molyneux, 2005; Kuran, 2004; Lewis and Algaud, 2001;

Yousef, 2004). In many Islamic banks' asset portfolios, short-term financing, notably *murœbaúah* and other debt-based contracts account for the great bulk of their investments. Yousef (2004) refers to the strong and consistent tendency of Islamic banks to utilise debt-like instruments in the provision of external finance as the '*murœbaúah syndrome.*' Many Muslim economists now acknowledge that Islamic banks are avoiding risky investments. Ahmad al-Naggar, an Egyptian whom Islamic economists credit with founding the first Islamic bank (Mit Ghamr, Egypt), characterizes the existing Islamic banks as terrible failures. Their operations differ only cosmetically, he says, from those of conventional banks. Indeed, only a minuscule portion – generally well under 5 percent – of the assets of Islamic banks consist of loans based on genuine profit-loss-sharing (Kuran, 2004).

There is a strong tendency for Islamic banking today to be modelled after conventional banking although the latter is clearly based on *ribœ'* or interest, which Islam totally rejects. A thorough and rational examination of some basic financing modes as practiced by some Islamic banks and financial institutions will prove that they are no different from those offered and practiced in the conventional banks and financial institutions. The only difference the examiner may find is in the technicalities and legal forms, while in essence, the substance is the same. For example, the bank sells you an asset for RM30,000 and you owe the bank RM33,000, a year from now after you sell back the same asset to bank. This arrangement is an example of *bayᶜ al-ᶜ¥nah* which is acceptable from the standpoint of Islamic banking practice in Malaysia, but looks to the outsider like a simple loan at 10 percent interest. Repaying by five yearly instalments of RM7,913.92 would be equally acceptable and also implies an interest rate of 10 per cent. In fact Islamic bankers use the same financial computation just like other bankers to calculate present and future values of investments. Hence, at the end of the day, unconvinced Muslims and other critical outsiders, observe that Islamic banks in reality keep interest but just call it by another name, such as commissions or profits (*ribú*).

A more distressing scenario is when many Islamic contracts are either misused or abused. These contracts of sale are often used as a legal trick (*ú¥lah*) to circumvent the prohibition of *ribœ'*. *Bayᶜ bithaman œjil* (deferred sales contract) which is widely practiced by Islamic banks in Malaysia and Brunei, is an example of such an abuse of sale contract. While *shar¥ᶜah* requires a selling party to hold all liability arising from all defective goods sold based on *khiyœr al-ᶜayb* rules, in practice, the

Islamic bank holds no such liability. Apparently, the Islamic bank transfers all the risks and liabilities to the customer, thereby leaving the bank with practically no risk to bear while securing profits which are fully guaranteed by way of executing a sale contract i.e. *bayᶜ bithaman Œjil*.[2]

Another example is the *rahn* contract, which is originally meant to be used as a means of documenting a debt. But in some Islamic banks it is used to generate profit under a transaction called Islamic Pawn Broking. In this transaction, the Islamic bank will provide its customer with a so called benevolent loan on condition that the latter provides a *rahn*; e.g. valuable jewellery to be kept by the bank as collateral; however, the problem arises when the Islamic bank charges this customer the custodianship fee of this jewellery. The amount of this charge is subject to the amount of the loan and, in practice, equivalent to the bank rate of profit.

3. THE MISGUIDED JUSTIFICATIONS

The proponents of current controversial practices of Islamic banks and financial institutions argue that Islamic banks need to be dealt with leniently especially at its infancy stage. Thus, the main reason for allowing Islamic banks to practise certain controversial contracts is to facilitate their development and to ensure sustainability and viability amid the hegemony and prevalence of conventional banks and the interest-based economic systems. Otherwise, Islamic banks would be doomed to fail, and their failure is a failure of the whole Islamic economics project, which in turn affects the very project of the modern Islamic state. This necessitates a more flexible and a liberal approach when structuring the Islamic financial system, its products and services. They base their arguments on various *sharᶦᶜah* concepts including *al-siyŒsah al-sharᶜiyyah*, *maqŒ§id al-sharᶦᶜah*, *ma§laúah* and *èar´rah*.

To further address this issue we need to examine these concepts in detail in order to have a better understanding of how to approach the contemporary issues of financial transactions. The following sections delineate some of the common tools used to construct and develop *sharᶦᶜah*-compliant financial products and services.

3.1 *AL-SIYASAH AL-SHARᶜIYYAH*

Al-siyœsah al-sharᶜiyyah refers to the area in Islamic jurisprudence that explains rulings related to policies and approaches taken in managing and organising national policies in accordance with the spirit of the *shar¥ᶜah*. It covers a whole spectrum of issues in areas like economics, the judiciary, peace, international relations etc.[3] Indeed, the concept of *al-siyœsah al-sharᶜiyyah* entails an in-depth comprehension of the function of *ma§laúah* (public interest). Indeed, the relationship between *al-siyœsah al-sharᶜiyyah* and *ma§laúah* emerges from the fact that Muslim rulers must govern the state and public affairs to achieve *ma§laúah*. Realization of *ma§laúah* and prevention of evil must be the basis as well as the objective of an Islamic state's ruling, which should be embedded as part of the noble mission and responsibility to apply *shar¥ᶜah* and impose its rulings.

The management and administration of economic matters, known as *al-siyœsah al-sharᶜiyyah al-iqti§œdiyyah* is a branch of *al-siyœsah al-sharᶜiyyah*. Consequently, it is governed by the same principle, namely the realization of *ma§laúah* or specifically *al-ma§laúah al-iqti§œdiyyah*, which is the duty and mission of every Muslim ruler. A government policy must not contradict *shar¥ᶜah* injunctions. However if there is any conflict between the two, the latter must prevail since a Muslim ruler does not have the right to overrule definitive *shar¥ᶜah* rulings.[4] In other words, the Muslim ruler is neither authorised to permit the forbidden nor to forbid the permissible. If he does so then his governance is illegitimate and must not be observed even with proclamation of preservation of *ma§laúah*. This is because his mission is to apply the *shar¥ᶜah* rulings in its totality and not to alter the well-established *shar¥ᶜah* rulings on the ground of his own perception of *ma§laúah*.

If the definitive *shar¥ᶜah* (*qaᶜᶜiyyœt*) rulings can be overruled by *al-siyœsah al-sharᶜiyyah*, then the sanctity of *shar¥ᶜah* texts will be breached. Any person may then overrule and alter any *shar¥ᶜah* ruling according to his own perspective and interpretation of *ma§laúah*. Hence, the *shar¥ᶜah* will no longer be claimed as a divine law, rather a man-made law since it can be altered and adjusted according to people's perceptions. Therefore, changing the definitive *shar¥ᶜah* rulings or tampering with *shar¥ᶜah* texts is not within the purview of the functionality of *al-siyœsah al-sharᶜiyyah*.

3.2 *MAQAêID AL-SHARi^{C}AH*

Maq§id al-shar¥ah are the objectives and the rationale of the *shar¥ah*. A comprehensive and careful examination of the *shar¥ah* rulings entails an understanding that the *shar¥ah* aims at protecting and preserving *ma§laúah* in all aspects and segments of life.[5] Many *shar¥ah* texts state clearly the reasoning behind certain *shar¥ah* rulings, suggesting that every ruling in *shar¥ah* comes with a purpose, which is to benefit the *mukallaf*. For example, when the Qur'Ćn prescribes *qi§§* (retaliation), it speaks of the rationale of it, that applying retaliation prevents further killing *"There is life for you in qi§§."*[6] Similarly, when the Qur'Ćn prohibits wine it says that wine is the work of the devil as it causes quarrels and instills hatred and enmity among Muslims.

> "The devil only wants to excite enmity and hatred between you in intoxicants and gambling and hinder you from remembrance of Allah and from prayer."[7]

In depth comprehension of the objectives of *shar¥ah* is important for analogical deduction and other human reasoning and its methodology (Kamali 1999). Indeed, *maq§id al-shar¥ah* allows flexibility, dynamism and creativity in social policy (Zuhrah 1958; Mumisa 2002; Hallaq 2004). According to al-Imćm Al-Ghazćl¥ (d.1111)

> "The objective of the *shar¥ah* is to promote the well-being of all mankind, which lies in safeguarding their faith (*d¥n*), their human self (*nafs*), their intellect (*'aql*), their posterity (*na§l*) and their wealth (*mćl*). Whatever ensures the safeguard of these five, serves public interest and is desirable." (Chapra, 2000a)

Al-Shć‹ib¥ approves al-Ghazćl¥'s list and sequence, thereby indicating that they are the most preferable in terms of their harmony with the essence of *shar¥ah*. Generally, *shar¥ah* is predicated on benefits of the individual and that of the community, and its laws are designed so as to protect these benefits, and facilitate improvement and perfection of the condition of life on earth. This perfection corresponds to the purposes of the Hereafter. In other words, each of the worldly purposes (preservation of faith, life, posterity, intellect and wealth) is meant to serve the single religious purpose of the hereafter (Nyazee, 2000).

The uppermost objectives of *shar¥ᶜah* rest within the concept of compassion and guidance,[8] that seek to establish justice, eliminate prejudice and alleviate hardship. It promotes cooperation and mutual support within the family and society at large. This is manifested in the realisation of *ma§laúah* (public interest) which the Islamic scholars have generally considered to be the all-pervasive value and objective of the *shar¥ᶜah* and is for all intents and purposes, synonymous with compassion. *Ma§laúah* sometimes connotes the same meaning as *maqŒ§id* and scholars have used the two terms almost interchangeably (Abdel Kader, 2003). To further shed light on our discussion of the objectives of *shar¥ᶜah*, especially with regard to their application in the preservation of public interest, the following section elaborates on the principles of *ma§laúah*, serving as an important tool to uphold the *shar¥ᶜah*.

3.3 *MAêLA Î AH*

Ma§laúah is one of the juristic devices that have always been used in Islamic legal theory to promote public benefit and prevent social evils or corruption. The plural of the Arabic word *ma§laúah* is *ma§Œliú* which means welfare, interest or benefit. Literally, *ma§laúah* is defined as seeking the benefit and repelling harm. The words *ma§laúah* and *manfaᶜah* are treated as synonyms. *Manfaᶜah* (benefit or utility), however, is not the technical meaning of *ma§laúah*. What Muslim jurists mean by *ma§laúah* is the seeking of benefit and the repelling of harm as directed by the Lawgiver or *shar¥ᶜah.*[9]

Amongst the major schools of Islamic jurisprudence, ImŒm MŒlik is known to be the leading proponent of upholding *ma§laúah* as one of the sources of *shar¥ᶜah*. He uses the term "*al-ma§Œliú al-mursalah*" to connote interests which have not been covered by other sources of *shar¥ᶜah.*[10] On the other hand, the majority of other jurists reject it as a source of *shar¥ᶜah,* though they practiced it without theoretically admitting its authority as an independent source of the *shar¥ᶜah*. However, al-GhazŒl¥ (who is from the ShŒfiᶜ¥ school), uses the term *isti§laú* (seeking the better rule for public interest) but never claims it as the fifth source of *shar¥ᶜah*. He also restricts its application to situations that are deemed necessary to serve the interest of the public.

On the other hand, those who oppose *ma§laúah mursalah* as one of the independent sources of *shar¥ᶜah* argue that by endorsing this principle, it implies giving human beings a legislative authority which is premised on human perception of what is good and what is bad. Thus,

it sometimes functions in isolation from *shar¥ah* texts even though it may be based on certain legal principles in addressing a particular issue which is not clearly mentioned in any *shar¥ah* sources. This may imply that *ma§laúah* may indirectly nullify the textual rulings and their legislative authority.[11]

3.4 THE MODERN APPROACH TO *MAêLA î AH*

The modern approach to *ma§laúah* is directly related to *maqŒ§id al-shar¥ah* since the realization of *ma§laúah* itself is the primary objective of the *shar¥ah*. Here *ma§laúah* is supposed to play a bigger role as it is an indispensable criterion when reexamining and revaluating some *aúkŒm shar^ciyyah* (*shar¥ah* rulings). To comprehend this, we need to investigate the circumstances that led to this approach.

Apparently, Muslims today find themselves at a very low position, vis-a-vis other civilizations. Their past superiority in different areas and disciplines such as in the sciences and economics have been superseded by others, especially the West. Some Muslim intellectuals put the blame on religion and further argued that the *shar¥ah* was incompatible, and mostly posed a hindrance to modern civilization. Subsequently, these people called for a revisit of *aúkŒm shar^ciyyah* on the basis of *ma§laúah*. For them *ma§laúah* can function as the sole criterion to determine whether *shar¥ah* rulings can be maintained or altered and amended to meet the contemporary needs and interests. Moreover *ma§laúah* is also perceived as a means to specify a general text or as a qualifier to an absolute text. Their justification is that *ma§laúah* has already been recognized as one of the *shar¥ah* sources, and recognized by prominent scholars like al-ShŒ‹ib¥ in his *MuwŒfaqŒt*.[12]

3.5 EVALUATION OF THE MODERN APPROACH TO *MAêLA î AH*

The crux of the problem in the modern approach to *ma§laúah* lies in overemphasizing *ma§laúah* and treating it as a priority over textual *shar¥ah* sources. In other words, if there is a conflict between textual evidences and *ma§laúah*, the latter is presumed to prevail. This section evaluates some exaggerations and misconceptions in modern applications of *ma§laúah*.

First, the claim that conflict between the *shar¥ah* text and *ma§laúah* as inevitable is an erroneous presumption. If we believe that *aúkŒm shar^ciyyah* aims at the realization of *ma§laúah*, then why

do we assume a potential conflict is inevitable between *shar¥ᶜah* text and *ma§laúah?*

Second, even if such a conflict exists, it is the *shar¥ᶜah* texts that should be given priority over *ma§laúah*. This is particularly true when *ma§laúah* itself derives its authority from the *shar¥ᶜah* text and not vice-versa. It is illogical if one gives priority to a branch over its core and source of authority. Therefore, there is no reason for *ma§laúah* to be in conflict with the *shar¥ᶜah* text in any manner.[13]

Third, the approach of giving priority to *ma§laúah* fails to distinguish between the *qaᶜiyyℭt* (definitive) and the *½anniyyℭt* (speculative) texts. If the text is definitive with regards to its authenticity (*thub´t*) and meaning (*dilℭlah*), then the ruling it produces is final and binding; i.e. there is no room for human perception of *ma§laúah* to add any interpretation to the text in any way they see fit.[14] While, if the text is speculative with regards to its authenticity or meaning, then there may be avenues for *ma§laúah* to further interpret and give meaning to the text in a way that does not hinder its realization. This is acceptable as long as the perceived *ma§laúah* meets all its conditions: being public not private, authentic not false, definitive not probable.[15]

Fourth, the issue of potential conflict between a definitive *shar¥ᶜah* text and *ma§laúah* is not conceivable if we refer *ma§laúah* to the *shar¥ᶜah* point of view. However, if we are referring *ma§laúah* to human opinion then conflict is plausible. Since legitimacy of *ma§laúah* rests upon human perception alone, the rulings inevitably require continuous alteration and modification according to people's expectation and beliefs.

According to al-Shℭ‹ib¥, the determination of what is beneficial and what is harmful cannot be left to human reasoning alone.[16] Human reasoning plays a role only in a framework guided by the *shar¥ᶜah* (Nyazee, 2000). Islam recognises the role of reason and experience in theorising economic behaviour and business activities only in a manner that embraces the transcendental aspects of human existence. This is because the inherent limitations in human beings posit a strong case that requires Divine guidance to ascertain what is right and what is wrong. Hence, according to Ahmad (2003), the rational faculties can and should be used to complement, support and strengthen ethics and morality defined by the *shar¥ᶜah*.

Nevertheless, upon presuming an occurrence of a genuine conflict between the *shar¥ᶜah* text and *ma§laúah*, then as Muslims, we have to follow the text and ignore the perceived *ma§laúah*, simply because

being Muslims requires us to abide by all the *shar¥ᶜah* rulings regardless of whether we are convinced or aware of their usefulness. Furthermore, there is a devotional dimension (*ᶜibŒdah*) in every single *shar¥ᶜah* ruling, even if it is not directly related to ritual practices such as prayer and fasting. Therefore, observing the *shar¥ᶜah* conditions and requirements on contracts or transactions is also a form of *ᶜibŒdah*, while omitting one of them is an offence that may result in invalidating the contract, let alone its impermissibility.

4. ISLAMIC FINANCE AND *MAQĀêID AL-SHARi ᶜAH*

The preceding sections have elaborated on the fundamental principles of *shar¥ᶜah*, particularly in dealing with mundane affairs of human beings. Our next focus is to evaluate the application of the *shar¥ᶜah* tools especially with respect to *maqŒ§id al-shar¥ᶜah* and *ma§laúah* in Islamic banking and finance. Indeed, one of the biggest challenges of the Islamic banking and finance industry today is to come up with products and services that are *shar¥ᶜah* compliant or legitimate from an Islamic point of view, without undermining the business aspects of being competitive, profitable and viable in the long run.

4.1 *SHARi ᶜAH*-COMPLIANCE: VALIDITY VERSUS PERMISSIBILITY

The first question that needs to be raised is what should be the basis in justifying whether a product is *shar¥ᶜah* compliant or not? In other words, what are the approaches in *fiqh* when determining whether a contract is valid and permissible from *shar¥ᶜah* perspectives?

Schools of *fiqh* differ on the issue of determining the basis of contract validity (*§aú¥ú*). Some emphasize on its legal form while others stress on its substance and the intention of contracting parties. These differences can be attributed to the *shar¥ᶜah* texts as there are some who base their opinion on a *úad¥th* that "matters are determined by intention."[17] Based on this *úad¥th*, validity of all contracts must be determined by *niyyah* (intention), i.e. the purpose or substance of the contract, not by just looking at its form or structure alone. However, some scholars like al-ImŒm al-ShŒfiᶜ¥ found it impractical to determine the validity of contracts by means of intention, as it is difficult and sometimes impossible to identify the intention of the contracting parties. Moreover, they found some *shar¥ᶜah* texts suggesting that judging things must be based on their form and appearance.[18]

To reconcile between these two conflicting texts in a practical way, scholars distinguished between two types of *úukm* (ruling): *úukm qaèœ¥* and *úukm diyœn¥*. The former is concerned with contracts that comply with all *shar¥ᶜah* conditions and requirements pertaining to a contract in its form and structure, while the latter is concerned with compliance of the substance or contract purpose which must be in line with the *shar¥ᶜah*. If the contract structure is *shar¥ᶜah* compliant, then it could be termed as a valid contract (*§aú¥ú*). On the other hand, if all of the purposes of the contracting parties i.e. the substance of the contract are *shar¥ᶜah* compliant, then it is termed as permissible (*úalœl*). Thus, a transaction is deemed to be *úalœl* when it serves the legal purpose and intention, and *§aú¥ú* if the contract meets all contractual conditions and requirements. Consequently, a *§aú¥ú* (valid) contract is not necessarily *úalœl* (permissible).[19]

The first approach represents the Î anaf¥ and Shœfi'¥ position while the Mœlik¥ and Hanbal¥ schools emphasize that validity of a contract must be based on the real intention or the substance of the contract.[20] Apparently, the scholars of *fiqh* only differ in terms of determining the validity of a contract. However the *fuqahœ'* never differed on the issue of determining the permissibility of a contract on its substance or the intentions of the contracting parties. Even al-Shœfi'¥ gave examples of instances when real intention does invalidate a contract such as selling of grapes to a winery, or selling arms to the enemy (whose intentions must be to attack the Muslims). This implies that the emphasis on the form or expressed intention is more applicable when the real intention is difficult to determine.

4.2 CONTROVERSIES OVER ISLAMIC FINANCIAL PRODUCTS

The foregoing discussion has indicated that scholars generally agree that for an Islamic financial product to be deemed as *shar¥ᶜah* compliant, the contract must be both valid and permissible. This somehow raises an issue whether current Islamic banking and finance products indeed follow the same principles.

Perhaps the most controversial product of Islamic banking and finance is *bayᶜ al-ᶜ¥nah* (buy-back sale) which is widely practiced in Malaysia. Many financial applications are based on *bayᶜ al-ᶜ¥nah* such as *bayᶜ bithaman œjil* (deferred cost-plus sale), Islamic credit card (*bayᶜ al-ᶜ¥nah* model), Islamic private debt securities (IPDS) and Islamic overdraft facility. In all these applications the Islamic bank is supposed

to act as a trader selling or buying as the word '*bayᶜ*' suggests, but in reality, we find the Islamic bank merely acting as a financier who provides money without taking any risk and without being involved in the investment process, if any.

Bayᶜ al-ᶜ¥nah here is resorted to as a legal device (*ú¥lah*) to circumvent *ribŒ'*-based financing, but as far as the substance is concerned *bayᶜ al-ᶜ¥nah*-based financing and the conventional *ribŒ'*-based financing are the same. They serve exactly the same purposes, and share exactly the same economic substance and consequences, albeit their form may be different.

However, as discussed earlier, the legal form is not sufficient to certify and justify the permissibility of a contract, although it may be perceived otherwise for validity. Therefore, to claim permissibility by merely referring to the legal form of the transaction is definitely undermining *ijmŒᶜ* (consensus of jurists) and goes against the very principles of *shar¥ᶜah* and religion in general. Some contemporary practices in Islamic banking and finance have maintained the legality of the form but neglected the legality of the substance, despite the fact that the objective of form is to help in ensuring the compliance of the substance to the *shar¥ᶜah* and not for itself. This explains why the *fuqahŒ'* have compromised the form in many examples but never compromised the substance.

As a case in point, let us look again at a contemporary application of Islamic pawn broking. In this financing instrument**,** the bank offers the client a benevolent loan by stipulating a pawn as an exchange to be deposited under the bank's custodianship. Eventually, the bank generates profits out of this benevolent loan transaction by levying a custodial fee for the safe keeping of the pledged asset. Ironically, this custodial fee is equivalent to the interest rate imposed on such a loan.

If observing *maqŒ§id al-shar¥ᶜah* naturally entails observing the rationale and the spirit of the texts, then observing only the form and the structure of the contracts functions against the very concept of *maqŒ§id al-shar¥ᶜah*. Surprisingly enough, *maqŒ§id al-shar¥ᶜah* has been used here as a justification for the adoption of such controversial transactions, though observing *maqŒ§id al-shar¥ᶜah* must be the first factor to determine their prohibition.

4.3 MACRO *MAQÂêID* VERSUS MICRO *MAQÂêID*

One may think that by legalizing some controversial transactions such as *bayª al-ª¥nah* the macro *maqŒ§id* are observed. What we mean by macro *maqŒ§id* here is the interest or benefits related to the overall well-being and welfare of the society, which has been the objective of Islamic economics for so long; whereas micro *maqŒ§id* relates primarily to micro issues pertaining to individual financial transactions. Obviously, in this regard, macro *maqŒ§id* is given more attention and it is the concern and focus rather than any micro *maqŒ§id*. These macro *maqŒ§id* manifest themselves in structuring an Islamic economy and pushing it forward to compete with, and supersede, the conventional banks at least in the Muslim countries. On the other hand, we may argue that maintaining the prohibition of certain transactions help observe a particular *maqŒ§id* of certain detailed rulings, but at the expense of the macro *maqŒ§id* of *shar¥ªah*. Whereas the latter aims at building a strong, just economic system.

To address this issue, we need to recall our previous discussion regarding the conflict between perceived *ma§laúah* and *shar¥ªah* texts. To recapitulate, the *shar¥ªah* texts must always prevail over perceived *ma§laúah*. Only by acknowledging this hierarchy can the realization of *ma§laúah* for human beings be achieved, since we recognize the authority of the lawgiver Himself, Who is the Most Knowledgeable and the Most Wise. In other words, the determination of *ma§laúah* in terms of what is beneficial and what is harmful cannot be left to human reasoning alone. Instead, as Muslims, we should put high recognition to what has been prescribed by the Lawgiver in the *shar¥ªah* texts. In this regard, Ibn Taymiyyah says: 'What constitutes a *ma§laúah* or a *mafsadah* is subject to the *shar¥ªah* standards.'[21] Al-Dahlaw¥ says: 'Our lawgiver is more trustworthy than our reasons.'[22]

If there was any kind of *ma§laúah* in *ribŒ'* or its resemblance of buy-back sale-based on legal tricks, then the Lawgiver would not have considered *ribŒ'* as the worst of evils and one of the gravest sins that invoke a strongest curse and declaration of war by the Almighty. The Qura'an says: "But God has permitted sale and forbidden *ribŒ'"* (2:275) and, "God destroys/eliminates *ribŒ';*" (2:276) and, "O ye who believe, fear God and quit what remains of *ribŒ'* if ye are indeed believers; but if ye do it not, take notice of war from God and His Messenger" (2:278-279). No other sin is prohibited in the Qur'Œn with a notice of war from God and His Messsenger.

4.4 OVERULING PROHIBITED PRACTICES ON THE GROUNDS OF *ëARÇRAH*

ëar´rah, which means necessity, unanimously renders the prohibited things permissible as this constitutes a well-established *fiqh* maxim in the *shar¥cah* "Necessities permit the forbidden" (*al-èar´rŒt tub¥ú al-maú½´rŒt*). However, when jurists discussed and explained the applications of this *fiqh* maxim they mentioned what is known in Arabic as *èŒwŒbi‹*, which means conditions and guidelines, for the functionality of this maxim. These guidelines are of course stated in or derived from *shar¥cah* texts. The first guideline (*èŒbi‹)* is: what constitutes a *èar´rah*. The jurists' approach to the concept of *èar´rah* can be summarized by saying that *èar´rah* is something which is indispensable for the preservation and protection of the five essential values or *ma§Œliú*: Faith, Life, Intellect, Posterity, Wealth.[23] This means the concept of *èar´rah* would give the *mukallaf* legal excuse to commit the forbidden; what is indispensable for his survival, spiritually and physically.[24]

Applying the principle of *èar´rah* to the case of the Islamic bank may not be appropriate. Even if we rightly presume that such products are inevitable for the Islamic bank's survival and long-term sustainability due to certain considerations, the argument is that the very concept of bank itself is not indispensable for the *mukallaf's* survival from the *shar¥cah* perspective. If such *èar´rah* hypothetically exists, then it would rather legitimize dealing with conventional banks directly.

Obviously, when the *shar¥cah* prohibits something it always provides alternatives. For example when *shar¥cah* prohibits *zinŒ* it permits marriage, when it prohibits wine and pork for consumption it permits all other sorts of food and drinks. Likewise, when the *shar¥cah* prohibits certain contracts such as contracts based on *ribŒ'* and gambling, it alternatively permits many contracts like sale, lease, *salam*, *istisnŒc*, *muèŒrabah* and *mushŒrakah*. To economists, such contracts are better alternatives to *ribŒ'* and gambling, and ultimately can help to produce a prosperous and healthy economy. On the other hand an economy based on *ribŒ'* and gambling which is premised on exploitation, leads to disparity and inequitable wealth distribution between the rich and poor.

So, where is the *èar´rah* that may allow Muslims to abandon these beneficial contracts in favour of harmful and destructive ones? Legalizing a forbidden thing on the grounds of *èar´rah* is supposed to solve a problem, not to create a bigger one. Islamic banks have been in the business for more than three decades, and so far they still offer the the

same excuses of *èar´rah* and the impracticality or impossibility of adopting lawful business contracts, due to the existence of certain obstacles and deterrents. Do these obstacles and hindrances still exist after more than three decades of Islamic banking? Are there any indications to suggest a possible change?

Even in a worst case scenario, there has been a well-established ruling that when a person is given the excuse to commit the forbidden on the grounds of *èar´rah*, he can never deny the original ruling of its prohibition. Hence he cannot claim the original permissibility of his commission of the forbidden. If a person is excused to seek a *ribâ'*-based loan due to the occurrence of an extreme urgency and the absence of any possible alternative source of finance, under no circumstances can he deny the prohibition of *ribâ'* or regard it as permissible. Otherwise, such an act is tantamount to betrayal of God's ruling since *ribâ'* impermissibility is definitive.

There is a tendency in some Islamic banks today to conveniently use *èar´rah* as an excuse to legalise certain activities such as *bayª al-ª¥nah*-based transactions although all jurists agree on its impermissibility if it is used to circumvent the prohibition of *ribâ'* as discussed earlier. Even if the justification of *èar´rah* is considered valid, they should acknowledge the original ruling of the contract. Surprisingly, some use *èar´rah* as a justification for the adoption of *bayª al-ª¥nah*, which implies that they admit that this sale is originally prohibited; at the same time, they justify the adoption of *bayª al-ª¥nah* by claiming its permissibility through attributing it to the Shafiª¥ school. The whole situation here can be likened to a person who has already predetermined doing something shameful without any considerations, and then tries to find as many excuses as possible to justify his action.

4.5 HAS ISLAMIC ECONOMICS BEEN ISLAMISED?

In the final analysis, based on our discussion, it is very clear that Islamic economics, represented here by Islamic banking, unfortunately has not been fully Islamised since we still do not have Islamic banking in the real sense of the word. What has been achieved so far is mainly a replication of conventional banking and finance. So far the attempt to Islamise the transactions of banking and finance has been focusing on its forms and technicalities, while the economics substance is hardly differentiated from that of conventional banking and finance.

Undoubtedly, implementing controversial transactions has defamed our *shar¥ᶜah* by transforming some of its rulings into a meaningless set of rules that is incapable of convincing the Muslim population of its rationality and wisdom. Rather, it leaves the public baffled; not able to comprehend why *ribŒ'* or bank-interest is prohibited for them while *bayᶜ al-ᶜ¥nah* is permissible, although both share the same economic and social implications. Why is it illegal for the Muslim to seek an interest-based loan from a conventional bank while it is legal for him to seek a 'loan' from the Islamic bank whereby he is required to pay higher on the so-called deferred sale BBA product?

5. CONCLUSION

This paper has deliberated on the challenges of realising *maqŒ§id al-shar¥ᶜah* in Islamic banking and finance. These challenges include the proper understanding of *maqŒ§id al-shar¥ᶜah* and the various tools in Islamic jurisprudence such as the *ma§lŒúah* and *èar´rah* concepts. Failure to understand the very objectives of *shar¥ᶜah* and its application to modern *muᶜŒmalah* transactions lead to potential abuse of *maqŒ§id* to justify certain contracts which in fact are contradictory to the *shar¥ᶜah* texts and principles. Circumventing the prohibition of *ribŒ'* by means of *bay' al-ᶜ¥nah* for example is against the very objective of *shar¥ᶜah* prohibition of *ribŒ'*. Therefore, those who claim the permissibility of such transactions under the pretext of realizing *maqŒ§id al-shar¥ᶜah* are effectively acting against the true spirit of *maqŒ§id al-shar¥ᶜah*.

After a deep deliberation on the foregoing arguments, this paper concludes that to realise the *maqŒ§id al-shar¥ᶜah*, Islamic banking and finance institutions must ensure that all of its transactions are *shar¥ᶜah* compliant not only in its form and legal technicalities but more importantly, the economic substance which is premised on the objectives outlined by the *shar¥ᶜah*. As discussed, if the economic substance of a given transaction is identical to that of the prohibited transaction, (such as the one in which the bank or the financier acts as a creditor not as a trader of real property) then this must render the transaction impermissible regardless of its legal form. The adoption of these prohibited transactions on the grounds of *maqŒ§id al-shar¥ᶜah* or *al-siyŒsah al-sharᶜiyyah* or *èar´rah* is legally wrong, leads to more harm than benefit and has fatal implications. The role of *ma§laúah* in the *shar¥ᶜah* is thus confined to making *ijtihŒd* on a particular issue in the absence of a respective definitive text, and to choosing the opinion that

is believed to serve public interest better when there is a plurality of opinions. Committing the forbidden on the grounds of necessity does not entitle one to claim its original permissibility.

In a nutshell, Islamic banks should do away with all the controversial contracts that may impede the growth and progress of the Islamic banking and finance industry. Indeed the Islamic banking system has the potential to become one of the promising sectors to realize the noble objectives of the *sharīᶜah*, as it resides within a financial trajectory underpinned by the forces of *sharīᶜah* injunctions. These *sharīᶜah* injunctions intergrate Islamic financial transactions with a genuine concern for a just, fair and transparent society, at the same time as prohibiting involvement in illegal activities which are detrimental to social and environmental well-being. There are fundamental differences between Islamic banking and conventional banking, not only in the ways they practice their business, but also in the values that guide Islamic banking operations and outlook. The values that prevail within the ambit of the *sharīᶜah* are expressed not only in the minutiae of its transactions, but in the breadth of its role in society. This demands the internalisation of *sharīᶜah* principles in Islamic financial transactions, in its form, spirit and substance. By so doing, it will help to materialise the objectives of *sharīᶜah* in promoting economic and social justice.

ENDNOTES

1. Al-Harran (1990) contends that the ideal operation of the Islamic bank is to emphasise the project viability and usefulness together with the intrinsic trustworthiness of a person while placing collateral at a very minimum significance. As such, the small saver, investor, trader and producer become more important, rather than merely focusing on individuals who are financially well-off or with collateral worthiness. For example, the experience of the Sudanese Islamic Bank (SIB) in implementing the *mushārakah* financing concept to small rural farmers in Sudan has proven without doubt that such profit-loss sharing technique is applicable and can bring benefits to the rural community. For details refer to (Al-Harran, 1990).

2. The practice of BBA in Malaysia is criticized by many scholars outside Malaysia due to its apparent *bayᶜ al-ᶜīnah* structure. In brief, customers who are in need of financing would sell their beneficial ownership of the property to be financed to the banks by signing a contract called Property Purchase Agreement (PPA). After the execution of the PPA, the parties immediately execute another contract called Property Sale Agreement (PSA), to reflect the act of reselling the same property to the customer upon deferred payment,

which includes the bank's profit margin. The contract effectively frees the bank from all risks and liabilities attached to the property. For details see Rosly, S.A. (2001) 'Iwad as a Requirement of Lawful Sale: A Critical Analysis' IIUM Journal of Economics and Management 9, No. 2, 187-201.

3. *WizŒrah al-AwqŒf wa al-Shu'´n al-IslŒmiyyah, Al-Maws´ᶜah al-Fiqhiyyah*, Kuwait, 1990, vol. 25, pp.294-210, Aúmad al- î usary, *Al-SiyŒsah al-Iqti§Œdiyyah wa al-Nu½um al-MŒliyyah f¥ al-Fiqh al-IslŒm¥*, Maktabah al-KulliyyŒt al-Azhariyyah, Cairo, p.12.

4. For detailed discussion on the issue refer to Ibn al-Qayyim, *Al-$uruq al-î ukmiyyah*, p.16.

5. Ibn al-Subki, Al-IbhŒj, 3/52; Al-ShŒ‹ib¥, *Al-MuwŒfaqŒt*, 2/2.

6. See the Qur'Œn 2:179.

7. See the Qur'Œn 5:91.

8. These attributes correspond to the verses of the Qur'Œn, (21:107 and 10:57).

9. Cited in Nyazee, "Jurispudence," 161.

10. The formulation of a rule on the basis of '*al-ma§Œliú al-mursalah*' must take into account the public interest and conform to the objectives of *shar¥ᶜah*. According to the Maliki school, the application of this tool must fulfill three main conditions. First, it only deals with transaction matters (muᶜŒmalah) where reasoning through rational faculty is deemed to be necessary and not relating to specific religious observance such as an act of worship (ᶜibŒdah) which is strictly subject to the main sources of *shar¥ᶜah*. Second, the interests should be in harmony with the spirit of *shar¥ᶜah*. In other words it must not be in conflict with any of its main sources. Third, the interests should be essential and necessary (*èar´rah*) and not of a luxury type. Here the essential implies the preservation of five main objectives of *shar¥ᶜah*. For details, see êubh¥ R. MaúmasŒn¥, *The Philosophy of Jusrispudence in Islam* (Kuala Lumpur: Open Press, 2000). 87-89.

11. Ibn'Ash´r, *MaqŒ§id al-Shar¥ᶜah*, p. 86; Al-Zuúayl¥, W. *Al-Was¥‹ F¥ U§´l al-Fiqh*, p. 361.

12. See the article published in Arabic on (www.elharakah.com) under the title "The Role of MaqŒ§id al-Shar¥ᶜah in Managing the Public Affairs."

13. Al-Zuúayl¥, W. *Al-Was¥‹ F¥ U§´l al-Fiqh*, p. 361.

14. See in Al-Ghazœl¥. *Al-Musta§fa'*, p. 176; Al-Bouti, M.S.R. *ëawœbi‹ Al-Ma§laúah F¥ al-Shar¥ᶜah al-Islœmiyyah*, p. 119.

15. Al-Bouti, M.S.R. *ëawœbi‹ al-Ma§laúah F¥ al-Shar¥ᶜah al-Islœmiyyah*, p. 119.

16. His argument is supported by a number of Quranic verses. One of which is Qur'œn 23:71.Refer to Al-'iz ibn 'Abd al-Salœm, *Qawœid al-Aúkœm F¥ Ma§aliú al-Anœm*, 2/161.

17. This î ad¥th was narrated by 'Umar ibn Al-kha‹‹œb (ra). See *êaú¥ú al-Bukhœr¥*, 1/3, î ad¥th No. 1; *êaú¥ú Muslim*, 3/1515, î ad¥th No (1907).

18. For more details on this matter see *Contemporary Inah is it a sale or usury* by Abdulazeem Abozaid, p 47.

19. Al-Shœfiᶜ¥. *Al-Umm*, 4/114; Al-Ghazœl¥. *Al-Musta§fa'*, 2/36.

20. Ibn 'Abid¥n. *îœshiyœt (Rad al-Mukhtœrᶜalœ' Sharú al-Dur al-Mukhtœr)*, 5/48; Qœraf¥. *Al-Dur´q*, 3/268; Ibn Juzay. *Al-Qawœn¥n Al-Fiqhiyyah*, p. 140; Al-Shœfiᶜ¥. *Al-Umm*, 4/114; Ibn al-Qayyim. *I'lœm al-Muwaqiᶜ¥n*, 3/109-121; Ibn î azm. *Almuúalla'*,10/180.

21. Ibn Taymiyyah, *Al-Fatœwa'*, 8/129.

22. Al-Dahlaw¥, *îujjah al-Bœlighah*, 1/13.

23. Al-Shœ‹ib¥, *Al-Muwœfaqœt*, 2/10.

24. Majallat Al-Ahkœm Al-'adliyyah, section 22; Ibn Nujaym, Zainulddin, *Al-Ashbœh Wa al-Na½œir*, 1/105-107; Al-Seyoti, Jalaulddin, (911 H). *Al-Ashbœh Wa al -Na½œir*,p. 84-92;Al-Kurdi, Ahmad. *Al-Madkhal Al-Fiqh¥*, p. 48.

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