

Islamic law, adaptability, and financial development



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Islamic Law, Adaptability, and Financial Development www.LearnIslamicFinance.com Disclaimer The views and opinions presented in this presentation are personal and do not represent those of Islamic Research and Training Institute or the Islamic Development Bank. www.LearnIslamicFinance.com Lecture Plan • Session 1: Law, Adaptability, and Financial Development—Introduction - - - Common and Civil Laws Adaptability Features & Financial Development Islamic Law: Sources and Evolution Session 2: Adaptability of Islamic Law and Financial Development - - - Adaptability of Islamic Commercial Law Islamic Legal Infrastructure & Financial Development Conclusion www.LearnIslamicFinance.com Session 1 Law, Adaptability, and Financial Development—Introduction - Introduction - Common and Civil Laws - Adaptability Features & Financial Development - Islamic Law: Sources and Evolution www.LearnIslamicFinance.com Introduction Literature discusses the role of law and legal • • • • systems on financial development An important determinant—adaptability of law to changing conditions Adaptability—the ability of legal traditions to evolve Studies compare adaptability of common and civil legal systems and financial development This lecture looks at Islamic law and its adaptability features with implications to financial development www.LearnIslamicFinance.com Basic Definitions (1) • Legal system entails legal order and legal regime - Legal order—legal norms of the system (constitution, statutes, regulations, juridical decisions, etc. - Legal regime: legal institutions (legislature, administrative agencies, courts, etc.) - While we discuss law, some support legal institutions will be touched on - This paper focuses laws related to commercial/financial transactions www.LearnIslamicFinance.com • The focus of this lecture is narrow • Islamic law <https://assignbuster.com/islamic-law-adaptability-and-financial-development/>

covers many subjects

- Basic Definitions (2)
- Financial structure consists of financial markets and intermediaries
- Financial Development—efficient functioning of the markets and intermediaries in providing the financial needs [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com)

Contemporary Legal Regimes

- Western legal systems dominate the world
- Most Muslim countries have adopted variants of these laws.

- English Common law
- Continental (European) Civil law
- While they are different in form, they have similar social objectives (individualism, liberalism, and personal rights) [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com)
- Roots in Justinian’s Roman Law
- Strong central legal system, state above the
- • • • • Civil Law—Features courts Civil laws are codified in complete, coherent, systematic and exhaustive codes Statutes complement and complete the codes Judges enjoy authority of reason—interpret codes and rules for specific cases.

Judgments of one court has no bearing on other courts

Continental Europe (France, Germany, Italy, Poland, etc.) and ex-French Colonies (Northern and sub-Saharan Africa). [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com)

Common Law—Features

- Developed in England in the 11th Century
- Emphasis on property rights and law over the
- • • • • state

Jurisprudence (case law and judgments) forms the core of the law Judges can interpret and create new laws as circumstances change Reason of authority exists—lower courts are bound by decisions of higher courts (stare decisis) Statutes completes the case laws UK, USA, ex-British Colonies [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com)

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Adaptability of Laws

- Adaptability focuses on ‘ process of law making’
- Ability of the law to evolve in response to changing conditions
- Adaptability can be measured by: - Sources of law: juridical

decisions versus statutory law/codes - Legal justifications: juridical decisions based on equity or statutory law [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) Sources of Law & Financial Development Case law enables inefficient laws to be replaced • • by efficient laws through litigation and jurisprudence Law based on statutes and codes framed by legislatures is slow and costly to change Empirical studies confirm that case law as a source of law is positively related to financial market development (Beck and Levine 2003, LaPorta et. al 2002) [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) Legal Justification & Financial Development • Firms face higher financing obstacles here juridical decisions are based on statutory law rather than equity • Empirical studies indicate countries where statutory law is the basis of judgments face higher obstacles to get external finance (Beck et. al. 2004) • Common law countries have fewer obstacles than civil law countries [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) Adaptability of Law and Financial Development-Conclusion • The common law is more adaptable than civil law according to both measures of adaptability (Sources of law and Legal justifications) • Common law countries appear to have more financial development compared to civil law countries [ww. LearnIslamicFinance. com](http://ww.LearnIslamicFinance.com) Islamic Law—Sources • Sources of Islamic law are two: - Revealed: the Shari'ah is the primary source of principles and rulings—the Qur'an and the Sunnah - Derived: knowledge derived from the Shari'ah by exerting human intellect through ijtihad—fiqh • Usul al fiqh: Islamic legal theory—the rules of • • application of reason in developing laws (fiqh) from Shari'ah While Shari'ah is divine and immutable, fiqh can change over time and place Islamic law—law of scholars/jurists [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) Islamic law—Features • Overall goal of Islamic law is to promote elfare (masalih) • Specific goals (maqasid al-Shari'ah)—<https://assignbuster.com/islamic-law-adaptability-and-financial-development/>

protection of religion, life, reason, progeny, and property • Law precedes the state—state's role is to maintain and enforce the law [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) Islamic Law—Evolution (1) • Legal schools established by the end of 9th century AD • 13th century AD—a long period of taqlid (imitation) - Doors of ijtihad closed—reasoning became mechanical - Teachings of respective schools followed strictly - Stagnation of Islamic jurisprudence [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) Islamic Law—Evolution (2) • Under the influence of Western legal system, the Ottomans adopted a code called Majallah (1877-1926)—legal rules mainly on commercial transactions • 19th century—most Muslim countries adopted Western laws due to colonization • Middle of 20th century—-independent Muslim states inherited the same legal systems [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) Islamic Law—Evolution (3) • 1970s—Islamic banks emerged - Rules/resolutions (fatawa) from Shari'ah academy/boards/scholars - Laws related to Islamic banking and finance • The above form the essence of contemporary Islamic commercial law [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) Comparison of Laws (1)

Features Civil Common Origins Sources of Law Lawmakers Role of State England Rome (6th century AD) (11th Century AD) Legislature (Codes and statutes) Legislatures State above the courts (law) Precedent judgments of courts Judges Law over the state Islamic Advent of Islam (7th century) Shariah and Fiqh Shariah scholars/ jurists Law over the state [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) Comparison of Laws (2) Features Civil Common Sources/ implementers of law Legislature creates, courts apply Rulings of one court have no bearing on others Closed-all situations governed by broad principles Rigid and slow to change Courts create and apply

Islamic create and judges apply Judgments of one court has no bearing on others Shari'ah scholars Status of judgments Closed/ open Evolution Lower courts follow the decision of higher courts (Stare decisis) Open-new rule may be created based on new facts Can change with new court decisions Shariah - Closed Fiqh - Open Can change within the boundaries of Shariah www.LearnIslamicFinance.com Session 2 Adaptability of Islamic Law and Financial Development – Adaptability of Islamic Commercial Law – Islamic Legal Infrastructure & Financial Development – Conclusion www.LearnIslamicFinance.com

www.LearnIslamicFinance.com Adaptability of Islamic Commercial Law • Adaptability of Islamic Commercial Law is discussed at three levels: – General adaptability principles – Specific cases of adaptability – Islamic law and adaptability indicators (source of law and legal justification www.LearnIslamicFinance.com Islamic Law & Adaptability: Basic Principle • Islamic Law can be broadly classified as: • Ibadat – Any act (ritual/worship) which is not • • – – Ibadat (devotional matters) Muamalat (dealings/transactions) egalized by Shari'ah is void Muamalat —Transactions are permitted unless prohibited by Islamic law—ibahah (principle of permissibility) In muamalat, new transactions/rulings can be adopted through ijtihad as long as they do not contain the prohibited (riba and gharar) www.LearnIslamicFinance.com Islamic Law & Contemporary Finance • Traditional nominate contracts – – – Exchange: Sale (bai), hire (ijarah), work done for reward (juala). Accessory: Agency (wakala), partnerships (sharika), assignments (hawalah), pledge or mortgage (rahn). Gratuitous: Loan (qard), deposit (wadia), gift (hiba), guarantee or security (daman or kafala). While some of the contracts can be used for • financing, it

was done directly Contemporary financing done through markets and intermediaries [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) Adaptability of Contemporary Islamic Commercial Law • The challenge for Islamic law was to adapt the traditional nominate contracts to new financial contracts to cope with the transactions of contemporary financial system (markets and intermediaries) During contemporary times, Islamic law has adapted and expanded in mainly three ways: • 1. Adapting traditional contracts to contemporary transaction 2. Using multiple traditional contracts to create new ones 3.

Adapting Conventional Financial Products [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) 1. Adapting traditional contracts to contemporary transaction • The principles of traditional contracts are used in transactions with slight modifications 1. Copyright/patents recognized as something that can be bought/sold 2. Sale of arboon (advance payment) used as ‘ call option’ [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) 2. Using multiple contracts to create new ones • Combining multiple traditional contracts 1. Financial murabahah (Murabahah, promise, guarantee) sale) Diminishing musharakah (musharakah and to create new ones.

The most commonly used method of creating new contracts 2. Ijarah wa iqtinah (ijarah and gift, ijarah and 3. sale) [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) 3. Adapting Conventional Financial Products • Modifying conventional instruments and removing undesirable elements 1. Stocks and Islamic mutual funds. 2. Corporate law • Legal personality • preferred stock [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) Adaptability of law—indicators • Adaptability focuses on ‘ process of law making’ • Adaptability measured by: – Sources of law: juridical decisions versus statutory law/codes – Legal justifications:

juridical decisions based on equity or statutory law www. LearnIslamicFinance.com • Source of law—juridical decisions (common law) • • • • • Source of Islamic Law vs. codes/statutory law (civil law) Under Islamic law, both Shari'ah and fiqh are considered The evolution of Islamic law is on a case to case basis (like common law) Stare decisis replaced by taqlid (fiqh) No history of legislation of Islamic law Shari'ah provides immutable principles that cannot be violated (similar to statutes and codes of civil law) www. LearnIslamicFinance.com Source of Islamic Law and Adaptability • Given the permissibility principle, Islamic commercial law (fiqh) can evolve within the boundaries set by Shari'ah • The body of Islamic commercial law has expanded through ijtihad • Taqlid or anchors related to specific schools have been overcome • This has been practiced by various Shari'ah boards/Fiqh Academy www. LearnIslamicFinance.com Legal Justification of Islamic Law • Legal justification—judgments based on equity (common law) vs statutory law (civil law) • Islamic law—Shari'ah and fiqh • Maslaha and maqasid al-Shariah replaces equity in forming new laws • Shari'ah replaces statutory law as guiding principles that cannot be violated in making new laws www. LearnIslamicFinance.com Legal Justification of Islamic Law and Adaptability • Maslaha and maqasid al-Shariah (broader than equity) important ends to law and important goal in framing law • Shariah itself institutes welfare (masalih) of people • Islamic Law—Shariah and fiqh reinforce each-other to achieve welfare/benefit of people www. LearnIslamicFinance.com Islamic Law and Adaptability: The Way Forward (1) • Islamic law adaptable both in terms of source and legal justification • Sources of law—Shari'ah cannot

change, fiqh can • Fiqh has been rigid due to taqlid • Breaking away from taqlid— weak form and strong form www.

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- Weak form—breaking away from specific
- 1. school of thought Strong form may be done at two levels Given the new environment and technology, come up with new resolutions that do not have anchors in fiqh (e. g. Kamali and Chapra and Khan) Revisit usul al fiqh which did not change since the 13th century www. LearnIslamicFinance. com
- 2. Islamic Law and Adaptability: The Way Forward (3) • Legal Justification: Maqasid al-Shariah not eing given importance in framing new rules in contemporary times • Integrate the maqasid approach with the fiqhi approach www. LearnIslamicFinance. com
- Islamic Legal Infrastructure • Most Muslim countries have Western legal • systems. Development of Islamic financial sector would require supportive legal infrastructure institutions to reduce legal risks
- 1. Harmonizing Islamic law and Standardization of Shariah rules
- 2. Need for Islamic Financial Laws/Statues
- 3. Dispute Settlement/Conflict Resolution Institutions www. LearnIslamicFinance. com

Harmonizing Islamic Law & Standardization of Shari'ah Rules • Long history of fiqh under various schools—diversity of legal opinions • Variety of rules introduces legal risks— affect growth of Islamic financial industry • National level—Shari'ah rules standardized by a National Shari'ah body • International level—international body needed for issuing standardized rulings (to enable growth of global transactions) www. LearnIslamicFinance. com

Need for Islamic Financial Laws/Statues • The existing laws cannot support Islamic financial transactions (e. g. , activity in trading, equities, etc. • Islamic

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banking laws and provisions in existing laws passed • This is particularly needed in countries with civil law traditions [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) Dispute Settlement/Conflict Resolution Institutions • Lack of courts to enforce Islamic contracts • • • • increases the legal risks In case of disputes —law of the country will prevail over principles of Shari’ah ‘ Choice of law’ and ‘ dispute settlement clauses’ included in contracts Shari’ah as governing law—disputes settled by commercial arbitration Dispute settlement institutions (Islamic courts or arbitration centers) needed to reduce legal risks [www.](http://www.LearnIslamicFinance.com)

[LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) • Recent growth of Islamic financial industry • • Conclusion proves that Islamic commercial law is adaptable Principle of permissibility indicates Islamic law can evolve as long as principles of Shari’ah not traversed To sustain the Islamic financial sector development there is a need to: – Develop new Islamic commercial law keeping in mind maqasid al-Shari’ah and contemporary realities – Develop supporting legal infrastructure institutions [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com) THANK YOU! [www. LearnIslamicFinance. com](http://www.LearnIslamicFinance.com)