Challenges and Constraints in accepting Risk Sharing Based Instruments in Islamic Finance

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بسم الله الرحمن الرحيم

"*Unless we create a legal environment that promotes risk sharing finance by reinforcing mutual trust, the practice of Islamic finance is unlikely to converge towards its theoretical foundations*"

Governor, Central Bank of Kuwait

What is meant by sharing instruments?

It means contracts of partnerships where the two parties enjoy, on equal footing, the fruits of the investment and bear the loss pro-rata to their shares. In the context of Islamic finance, it means the bank "shares" on both sides of the balance sheet.

Why is it important to have sharing based instruments:

The economic argument for sharing modes can be summed up in equality because the value created by new investments would be distributed at a larger circle that just capitalist who borrow on the basis of interest. And stability because the trade cycle is almost eliminated because sharing reduces the bad effects of inflation and deflation.

Is there a shari'ah reason for this stand vis Musharakah?

This position on the preference of Musharakah, while justified from economic point of view, can't be said to be so from shari'ah point of view. It came as a natural outcome of the disillusion of the ills of debt financing. It is almost a forgone conclusion in economics that debt financing is ____ to the health of the economy and that debt is the root of every problem in modern capitalistic economics. Naturally such debate must end in suggesting an alternative which again naturally is share based financing.

- Is the assault on debt financing justified?

  It can't be denied that debt financing as practiced in modern capitalist economics is an effective means of redistributing wealth from poor to rich, and that it throws the economy into trade cycles the brunt of which is mostly born by the poor. But this is true for the interest based debt which is time based. Debt that grows by just the passing of time. Islamic debt is not like this. It doesn't change in amount no matter what.

Islamic debt that emanates from deferred payment sales remains a fixed obligation. Creditor can't make money by the mere passing of time. This is a completely different debt from that which is the backbone of conventional banking to which all economic ills are attributed. This point has never been the focus of any services study. It appears that Islamic economists tools the basic conclusions of the main stream economics as given, without sufficient attention to this important difference.

Is sharing of risk desirous from shari'ah point of view?

Some may find the question unreal or even improper.

But let’s face it, shari'ah related question must be answered through shari'ah methodology.

Would the Quran or Sunnah or Qyas guide us to a conclusion.

Putting Musharakah ahead of any other mode of finance? The answer is firmly no.