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☆لا تنتظر شكرا من احد، يكفي ثواب الصدق، وما عليك من جهد، وحقد وحسد.☆

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Scholars like Khan (2014) think that critics of practiced Islamic banking do not appreciate how important debt financing is for value creation in an economy and especially for inclusive growth and economic development through making financial services accessible for asset acquisition. Chapra (2007) argues that even if debt financing is predominantly used in Islamic banking practice, asset backed financing does not allow the debt to exceed the growth of the real economy. He argues that the introduction of such a discipline would ensure greater stability as well as efficiency and equity in the financial system.

Globally, Pakistan is widely acknowledged for its more conservative and cautious approach to Islamic banking and finance whereby, Islamic banking in Pakistan does not use Bai Inah, Organized Tawarruq and secondary market trading of Murabaha based Sukuk. Thus, it is not appropriate to disregard these differences and latest developments as substantial knowingly or due to lack of information.

Conclusion

This paper is a humble attempt to discuss the minor proposals which are outside the mainstream Islamic finance in Pakistan. Some of the minor proposals like two-tier Mudarabah are not used widely because of lack of preparation and government incentives at the practical level. Some other proposals like rationalizing bank interest through non-textual arguments (other than in Qur'an and Hadith) are not in compliance with Islamic source texts (Qur'an and Hadith). Furthermore, some minor proposals have misapplied the Islamic contracts, such as Qard-e-Hasan as in Time Multiple Counter Loan.

There are several features in conventional banking and finance which contradict with Islamic injunctions directly without any ambiguity. Islamic banking first and foremost attempts to be interest-free as well as avoid other non-permissible elements in Islamic contract law and rules of sale. In the presence of practiced Islamic banking and its growing penetration, accessibility and growth, Islamic banking should be preferred over conventional banking and finance products. The meticulous efforts of Islamic scholars, regulators, academia and industry players have contributed in instigating interest-free finance.

Islamic banking alone might not be the only solution to meet all sorts of economic and social objectives. This has increasingly been realized in the academia and the simultaneous growth of Islamic social finance in the form of Waqf and institutionalization of Zakat and Qard-e-Hasan based micro-finance has contributed in completing the access to Islamic finance to people of different economic standings. Now, people of all socio-economic sections can be served through either commercial Islamic banking and/or through Islamic social finance institutions. Thus, Islamic finance itself as a combination of commercial and social finance institutions is fast appearing to be a comprehensive and complete alternate financial system for faith conscious clients. As a result, there is no need to rationalize conventional interest based banking in part or in total ideal instrument for carrying out the real economic objectives of Islam. Therefore, this instrument should be used as a transitory step taken in the process of the Islamization of the economy, and its use should be restricted only to those cases where Mudarabah or Musharakah is not practicable." (p. 72)

The realist camp scholars argue that these redistribution objectives will be taken care of by Islamic social finance institutions which include Zakat, Wirssat, Islamic microfinance and Waqf while Islamic banks will continue to serve the short term recurrent finance needs of businesses and middle to urban class households and for which mostly the debt based Islamic modes of financing are the suitable options. In Malaysia and Indonesia, Islamic microfinance, Zakat and Waqf institutions have been used as social finance vehicles in the overall Islamic finance architecture very successfully. In Pakistan also, the institutions like Akhuwat have shown how Qard-e-Hasan can be used to help the downtrodden on a large scale. Mufti Muhammad Taqi Usmani (2004) has been a strong proponent for introducing equity based financing and regards them as more preferable in order to achieve Islamic egalitarian and redistributive objectives even through the Islamic banking institutions. But, the idealism from a financial and development perspective does not determine legitimacy and illegitimacy of the other alternatives which may lack in contributing significantly to the redistributive ideals, but which nevertheless provide a practical solution to avoid Riba and its ramifications. In his book, 'Ghair Soodi Bainkari [Interest Free Banking], the respected scholar, Mufti Muhammad Taqi Usmani (2007) has clarified that the criticism on underachievement of the ideal redistributive objective in current practice is different from the status of legitimacy of Islamic banking which by and large has to use Islamic debt based modes of financing. But, it does not help in improving the chance to use equity financing any better if an unqualified legitimacy is accorded to interest based borrowing by the borrowers, especially when the large majority of them are the corporate clients and well-to-do professionals. Banks do not finance anyone except in the top income quintile of income distribution by having collateral and income based lending criteria.

At the very least, Islamic banks take ownership of the asset for which they provide finance, bear the risks alongwith mitigating these risks as a custodian of depositors' funds, charge rent after the asset is transferred in usable condition and charge these rents only until the asset remains in their ownership and is being possessed by the client in usable condition. They do not charge late payment penalties as income. In practice, it is found that late payment surcharge is seldom charged and it is used in the contract to avoid the very real moral hazard problem and the eventuality of customers willfully defaulting on loans. As a result, the non-performing loan to financing ratio in Islamic banking has remained much lower than conventional banks in Pakistan (3.9% in Islamic versus 9.9% for the industry). Hanif (2014) argues that IFIs cannot claim interest on their balances with other banks and mandatory cash reserve maintained with a central bank. Islamic banks cannot invest in interest based government securities, interest based bonds. They cannot claim time value of money from defaulters and they have to bear risks in the sale.

the charging of rents or profits on an asset sale. In a conventional debt based financing, this feature is absent and the interest is charged no matter whether the asset exists and no matter whether it is available in usable condition or not.

In Pakistan, the first full-fledged Islamic bank was established in 2002 with the name of Meezan Bank. Currently, Islamic banking in Pakistan is an established industry with 11.7% and 13.2% market share in total banking assets and deposits respectively as at March 31, 2017. The industry experts are further aiming at a 20 percent market share for Islamic banking in the overall banking industry by 2020. There are 5 full-fledged Islamic banks operating in the country along with 17 conventional banks with Islamic banking branches. The market share of Islamic banking assets has grown from a meager 0.5% in 2002 to 11.7% in 2017. By year-end 2016, the total Islamic banking assets in Pakistan stood at Rs 1.88 trillion ($17.95 billion) while the total Islamic banking deposits stood at Rs 1.57 trillion ($15 billion). With increased participation of conventional banks in Islamic banking industry, the branch network has surpassed the mark of 2,300 branches by year-end 2016. With the launch of innovative products like Running Musharakah, now the Islamic banking is catering to the working capital needs of the corporate sector. This has also helped the industry to make effective use of equity based modes of financing and reduce the share of debt based modes of financing.

One can argue that the economic substance of Islamic banks is also no different in terms of economic outcome as argued by Siddiqi (2014), Shaikh (2013), Kayed (2012), Choudhury (2012), Siddiqi (2007), Haniffa & Hudaib (2010), El-Gamal (2005& 2007) and Hassan and Bashir (2003) to name a few scholars in Islamic economics literature. Nevertheless, except for El-Gamal, the other scholars in the idealist camp are critical of Islamic banking not for its legitimacy of product offerings, but with regards to their limited product offerings to achieve the redistribution objectives. This criticism is widely known and appears even from within. The respected scholar Mufti, Muhammad Taqi Usmani (2009) in his essay 'New Steps in Islamic Finance' writes:

> "...One must not forget that these instruments are not modes of financing in their origin. They are in fact some forms of trade that have been modified to serve the purpose of financing at the initial stage as secondary and transitory measures. Since they are modified versions of certain forms of trade, they are subject to strict conditions and cannot be used as alternatives for interest based transactions in all respects. And since they are secondary and transitory measures, they cannot be taken as the final goal of Islamic Finance on which Islamic Financial Institutions should sit content for all times to come. It is a matter of concern for a student of Islamic finance, like me, that both these points are increasingly neglected by the players in the field, and especially by the newcomers in the industry."

Furthermore, in his book, 'Introduction to Islamic Finance', the respected scholar, Mufti Muhammad Tami USANi (2004) writes:

> "It should never be overlooked that, originally, Murabaha is not a mode of financing. It is only a device to escape from "interest" and not an

This model has some issues from the perspective of Shari'ah as well as from the perspective of its practical implications. With respect to Shari'ah, two contracts cannot be executed contingent to each other. Also, from the Shari'ah perspective, time is not a commodity. A commodity can have different prices in different states of the time. However, time itself cannot be factored in price in monetary loans.

From the practical standpoint, savers and borrowers have different financial situations and needs. Savers have surplus money when they lend or invest the surplus money. They do not require a monetary loan in reciprocation. Thus, by lending Rs 1,000 for one year and getting a loan of Rs 100 for 10 years, the values are not even balanced even in a purely zero-interest economy.

In a positive inflation rate economy, the value of the medium of exchange will decrease overtime. To counter that, some authors suggested inflation-adjusted loans. Nonetheless, OIC Fiqh Academy has ruled out this proposal. If this proposal of indexing loans with inflation benchmark is suggested at the macroeconomic level in financial intermediation, then this is not practical. The bank is an intermediary between those who have surplus funds and those who need funds and itearns profits through the difference in interest rates on deposit and financing side. Indexing loans with inflation will not yield any return for the intermediary (the bank) in the two-tier loan based banking. Secondly, inflation is measured by an index which has an urban bias as Consumer Price Index (CPI) inflation is calculated by looking only at the prices in the urban areas. It has a period bias since in indexing; the choice of base year makes the calculations very different. It also has a representation bias as inflation in urban areas is not a true representative of inflation in all areas, especially if rural areas comprise two-thirds of the population in some developing countries. Plus, inflation is just a measure and there are at least four varieties of inflation measures used by Pakistan Bureau of Statistics (Consumer Price Index, Wholesale Price Index, Sensitive Price Index and Producer Price Index). The results depend on the methodology; the particular commodities in the index which change from time to time and not everyone have the same basket of goods relevant to them. Thirdly, cost-push inflation is driven by supply shocks resulting in higher oil, gas and electricity prices. Therefore, in this case, deterioration in real purchasing power is caused by factors, not in the control of the borrower. He cannot be held liable to compensate in a matter in which he was not responsible.

3. Why Current Islamic Finance is Mainstream in Pakistan

Upon reflection, it seems that time value of money is the basis of interest. As per Islamic principles, it seems that time value of money is the problem for the investor to avoid keeping his/her money idle and to avoid forgoing the use of money that may bring positive value to his/her investment. However, it does not mean that the investor can demand an arbitrary increase as the cost of using money without taking the risk of a productive enterprise. As per Islamic principles, a financial investor has to undertake the risk of the productive enterprise by becoming self-entrepreneur or an investing entrepreneur as an equity partner in others' business to have any justifiable compensation out of the production process. In short term finance, there are some Islamic debt based modes of finance which ensure distinct asset ownership of the financier in order to enable

Conventional banks provide loans as debts rather than providing finance on the basis of equity participation. Their receivables are the debts and the interest on these debts. It does not matter whether the debts are provided for the purchase of real assets or lent in the form of money. It makes no consequential difference whatsoever to the cash flow commitments decided between bank as lender and the client as a borrower. If the nature of finance provided creates debt, then banks cannot demand a premium over and above the principal amount of debt as per Islamic injunctions. What conventional banks charge is a proportional predetermined increase over the principal amount quoted as a percent of the principal amount. We can take a very simple example to illustrate the point. If the borrower obtains a loan of Rs 100,000 for two years at a rate of 10% and earns Rs 200,000 in the first year and incurs a loss of Rs 50,000 in the second year, then the amount payable to the bank in the form of interest is Rs 10,000 in each year. The proposal to not charge interest in the period of loss does not change the contractual relationship of debt based lending. It also does not justify the pre-determined Rs 10,000 taken as interest no matter whether the profit is Rs 100, Rs 10,000 or Rs 1,000,000.

If we look at the product structures in both conventional and Islamic banking, only Islamic banks become the owner of the assets and bear the risks related to the ownership. Conventional banks do not take ownership or bear any risk related to the assets. They start charging interest as soon as the loan is sanctioned and not from the date of transfer of an asset in usable condition. They continue to charge interest even when the asset is not in usable condition. If the client wants to obtain a loan for purchasing an asset from a conventional bank, the only thing that changes is that the loan would be considered as more secure for the bank as it has a ready collateral available for effecting repayment, in case of eventual default. From all perspective of cash flow commitments, contractual rights, responsibilities, accounting, recording, regulation and documentation, the bank remains the lender only. If during the mortgage finance term, the client wants to give back the asset or property in use to the bank/financier, it is not possible because mortgage finance is simply not a rental agreement. The installments have no connection with market rents for the same or similar assets or properties. For financing different years of finance, the same amount of property will have different installment structure, i.e. higher installments for a shorter duration of the lease and lower installments for a longer duration of the lease. This is because the bank wants to recover all its costs alongwith interest from the cumulative sum of installments. Nowhere, a conventional bank even mentions that it is entering into a rental agreement in the documentation, accounting books, financial statements or even in marketing supplements or brochures.

2.3 Time Multiple Counter Loan

This model was presented by Shaikh Mahmud Ahmad. Ahmad (1989) builds his model on the premise that 'time is an ingredient of a loan as the value of loan itself'. Specifically, what the proposal practically implies is that if a person needs a loan for any purpose from a bank for a certain period of time, he should also give a loan to that bank in an amount such that the 'values' of the two loans are equal. For example, if a person needs a loan of Rs. 1,000 for one year, he should give a loan of, say, Rs. 100 for ten years to the bank. At the expiry of the stated period, both parties will repay their loans in original. This is the essence of Time-Multiple Counter-Loan (TMCL) based interest-free banking.

projects. Since governments pay premium or prize unilaterally, that is why it is not akin to interest prohibited in Qur'an. Though it is undesirable, the needy persons can benefit from this scheme.

In response to this view, we should note the fact that Pakistan pays around half of all the tax it collects in the form of debt servicing. If the payment of interest is regarded as completely permissible, then the government could opt for more debts. These domestic borrowings by the government are mostly used for non-development expenditures. Development expenditure is a very small portion of government's total expenditure. The government has run a fiscal deficit in almost every year since its independence. The possibility of project based and development infrastructure finance is promised by the instrument of Sukuk structure in Islamic finance.

For the individuals who are risk averse and who want relatively regular incomes, Islamic asset management companies have designed tailor-made income funds, cash funds and capital protection funds. There are at least 19 Islamic income funds operating in Pakistan to date. There are 5 full-fledged Islamic banks and at least 17 conventional banks with Islamic banking windows. The total branch network of Islamic banking in Pakistan alone has reached 2,300 in number. In the developed world, even more structures and variety is available. It would be a worthwhile effort to make people know about these products, especially when Islamic finance is being offered in all major countries of Asia, Africa and Europe and is set to grow further.

Entering into an interest based transaction is a voluntary contract between two parties who can enter into a contract with their free will. In contemporary finance, most of the borrowers are organized businesses operating as corporations. In Pakistan, around 70 percent of the financing provided by banks is concentrated with corporate clients. These clients are corporations established with equity first and most of them have their shares publicly held. Other than 5 fully-fledged Islamic banks and 17 banks with Islamic banking operations, these corporations also have access to capital markets for obtaining equity finance through the issuance of shares.

The reason why equity based modes of financing are not widely practiced in Pakistan owes to the fact that these corporations are comfortable in obtaining bank finance and to pay a fixed interest rather than sharing their high return on equity with banks. As a whole, most of these corporations overall have a higher return on equity than the average interest rates which they pay to the banks. The insistence of bigger and profitable corporations on debt based finance and their reluctance on using equity based modes of financing is one of the great hindrances in fostering equity based financial intermediation. That is why it makes a lot of sense that they are as much part of the status quo in fighting the interest based debt finance as the conventional financial institutions themselves.

As a matter of fact, bank interest had been declared un-Islamic by the Supreme Court of Pakistan since a long time ago. Mufti Taqi Usmani has given a detailed account of the case and verdict in his book 'Historic Judgement on Interest'. Amidst the ruling of prohibition of bank interest by the Supreme Court of Pakistan and wide access to Islamic banking, granting unqualified freedom to borrowing on interest basis voluntarily is not a justifiable stance.

market or the central bank and may be used by the latter as an alternative instrument of credit control. This framework has remained outside of mainstream Islamic finance not because of its socio-economic merit or its lack of affinity with Islamicprinciples. Rather, this proposal had been favored by early academicians. Shaikh Mufti Taqi Usmani has repeatedly emphasized the preference of Mudarabah and Musharakah over other modes of financing from the socioeconomic, income distribution and Maqasid-e-Shari'ah perspective. Mufti Taqi Usmani (2004) in his book "Introduction to Islamic Finance" stated at least 5 times that Mudarabah and Musharakah are ideal modes of financing on page 12, 17, 72, 107 and 164 respectively

The reason why these modesof financing had not been used often in practice owes to practical difficulties such as non-standardization of accounting, tax disadvantage to equity over debt finance, the weak motivation of commercial stakeholders and the agency problems. Some authors have emphasized agency problems in Mudarabah, such as Bacha (1997), Khalil et al. (2002), Dar and Presley (2000), Warde (1999) and Rosly and Zaini (2008). Nonetheless, the lack of this proposal's practical use is not due to its nonconformity with Shari'ah principles.

2.2 Narrowing the Scope of Riba Prohibition in Contemporary Finance

In the early period since the establishment of Pakistan, there were some intellectuals who had given some non-traditional views on Riba. For instance, Rehman (1964) gives this definition of Riba: "An exorbitant increment whereby the capital sum is doubled several-fold, against a fixed extension of the term of payment of the debt." Rehman (1964) and Saeed (1996) argued that only the exorbitant rates of interest charged on consumption loans from the poor borrowers by rich lenders were condemned by Islam. However, this view has been effectively and comprehensively dealt with both in academics and then subsequently in the legal sphere.

Early writers in Islamic Economics like Mawdudi (1961) defined Riba as follows: "Excess money which is obtained on determinate conditions and at a fixed rate for the principal loaned out in consideration of the period for which the money has been lent". The Pakistan Council of Islamic Ideology (1980, p.1) clearly reflected a consensus view when it concluded in its 1980 report on the elimination of interest from the Pakistan economy: "The term riba encompasses interest in all its manifestations irrespective of whether it relates to loans for consumption purposes or for productive purposes, whether the loans are of a personal nature or of a commercial type, whether the borrower is a government, a private individual or a concern, and whether the rate of interest is low or high." Subsequently, the Historic Judgment on Interest settled the debate both in academics as well as in legal sphere.

On the other hand, some authors attempt to contextualize the scope of Riba. One suggestion put forward is that government national saving schemes for retired employees are allowable since government gives the premium on principal on its own and can change the premium by its own desire. This understanding is based on the misconception that government borrows funds for investment purposes and gives the residual from the returns on investment projects to the borrowers. As per this understanding, issuing prize bond is also a source of finance adopted by the governments to finance investment

complete alternate financial system for the faith conscious clients. As a result, there is no need to rationalize conventional interest based banking in part or in total.

Keywords Riba, Islamic Banking, Insurance, Takaful

1. Introduction

Ever since the establishment of Pakistan, there was a great zeal to introduce Islamic institutions in the socio-economic milieu to realize the vision for which the independence struggle was carried out. Muhammad Ali Jinnah, the First Governor General of the country stated in his address at the inauguration of State Bank of Pakistan: "The adoption of Western economic theory and practice will not help us in achieving our goal of creating a happy and contented people. We must work our destiny in our own way and present to the world an economic system based on true Islamic concept of equality of manhood and social justice. We will thereby be fulfilling our mission as Muslims and giving to humanity the message of peace which alone can save and secure the welfare, happiness and prosperity of mankind."

Later on, the political turmoil did not give adequate attention to this vision. However, given the increased focus in the 1970s around the Muslim world to develop an Islamic financial system for Muslims, the positive effects were also felt in Pakistan. The 1973 constitution of Pakistan in Section 38(f) stated that Riba should be eliminated as early as possible. However, lack of political will in the subsequent governments has still remained as a hurdle in the way of completely replacing the interest based banking system with an Islamic one. Nonetheless, Islamic banking has begun its journey. At the same time, outside the mainstream Islamic finance, there have been some minor proposals proposed by certain quarters. This paper gives an account of these minor proposals to explicate why these proposals are not part of the mainstream Islamic finance. This paper is divided into 3 sections. After a brief background introduction in Section 1, Section 2 provides a critical account of some minor proposals which have been put forward in Pakistan. Section 3 discusses how the mainstream Islamic finance has streamlined the development of Islamic finance products by giving primary emphasis to compliance with Islamic injunctions (Qur'an and Sunnah) and by keeping in line with market dynamics and needs of faith conscious clients and stakeholders in the current scenario.

2. Minor Financial Proposals Outside the Mainstream Islamic Finance

Besides the mainstream Islamic banking that operates in Pakistan under the careful supervision of Shari'ah Advisors, some other proposals had also been put forward by other writers. In this paper, we analyze these proposals and alternate perspectives and see as to why they did not become the mainstream view due to Shari'ah related or other practical difficulties.

2.1 Two Tier Mudarabah Framework

Uzair (1978) envisaged two tiers of Mudarabah partnership, one between depositors and bankers and the other between bankers and investors. These parties may share the profit according to a pre-arranged ratio. These ratios may be regulated by the

Analysis of Minor Proposals outside the Mainstream Islamic Finance in Pakistan

By
Salman Ahmed Shaikh

Abstract

This paper is a humble attempt to discuss the minor proposals which are outside the mainstream Islamic finance in Pakistan. Some of the minor proposals like two-tier Mudarabah are not used widely because of lack of preparation, government incentives and initiatives at the practical level in the current scenario. Some other proposals like rationalizing bank interest through non-textual arguments (other than in Qur'an and Hadith) are not in compliance with Islamic source texts (Qur'an and Hadith). Furthermore, some minor proposals have misapplied the Islamic contracts, such as Qard-e-Hasan as in Time Multiple Counter Loan. There are several features in conventional banking and finance which contradict with Islamic injunctions directly without any ambiguity. Islamic banking first and foremost attempts to be interest-free as well as avoid other non-permissible elements in Islamic contract law and rules of sale. In the presence of practiced Islamic banking and its growing penetration, accessibility and growth, Islamic banking should be preferred over conventional banking and finance products if one wants to be compliant with Islamic injunctions. Islamic banking alone might not be the only solution to meet all sorts of economic and social objectives. The simultaneous growth of Islamic social finance in the form of Waqf and institutionalization of Zakat and Qard-e-Hasan based microfinancecan contribute in completing the access to Islamic finance to people of different economic standings. Now, people of all socio-economic sections can be served through either commercial Islamic banking and/or through Islamic social finance institutions. Thus, Islamic finance itself as a combination of commercial and social finance institutions is fast appearing to be a comprehensive and

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