EDITORIAL

Federal Sharīah Court’s Judgment for Ribā Free Pakistan

Zeeshan Ghafoor
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The controversy of whether modern-day commercial interest falls under the purview of ribā and, therefore, prohibited or not was resolved globally by the end of the 1980s by resolutions, fatwas, and reports of various forums and committees. Accordingly, Islamic banking started evolving, and Pakistan was the pioneer in this regard. Yet, as the Constitution of the Islamic Republic of Pakistan required elimination of ribā from the entire economy, certainly a difficult task, the controversy was re-initiated when an appeal was preferred by the government against the judgment of the Federal Sharīat Court (FSC) of Pakistan declared in its of 14th November 1991. The FSC (1991) declared that the Non-Interest Based (NIB) system introduced by the SBP in 1985 was un-Islamic mainly due to the involvement of ‘Sell and Buy-Back’ and sale of debts/receivables and ordered that the whole system be Islamised in its true sense by the end of June 1992.

The Sharīat Appellate Bench (SAB) of the Supreme Court of Pakistan rejected the appeal against the FSC judgment (1991) in its verdict given on 23rd December 1999 and ordered that the laws involving interest Laws would cease to have effect finally by 30th June 2001. The government first got an extension of one year but then filed a review petition, and the newly constituted SAB remanded both earlier judgments back to the FSC in June 2002.

In the FSC, the case remained pending for 2 decades till it was decided on 28th April 2022. The FSC (2022) again declared that all types of interest on loans and debts (either for commercial, production-related, or personal purposes) fall under the definition of ribā. The FSC directed the government to complete the necessary legislative amendments by 31st December 2022 to replace the laws declared void due to involvement of interest and that the interest must be eliminated from the economy by the end of 2027.

The scholars who have reviewed the Judgment (FSC, 2022) have identified the missing aspects such as ignoring the delayed exchange of two different currencies having a potential to open the avenues of currency salam and futures contracts which are prohibited by Islamic Fiqh Academy, Jeddah and AAOIFI, Bahrain. It also ignored the unsettled issue of inflation and indexation of loans and did not focus on the financial transactions outside the banking system. An invited peer-reviewed paper is being included in this Issue of the Journal that the

*Email: zeshan.ghafoor@riphah.edu.pk ; ORCID: https://orcid.org/0000-0002-0398-3247

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readers may like to see. Here, we wish to draw the attention of the government, the SBP, the Parliament, the Islamic banks and the Sharīah scholars, researchers and economists to assist the implementing institutions and authorities by R & D work and providing a blueprint of the transactions and business structures in the new system.

In response to the judgment, the finance minister, Miftah Ismail, welcomed the decision mentioning that the government and central bank will “carefully study this important decision and then seek guidance and clarification from the FSC about the process, steps and time frame to implement this decision”. Practically, however, the State Bank of Pakistan and some commercial banks preferred an appeal before the SAB on 25th June 2022. As per Constitutional provision (Article 203D (2) (b)), the judgment would not become effective until any such appeal is disposed of. The appeal would result in complacency, and there would be no effective move to the accomplishment of the religious and constitutional obligation.

For the Government, we would like to suggest that huge and increasing debt is not sustainable at all. The task is becoming increasingly difficult. Pakistan’s total debt and liabilities as of the end of June 2021 stood at Rs. 47.8 trillion (100.3 % of GDP). Total public debt from external resources amounted to US $ 95.2 billion which also included debt taken from IMF (7.4 billion US $). Public foreign debt also includes that of PSEs amounted to $ 102.2 billion (SBP, 2021)\(^1\). It would have been much easier if some effective steps were initiated in the early 1990s [external debt = $20b], and in 2001 [external debt = $37b] respectively when the appeals were preferred against the FSC judgment (1991), and then SAB judgment (1999); and the case ultimately remanded back to the FSC. The reasons and the bases given by SBP in its appeal (25th June 2022) are almost similar to the arguments given by it and the government during the review hearing by the SAB in 2002. It could be the last chance that we initiate effective measures to transform the economy of Pakistan in the light of the judgment. The FSC (2022, Para. 104) instructed in this regard, “Therefore, to eliminate ribā we direct that all Public Sector entities start dealing only in Interest-free Sharīah-compliant modes which are approved by the State Bank of Pakistan”.

The FSC (2022) in Para 155 of the judgment also emphasized the need to have an equitable economic system, free from exploitation and speculation. It requires that all future strategies and courses of action should be linked to the above overarching principles and guidelines. Required substitute legislations should also be focused on these principles. Further, it may amend the SBP Amendment Act 2021 that has prohibited the SBP to finance the government. Even in case of a liquidity crunch in the market, SBP has been asked to lend to the banks that would lend to the government. It enriches the banks at the cost of the public, who are bound to pay in the form of increasingly high rates of taxes for servicing the extraordinarily high-cost debt. The central bank’s independence must not be at the cost of proper coordination. Economic management requires effective coordination between the central bank and the government. In that case only, the system might be working smoothly subject to the ‘measured accountability’ of SBP and other related institutions in case of not realizing the targets.

According to a Working Paper of Finance Division, the Prime Minister of Pakistan has directed to constitute a Task Force to be headed by the Finance Minister with members

\(^1\)https://cutt.ly/qXJbwiC
also including, among others, SBP Governor and some Sharia scholars namely, Mufti Taqi Usmani, Sheikh Azhar Iqbal, Mufti Qasim Attari, Dr. M. Hussain Akbar, and Dr. Raghib Naeemi. However, the TOR of the Task Force is not clear and requires reconsideration before the formal announcement. The Task Force for Strategy & Planning (TFSP), with an elaborated TOR, has to be broad-based, comprising experts in finance, monetary economics, accounting, legal and Sharia matters, and all selected on merit. An important point in TOR will be the identification of gaps and hurdles in the way of Islamisation. The TESP must take benefit of the work already done by various commissions and committees available with the SBP.

For different development and infrastructure projects, financing in local and foreign currencies can be taken from banks, individually or in syndicates. The banks might be allowed to transfer such funding to private investors also, including overseas investors. As suggested by the FSC (2022, Pp 207 - 209) in respect of financing by World Bank Group and IsDB during the last few years, all infrastructure and project based or commercial financing can be taken based on Islamic modes like Salam, istisna, leasing, diminishing musharakah, murabaha, istisna – ijarah and wakala – ijarah based financing, and musharakah – istisna – ijarah based financing structures. The World Bank and the IsDB signed a Deep Dive Initiative (DDI) in 2015, a strategic partnership framework aimed at scaling-up development assistance in common member countries. Further, IsDB and the ADB established Islamic Infrastructure Fund (IIF) to facilitate the mobilization of public and private sector equity funds and attract foreign investment in the twelve common member states. “The World Bank and the IMF view the growth of Islamic banking as an effort to encourage inclusion, stability, and strength of the financial markets so that newer and resilient funding sources can be created”, the FSC added (P. 211, 12; Para 97). Regarding the State Bank, we feel that it should have done some initial work for implementing the judgment and then make a request for more time. If five Islamic banks can do their business on Islamic principles, 17 banks have got experience in conducting Islamic banking over the last 15 years, and the Faysal Bank has successfully shifted its entire business as per SBP’s Sharia governance framework, then other banks could also transform fully to Islamic banking within five years. Converting the huge public debt held by the banks (53% of their total investments) is a problem, but for that either more time could be demanded for long term debt or any adhoc tool could be adopted in consultation with the TFSP to be constituted as suggested above. SBP may also take into account the crowding out of the small and medium commodity producing and priority sectors like agriculture, renewable/green energy, and other micro businesses in the economy, as most of the bank financing is being made either to the government or to the corporate clients.

The Parliament has to perform its duty in implementing the principles of policy set by the Constitutions by providing proper legislation and also by ensuring effective involvement of the state institutions in the process of transformation. The FSC has referred to the systemic procedure of reporting about the progress of implementation as required by the Constitution, “Article 29 (3) submission of the annual report before the National Assembly and the Senate on the observance and implementation of the Principles of Policy, specifically Article 38 (f) on the elimination of riba from the economy”.
We understand that there is a constitutional provision that the SBP, the government, or even any individual can approach the FSC to get clarification on different points or even get more time in case of time-bound or sectoral-specific transactions. So, the SBP may like to approach the FSC instead of preferring appeal before the SAB.

The banks need to ensure Sharīah compliance of their business in substance if they wish to expand their outreach to the whole population of the country that is predominantly Muslim. Currently, Islamic banking is facing a crisis of identity. Although the FSC (2022) has dispelled the impression that Islamic banking in vogue is based on any kinds of heelas (Para 80, Page 189), yet, there are many issues arising from the use of some grey area modes like organized tawarruq, currency salam, running mushārakah and sale of near-to-maturity GOP ījārah ṣukūk to SBP. As suggested by the FSC (2022), Islamic banks must consider the results (ma’alat) of the financing activities for realizing Sharīah compliance in spirit, and for desired socio-economic impacts. It would require a change in paradigm and policy, and the direction of Islamic banking - to serve as business and trade intermediaries.

As regards the universities, business schools and research centers must undertake R & D work in collaboration with the banks. Universities have to be involved in Research and Development work for surveys for profit margins and rental rates in various sectors and businesses. They need to work on developing benchmark rates for financing of main sectors in the economy based on the market rates for various sectors and transactions. They may also prepare illustrations of various banking and finance transactions so that the same could be Sharīah compliant in spirit and helpful in social justice. They may also review the instruments and products approved by Sharīah Boards and implemented by banks for redressal of the problems. The R & D centres may also be providing practical suggestions for the Parliament, Sharīah Court, and higher judiciary, as and when required. They may also provide practical training and orientation for professionals, Sharīah Board and Board members of banks, product developers, and middle & senior-level practitioners.

Last, but not least, Sharīah scholars have to guide the government and the regulators of financial markets while ensuring that the objective of transformation as indicated by the Court (Para. 155) is realized, and the economy and the people of the Islamic Republic of Pakistan get rid of ribā both in form and substance.

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