

# The moral deficit in Islamic Banking & Finance;

Muslim meta-ethics and the *fiqi* equivalence of  
profit loss sharing and fixed income modes of  
financing

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# Islamic economics

- Deals with macro issues
- Achieving 'Justice' and 'Human well being'
- 'Functional' socio-moral goals
  - Dual utility function worldly life & hereafter
- Substantive notions of morality and justice

# Failure of IBF

- IBF operational tool of Islamic economics
- Widely recognized to have failed in achieving the socio-economic goals of Islamic economics
- In fact has allowed “capitalism to thrive in the Muslim World” leading to accusations of a “bastardization” of IBF

# Profit loss sharing instruments

- PLS “dominates theoretical literature”
- Theoretically ideal *Mudharaba & Musharaka*
- Seeks to prioritise “equity financing towards value added creating economic activity”
- Contractual pooling of investment, sharing of profit & loss

# However...widespread failure to adopt PLS

- negligible portion of financing is strictly PLS
- Even in deposit accounts, “not interest-free, closely pegged to conventional deposits”
- Void of PLS instruments filled with fixed-income modes of financing

# Fixed income modes of finance

- Again based on pre-modern contracts
- *Murabaha, Ijara, Ba'i mu'ajjal, ba'i salam, istisna & even tawaruq*
- Validated by *Fiqh* **but** not expected to lead to functional socio-economic goals
- Seen to replicate interest bearing instruments in all but name and form

# Explanations for “Murabaha” effect

- **Apologetic-** Pragmatic mechanism
- **Critical-** legal arbitrage synthesizing forbidden contracts into permissible ones
  - Incoherent contract-based jurisprudence in an age of low cost financial engineering
- **Analytic-** Market forces
  - *Dar et al* cite eight factors
  - Range from issues of agency, logistics & management.....

# Role of meta-ethical theory unexamined

- legal tools and market incentives widely recognised
- But how is *islamicity* of fixed income modes of finance not only maintained but considered equal to PLS?
- Why are they considered equally Shari'a compliant?
  - Need to examine role of meta ethical theory in establishing *fiqi* equivalence of two modes
  - Expose moral deficit at heart of IBF

# Asharite meta ethics in Muslim religious law

- Asharite meta-ethics informs reading of *fiqh* regulating IBF
- Beyond being noted, influence not explored
- Can explain failure of IBF to operationalise substantive socio-economic moral goals of Islamic economics

# Asharite meta-ethics

- A “Theistic Subjectivism”
- “Praiseworthy (*husn*) is that which the Divine Legislator has stipulated as praiseworthy and blameworthy (*qubh*) is that which is stipulated as blameworthy”
- Morality is defined by God and according to his will

# .....Divine legal positivism

- Theft and idolatry, if commanded, “right” or “good”
- Theory can not support a substantive notion of justice
- Any norm derived from authoritative sources and in appropriately deemed manner *is* just
- Moral worth irrelevant to validity of law
  - Prioritises discharge of legal duty & formal compliance

# *Fiqi* equivalence of PLS and fixed income modes of finance

- PLS and fixed income modes **equally valid**
- Both 'just' and 'good', not due to socio-moral impact, but because jurists have derived their validity
- No legal incentive to prefer PLS & **no moral distinction** between the two instruments
- thus market forces & legal arbitrage will continue to perpetuate **moral deficit in IBF**

# Theoretical incompatibility

- Meta-ethical theory in *fiqh* not compatible with substantive notions of morality central to Islamic economics
- “Jurisprudential schizophrenia”
  - formalistic legal system searching for functional ends
- Compounded by a “meta-ethical schizophrenia”

# Solutions for Islamic economists

- Either Islamic economic system is **only discharge of divine obligation....**
- **Or** accept that reading of *Fiqh* currently employed **incapable of fulfilling their aims...**

# Limitations recognised in *fiqh*

- I E's unlikely to drop socio-moral goals
- “Exercises in Islamic economics have been too focused on *fiqh*” (Siddiqui, 2004)
- But move to *maqasid* still incomplete
  - *Maslaha* allows determination of non-explicit '*illa*' consistent with *maqasid*
  - *Neo maqasidi* extension still not impacting derivation & subject to theoretical inconsistencies
  - Notions of God's 'purpose', est. 'Good' and 'just' societies not supported by 'Asahri meta-ethics

# Need for an alternative meta-ethical theory

- Islamic financial system “defined by the social goals not simply mechanics of its operation” needs “robust social justice orientated principles”
- To maintain authenticity of such a system requires a reading of Shari’a which adopts a meta-ethical theory that can support the substantive notions of morality & justice
- Not unknown to Muslim theology- *'Adliyya*

# 'Adliyya- people of justice

- Term used self referentially by Mutazila and Shi'a
- Reflects fundamental acceptance of a substantive notion of justice which can be predicated to Gods actions
- Meta-ethical 'Rational objectivism'
  - Moral values exist & can be understood by unaided human reason
- Supports substantive usage of concepts such as God's purpose and 'good and just' societies central to IE

# Moral worth a condition for validity

- God's law is 'just' and 'moral'- in a sense understandable by humans
- Any derived law not considered to be 'just' or 'moral' cannot be reflective of God's intention
- Potentially allows for a *fiqi* distinction between two otherwise formally compliant contracts based on their moral worth and socio-economic impact

# Towards an 'Adliyya reading of Shari'a for IBF

- Islamic economists have noted value in Mutazili theology
  - Explicit & Implicitly in favouring discourse of *maqasid*
- However developing an 'Adliyya reading of *fiqh* no small project
  - Mutazili & Shi'i failed to develop a distinctive legal system largely epistemic reasons
  - 'New power alliance', integral to success of IBF, with scholars employing an entrenched method & methodology
- But without it Islamic economics can not fulfil its substantive functional goals, & maintain its Islamic brand which relies on its regulation through MRL

# Summary

- Substantive moral goals of Islamic economics not fulfilled by Islamic finance
- Islamic finance regulated by Asharite reading of *fiqh*, which detaches moral worth from validity
- Divine legal positivism results in the *fiqi* equivalence of PLS & fixed income modes of financing → moral deficit in IBF
- Islamic economist must review their substantive functional moral goals or actively engage in efforts to develop an '*Adliyya* or moral reading of Shari'a

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