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The Financial Sharia as Law and as Ethics: A Suggestion

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ABSTRACT

In this paper I suggest that it is worth considering an approach based on separating the legal aspects of the Financial Sharia from its ethics, or at least using those aspects in a more flexible way.

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¹ The rights of Nicholas Foster to be identified as the author of this work have been asserted in accordance with s 77 and s 78 of the Copyright, Designs and Patents Act 1988. A few small amendments have been made to the text prepared for the LSE/HBKU Islamic Finance Workshop 2016 and the title of the paper has been changed.

Introduction

In this paper I take the opportunity to offer a few thoughts from a very broad, but still legal, perspective on the use of the sharia in Islamic finance.

Islamic Finance and Sensitivity to Initial Conditions²

The shape, culture and approach of Islamic finance are conditioned by the circumstances in which it operates, but also by the way in which it developed. As a part of the Islamic revival, and its so-called 'legalistic' basis, it has an inbuilt tendency to look, to a significant extent, towards the past, to the jurisprudence of the classical age of Islam.³ It seems that this was inevitable, for the only practical way in which the system could be constructed was to build on the vast legal experience of the many centuries of the Islamic past.

Those working in and studying Islamic finance are, of course, eminently practical people who live in the real world and have to deal with present-day realities. Hence the flexibility which produced, inter alia, the *murabaha* and the *sukuk*, and the professional expertise which is growing and deepening in Islamic finance products and practice.

It remains the case, however, that Islamic finance is rooted in the law (by which I mean the *sharia/fiqh*), or at any rate feels obliged to look as if it is rooted in the law, of the past. The classical period of Islam is the touchstone by which products are still, to a large extent, judged.

This poses numerous questions, some of them technical, some of them of a much broader nature. As regards the former, is it necessary, for example, for a transaction to be sharia-compliant that the law fit into a classical model? This might be an unnecessarily restrictive way in which to structure transactions, but things have not turned out that way in practice, because a flexible approach has been taken. As regards the latter, some more serious issues arise.

The Financial Sharia as Law

These issues include the form/substance debate, which has rolled on for many years and shows no sign of going away. For example, it has been discussed at every LSE workshop I have attended to date, and it appears in the papers for this one. But it seems that no progress is ever made. The economic nature of Islamic finance transactions remains different from what it is made out to be.

This lack of progress is both understandable and inevitable. It derives from the very nature of the initial conditions in which Islamic finance was born. The key here is the distinction between law and ethics and the way in which law and ethics played out in the classical period.

It is trite to say that the sharia is not law in the modern Western sense of the latter word. Indeed, law is a Western concept, although we must also be aware that the

² 'Sensitivity to initial conditions' is a concept taken from chaos theory. See, eg, Gleick, J (1997) *Chaos: Making a New Science* Vintage.

³ See, eg, Hegazy, WS (2007) 'Contemporary Islamic Finance: From Socioeconomic Idealism to Pure Legalism' (7) *Chicago Journal of International Law* 581 and Hamoudi, HA (2011) 'Present at the Resurrection: Islamic Finance and Islamic Law' *American University International Law Review* 1107.

word has numerous meanings and the concept has changed significantly over time and varies as between Western cultures themselves. However, we must also bear in mind that those parts of the sharia commonly used in Islamic finance (the Financial Sharia) are certainly law-like.⁴ Take the law of sale, or agency, or pledge. These bodies of rules look like law; the same issues are discussed as in Western law; the same sort of reasoning is used.⁵ 'If it looks like a duck, swims like a duck, and quacks like a duck, then it probably is a duck.'⁶ This law was devised in what a modern Western mindset would think of as ethical, in the sense that those who developed it took account of religious/ethical principles. But this is not radically different from the ideas of justice which were part of the background to the formulation of Western law.

The difficulty which then arises is a jurisprudential one. What Islamic finance uses is *law*. And as any lawyer knows, law, being a system of formal rules, is plastic, it is maniable.⁷ In other words, it can be manipulated to achieve all sorts of things, some of which may be viewed as illegitimate.

This is not to say that sharia scholars do not think about, and use, principles. Of course they do. However, there are basic difficulties in reconciling a rule-based system and ethics. This is not a soluble problem as such. Consequently, there are limits to the extent to which the *maqasid* cannot be used to create a better, more sharia-based (whatever that term means) system. Maniability is an inherent property of legal rules. And once one realises that the Financial Sharia *is* law, then the conclusion that the Financial Sharia can be used to achieve 'non-sharia-based' results becomes inevitable.

This is not to say either that efforts to use principles such as the *maqasid* and others to improve the ethical nature of the way in which legal rules are used should be abandoned. Such efforts are part and parcel of a developing legal system.⁸ But they will not provide a comprehensive solution.

Conclusion: Using the Sharia as Ethics

This conclusion is relevant for all Islamic finance, but is particularly significant for infrastructure projects. Such projects are typically associated with serious environmental and human rights issues. Examples are numerous; one which springs to mind is the Three Gorges Dam in China.

A path which may be worth exploring can be derived from the analysis above. Given that the Financial Sharia is law-like, one might consider an approach based on separating the legal aspects of the sharia from its ethics, or at least using those aspects in a more flexible way. Various parallels in Western regulatory thought can be found. These include corporate social responsibility (CSR) and principles based regulation.

⁴ On this term see Foster, NHD (2015) 'Some Concepts and Related Terms for the Analysis of the Law of Islamic Finance' *SOAS Law of Islamic Finance Working Papers Series No 8*, available at www.soas.ac.uk/cimel/workingpapers/file108564.pdf, p2.

⁵ See, eg, Foster, NHD (1998-1999) 'Guarantees in the UAE: A Comparative Analysis in the Light of English Law, French Law and the Shari'a' in Cotran, E (ed) *Yearbook of Islamic and Middle Eastern Law* Vol 5 Kluwer.

⁶ The precise wording is taken from <http://www.yourdictionary.com/duck-test> (last visited 11 February 2016).

⁷ Maniable: 'capable of being handled or worked' – www.merriam-webster.com/dictionary/maniable (last visited 11 February 2016).

⁸ See Foster, NHD (2007) 'Islamic Finance Law as an Emergent Legal System' (21) *Arab Law Quarterly* 170 and Foster, NHD; and Archer, S (Forthcoming) 'Islamic Financial Law: Law without a Legal System'.

Such an approach is not a magic bullet and numerous issues will need to be addressed in its formulation and implementation. Principles based regulation, for example, has many critics.⁹ CSR is seen by many as an exercise in corporate marketing.

An ethics-based approach in Islamic finance may, however, in conjunction with efforts to improve the more formal legal aspects, be of value. A useful example from recent history of what can happen when ethical principles are brought into a previously law-based environment is that of the World Bank. Not so long ago the World Bank took scant account of environmental or social issues. Nowadays, whatever one thinks of the World Bank's actual performance, it is far more conscious of those issues.

An ethics-based approach would also enable Islamic finance to take its rightful place in, contribute more meaningfully with, and cooperate with, the rest of the ethical finance movement. This movement is presently fragmented and, if its activities could be coordinated, it could have a much greater impact than it does at present. Coordinated activity in a more cohesive ethical finance movement could give Islamic finance much more of a moral conscience role in world finance, and in areas such as infrastructure projects could allow it a role beyond its contribution in funds lent.

⁹ See, eg, Black, J (2012) 'Paradoxes and Failures: 'New Governance Techniques' and the Financial Crisis' (75) *Modern Law Review* 1037.

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