Islamic Banking in Theory and Practice

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Islamic banks have expanded rapidly since the mid 1970s and there are now 400 such financial institutions world-wide. Because of the ban on *riba* (interest, usury) an Islamic bank cannot charge or pay interest. This paper explains the religious, ethical and legal principles underlying Islamic financing, and then compares the Islamic banking model, in theory and reality, with that of conventional Western banking.

Islamic law

Two aspects shape the relationship between Islam and finance. One is that Islamic law, the *shari'a*, claims to regulate all aspects of life, ethical and social, and to encompass criminal as well as civil jurisdiction. Every act of believers must conform to Islamic law and observe ethical standards derived from Islamic principles. These ethical principles define what is true, fair and just, the nature of corporate responsibilities and the priorities to society (Lewis, 2001). Second, in addition to providing a set of business ethics, certain Islamic economic and financial principles have a direct impact upon financial systems. These principles include, most importantly, the institution of z*akat* (the religious levy), and the prohibition of *riba* (usury) and the institution of an interest free economic system.

Those who pioneered Islamic economic thought developed rules for carrying on commerce, banking and finance from Islamic law or the s*hari'a* (formally *shari'a Islami'iah* but generally abbreviated to *shari'ah* or *shari'a*). The literal meaning of the Arabic word *shari'a* is 'the way to the source of life' and, in a technical sense, it is now used to refer to a legal system in keeping with the code of behaviour called for by the Holy Qur'an and the *hadith* (the authentic tradition). Muslims cannot, in good faith, compartmentalise their behaviour into religious and secular dimensions, and their actions are always bound by the *shari'a*. Islamic law thus embodies an encompassing set of duties and practices including worship, prayer, manners and morals, marriage, inheritance, crime, and commercial transactions. That is, it embraces many aspects that would not necessarily be considered as law elsewhere. It is thus entirely religious, and as sacred law contains the core of Islamic faith itself.

Nature of Islam

Islam is numerically the second-largest religion, with an estimated 1.3 billion followers (after Christianity's 2 billion), and follows the Judaeo-Christian heritage as the third and last of the great monotheistic religions. One who professes the faith of Islam is a Muslim. The origins of the word *Islam* are in the root *s-l-m* which means 'tranquillity', 'peace' (*salâm)* or 'to remain whole'. The term *aslama* means 'to submit oneself with complete peace of mind' or 'to give oneself up to God', and it is from this that the word *Muslim* derives. Frequently *Islam* is defined simply as 'submission to God' or 'surrender to God'. Those who 'submit to' this path form the *umma*, the community of Muslims.

Belief in the sovereignty of God is at the centre-piece of the Islamic faith, in that it is focused around the worship of God (in Arabic *Allah*) and divine revelations as given in the Holy Qur'an, revealed between 610 and 632 C.E. to the Prophet Muhammad ibn 'Abd Allah'[1]. A work roughly the same length as the New Testament, the Holy Qur'an[2] calls on polytheists (believers in many Gods), Jews and Christians alike to commit themselves to God's final revealed message. The Holy Qur'an is for Muslims in the most literal sense the word of God, and Islamic law flows directly from it and is wholly inspired by it.

Muslims are devoted to observance of the Six Beliefs and the Five Duties of their faith. The fundamental articles and duties of the Islamic faith are contained in the Six Beliefs (in God, the angels, the prophets, the holy books, the day of judgement, and the decree of God) and the Five Duties (testimony/affirmation of God and Muhammad, prayer, almsgiving, fasting, and pilgrimage) which every Muslim must uphold or perform. Above all, however, the practising Muslim is expected to respect the teachings of the Holy Qur'an in its entirety - the basis of Islamic law.

Sources of Islamic law

The unique validity of Islamic law comes from it being the manifested will of God, who at a certain point in history revealed it to mankind through his prophet Muhammad; as such it does not rely on the authority of any earthly law-maker. Its origins, in addition to the Holy Qur'an, are to be found in the judgements given by the Prophet himself, reflecting the application of rules, principles and injunctions already enunciated in the Holy Qur'an. As the centuries passed these rules grew into a complete system of law, both public and private, as well as prescriptions for the practice of religion.

While the Holy Qur'an produced a number of general rules, these did not delineate all possible problems, and the century after the death of the Prophet Muhammad they were supplemented by references to the *sunna* or standard practice. This was known from thousands of statements about what the Prophet had said or done, and found in the literature of the *hadith*. The *shari'a* grew out of the attempts made by early Muslims, as they confronted immediate social and political problems, to devise a legal system in keeping with the code of behaviour called for by the Holy Qur'an and the *hadith.*

The study of the *shari'a* is *fiqh,* 'jurisprudence', and its practitioners are *fuqaha,* 'jurists'. Another word used is *ulama*, which is properly 'those who know' but is mostly translated 'scholars' or 'scholar-jurists'. This is because in Islam the place of theology is taken by laws and jurisprudence. Those who deal with the intellectual aspects of the religion are jurists and not theologians, and at the centre of high education is jurisprudence and not theology. Thus the sources of the *shari'a* are the Holy Qur'an and the *sunna* (the primary sources) and the interpretations and reasoning of the learned jurists (the secondary sources).[3]

Since Islamic law reflects the will of God rather than the will of a human lawmaker, it covers all areas of life and not simply those which are of interest to a secular state or society. *Shari'a* duties can be broadly divided into those that an individual owes to God (*ibadat*, acts of devotion and ritual) and those owed to fellow people, ie. what would constitute law in the Western sense (*muamalat*). The former include prayer, ablutions, fasting, pilgrimage, the establishment of Mosques, observance of holy days, gestures and behaviour. Strict food laws forbid pork, blood, carrion, specify the method of preparing animals and ban the drinking of any alcoholic beverages. Also prohibited is the representation of animals or the human figure in art, as a precaution against any lapse into idolatry. The other areas covered by Islamic law are considerable, and include *inter alia*, marriage, divorce, sexual relations, care of children, adoption, maintenance, inheritance and so on, as well as financial activities, to which we now turn.

Nature of Islamic banking

There are strict rules applying to finance under Islamic law. In order to conform with Islamic rules and norms, five religious features, which are well documented in the literature, must be followed in investment behaviour (Lewis and Algaoud, 2001). These are:

(i) *riba* is prohibited in all transactions;

(ii) business and investment are undertaken on the basis of *halal* (legal, permitted) activities;

(iii) *maysir* (gambling, speculation) is prohibited and transactions should be free from *gharar* (unreasonable uncertainty);

(iv) *zakat* is to be paid by the bank to benefit society;

(v) all activities should be in line with Islamic principles, with a special *shari 'a* board to supervise and advise the bank on the propriety of transactions.

The five elements give Islamic banking and finance its distinctive religious identity.

Perhaps the most far-reaching and controversial aspect of Islamic economics, in terms of its implications from a Western perspective, is the prohibition of interest (*riba*). Financial systems based in Islamic tenets are dedicated to the elimination of the payment and receipt of interest in all forms. It is this prohibition that makes Islamic banks and other financial institutions different in principle from their Western counterparts. Both the Holy Qur'an and the *sunna* treat interest as an act of exploitation and injustice and as such it is inconsistent with Islamic notions of fairness and property rights. Islamic banking thus derives its specific *raison d' être* from the fact that there is no place for the institution of interest in the Islamic order.

An Islamic banking and financial system exists to provide a variety of religiously acceptable financial services to the Muslim communities. This agenda is much broader than the ban on *riba* as we noted above. There is also the prohibition in Islam of *maysir* and *gharar*, the need to ensure that investment be undertaken on the basis of *halal* (permitted) activities, and the requirement to benefit society through the collection of *zakat* (almsgiving) overseen by the special religious supervisory board. In addition to these specific requirements, the banking and financial institutions, like all other aspects of Islamic society, are expected to 'contribute richly to the achievement of the major socio-economic goals of Islam' (Chapra, 1985, p34). The most important of these are economic well-being with full employment and a high rate of economic growth, socio-economic justice and an equitable distribution of income and wealth, stability in the value of money, and the mobilisation and investment of savings for economic development in such a way that a just (profit-sharing) return is ensured to all parties involved.

The problem with interest

Islamic financing methods are designed to ensure that a just distribution of profit and losses occurs in banking and finance. What Muslims find most objectionable about lending at interest is that the interest rate on a loan is fixed and certain (Algaoud and Lewis, 2007). The interest rate is a fixed payment specified in advance for a loan of money without risk to the lender. It is certain because whether or not the borrower gains or loses from the venture, the lender uses collateral and other means to enforce payment. It is much fairer to have a sharing of the profits and losses. Fairness in this context has two dimensions: the supplier of capital possesses a right to reward, but this reward should be commensurate with the risk and effort involved and thus be governed by the return on the individual project for which funds are supplied (Presley, 1988).

Consequently, in banning *riba*, Islam seeks to establish a society based upon fairness and justice (Holy Qur'an 2: 239). The essence and basic building block of the Islamic banking alternative is to link the return on an Islamic financial contract to productivity in the real sector and the quality and success of the project, in this way seeking to achieve a more equitable distribution of wealth and financial returns.

Profit-and-loss sharing

Accordingly, the operations of Islamic financial institutions primarily are based on profit-and-loss sharing (PLS) arrangements. An Islamic bank does not levy interest as such but rather participates in the yield resulting from the use of funds. The depositors also share in the profits of the bank according to a predetermined PLS ratio. There is thus a partnership between the Islamic bank and its depositors, on one side, and between the bank and its investment clients, on the other side, as a manager of depositors' resources in productive uses.

Mudaraba and *musharaka* are the two profit-sharing arrangements preferred under Islamic law, and of these *mudaraba* is the PLS method employed by banks in the raising of funds. A *mudaraba* can be defined as a contract between at least two parties whereby one party, the financier (*rabb al-mal*), entrusts funds to another party, the entrepreneur (*mudarib*), to undertake an activity or venture. This type of contract is in contrast with *musharaka*, where there is also profit-sharing, but all parties have the right to participate in managerial decisions. In *mudaraba*, the financier is not allowed a role in management of the enterprise. The *mudarib* becomes a trustee (*amin*) for the capital entrusted to him by way of *mudaraba*. The *mudarib* is to utilise the funds in an agreed manner and then return to the *rabb al-mal* the principal and the pre-agreed share of the profit. The *mudarib* keeps for himself what remains of such profits.

The basic concept of a *musharaka* has been used as a technique for Islamic financial institutions to provide finance to commercial enterprises. For example, *musharaka* can be used to structure a working capital facility for a company, or it can be used for joint investment in activities such as real estate development and rural finance. In Western countries, diminishing *musharaka* has been used for residential property financing.

Islamic bankers have also adapted and refined the *mudaraba* concept to form the two-tier or triple *mudaraba*. In this arrangement, the *mudaraba* contract has been extended to include three parties: the depositors as financiers, the bank as an intermediary, and the entrepreneur who requires funds, The bank acts as an entrepreneur (*mudarib*) when it receives funds from depositors, and as a financier (*rabb al-mal*) when it provides the funds to entrepreneurs.

Mudaraba and *musharaka* constitute, at least in principle if not always in practice, the twin pillars of Islamic banking (Ariff, 1982). The two methods conform fully with Islamic principles, in that under both arrangements lenders share in the profits and losses of the enterprises for which funds are provided. The *musharaka* principle is invoked in the equity structure of Islamic banks and is similar to the modern concepts of partnership and joint stock ownership. *Mudaraba* is used for investment accounts for depositors, and the Islamic bank acts as a *mudarib* which manages the funds of the depositors to generate profits subject to the rules of *mudaraba.* There is a sense in which an Islamic bank acting as *mudarib* or agent in such a PLS arrangement can be considered more a fund manager than a bank (El Qorchi, 2005). The bank may in turn use the depositors' funds on a *mudaraba* basis, although in practice neither *mudaraba* nor *musharaka* constitute the main conduits for the outflow of funds from the banks.

Mark-up financing

Not all financing requirements are amenable to equity participation, and Islamic banks have shown a strong preference for other less risky financing modes. These alternative methods include mark-up (*murabaha*), instalments (*bai bi-thamin ajil*), deferred payment (*bai'muajjal*), pre-paid purchase (*bai'salam*), manufacturing (*istisnaa*), leasing (*ijara*) and lease-purchase (*ijara wa iqtina*), and beneficence (*qard hasan*). Almost all are based on the charging of a fixed cost rather than an allocation of profit and loss.

Debt instruments (eg *murabaha*) and quasi-debt instruments (eg *ijara*) have thus proven to be indispensable to the growth of Islamic banking, and the sales-based financing techniques represent the greater part of Islamic bank financing. The most commonly used mode is the 'mark-up' device of *murabaha.* In a *murabaha* transaction, the bank finances the purchase of a good or asset by buying the item on behalf of its client and adding a mark-up before reselling the item to the client on a 'cost plus' basis profit contract. This contract form is used especially for foreign trade and working capital financing for circumstances in which banks will purchase raw materials, goods or equipment and sell them to a client at cost, plus a negotiated profit margin, to be paid normally within a fixed period of time or in instalments. In the traditional *murabaha* in *fiqh* (jurisprudence) books, the markup differs from interest in that it is not to be explicitly related to the duration of the loan but instead computed on a transaction basis for services rendered and not for deferring payment.

To an outsider, it may appear that the mark-up is just another term for interest as charged by conventional banks, interest thus being admitted through the back door. Yet the legality of the traditional type of *murabaha* is not questioned by any of the schools of Islamic law (although there are disputes about some forms of *murabaha* which have come into use where the factor of time commitment is added). What makes the traditional *murabaha* transaction in *fiqh* books Islamically legitimate is that the bank first acquires the asset for resale at profit, so that a commodity is sold for money and the operation is not a mere exchange of money for money. In the process the bank assumes certain risks between purchase and resale; for example, a sudden fall in price could see the client refusing to accept the goods. That is, the bank takes responsibility for the good before it is safely delivered to the client. The services rendered by the Islamic bank are therefore regarded as quite different from those of a conventional bank which simply lends money to the client to buy the good.

Similarly, with an *ijara* or Islamic lease, the banks would buy the equipment or machinery and lease it out to their clients who may opt to buy the items eventually, in which case the monthly payments will consist of two components, that is, rental for the use of the equipment and instalments towards the purchase price. The original amount of the rent for the leased assets should be fixed in advance. The profit element in an *ijara wa iqtina* (or financing lease), for example, is permissible despite its similarity to an interest charge. According to Islamic jurists, the *shari'a* allows a fixed charge relating to tangible assets (as opposed to financial assets) because by converting financial capital into tangible assets the financier has assumed risks for which compensation is permissible. The bank bears the risk of recession or diminishing demand for these assets. Leasing also has been justified on the grounds that by retaining ownership the bank runs the risk of premature obsolescence, so that it may be regarded as a service-oriented business.

Theory and reality in Islamic finance

An Islamic banking and financial system is predicated on the complete renunciation of interest. Whereas a conventional bank borrows funds at interest on one side of the balance sheet and lends at interest on the other, an Islamic bank substitutes profit-and-loss sharing for interest as a method of resource allocation. Or, at least, this is the theory. In practice, Islamic financial institutions feel the need to match the characteristics of conventional financial products.

Changes in the industry

Islamic banks operating in 'mixed' financial systems have always faced competition from conventional banks. However, as well, the Islamic financial services market now includes many conventional banks offering, at the wholesale level, commodity-based and other Islamically acceptable investment vehicles, and acting as intermediaries between the commodity brokers and the purely Islamic banks (the 'pure-play' Islamic institutions). At the retail level, an expanding array of conventional banks competes head on with the purely Islamic banks by providing Islamic financial services in a variety of ways. Some are best described as 'hybrids', offering Islamic 'windows' or 'counters', hand-in-hand with conventional banking operations. Others have opened special branches that sell only Islamic banking products. In locations that restrict the operations of 'hybrids', conventional banks have established separate Islamic financial institutions with distinctive legal identity and management. Others have created separate brands for their Islamic activities, such as Amanah (HSBC) and Noriba (UBS). In these different ways, new banks or subsidiaries or offshoots of conventional banks rapidly are appearing and widening their market presence.

Islamic financial institutions as a consequence face a 'dual' assault from the conventional banks which not only provide tried and tested conventional banking facilities to their customers but combine the Islamic products they now offer with superior customer service skills and marketing know-how. There is a perceived need for the Islamic institutions to match the innovation and marketing structures underpinning conventional financial services. This desire has led to the search for Islamic financial instruments that essentially replicate the characteristics of conventional financial products, while remaining within the purview of acceptability in terms of *shari'a* oversight.

New financial instruments

Examples of such innovations are the adaptation of conventional hire purchase and leasing contracts to *ijara* (Islamic leasing) structures, and the development of *sukuks* by modifying and utilizing techniques developed in conventional structured finance arrangements. The former enables contractual forms and documentation employed in conventional banking to be adapted to Islamic finance. The latter 'financially engineers' the payoff profiles to generate returns to bankers and investors that are, since they are derived from the levying of a 'cost-plus' rate of profit formula, as fixed and guaranteed under Islamically-compliant financing modes as any interest-based conventional loan.

Consider, for example, the case of a *sukuk al-ijara*. The originator holds assets (land, buildings, aircraft, ships, etc) that are to constitute the basis of the returns to the *sukuk* investor. These assets are sold by the originator to a special purpose vehicle (SPV) and then are leased back at a specified rental. The SPV securitizes the assets by issuing *sukuk* certificates that can then be purchased by investors. Each *sukuk* certificate represents a share in the ownership of the assets, entitling the investor to periodic distributions from the SPV funded by the originator's rental payments on the leased assets. The returns can be either fixed rate or floating rate (often referenced to LIBOR) depending on the originator. Moreover, the certificates can be traded since they are ownership to real assets, enabling a secondary bond market to develop.

Devout Muslims refuse to buy conventional bonds because they violate the prohibition against earning interest. However, the fixed rate or LIBOR-linked *sukuks* do comply with Islamic laws by virtue of the ownership of the underlying assets. For example, the certificates for the first *shari'a*-compliant securitized market financing of US assets are structured so that Islamic investors effectively get a fixed rate of return (11.25% annually) while considering themselves owners of the underlying assets. An official *shari'a* adviser issued a *fatwa*, or declaration, certifying that the instrument 'will yield returns, Allah willing, that are lawful and wholesome' (*Business Week*, July 17, 2006, p9). Tellingly, a press report on a later issue referred to 'so-called Islamic bonds – or *sukuk* – that are structured to avoid overt *riba* payments' (*The Australian,* August 19-20, 2006, p47). The word 'overt' is revealing.

Another controversial development is that of *tawarruq,* the process of monetization of a commodity. Under the *tawarruq* mechanism, a bank purchases and then sells its customer a commodity at a marked-up price over spot to be paid over a predetermined time period. The customer then resells the commodity for cash at the current market spot price. Interest as such is not levied, with the bank's profit coming from the difference between the purchase price and the higher price agreed upon by its customer. All three trade transactions (cash sale to the bank, credit sale to the customer, and cash sale back to the commodity dealer) that arc embodied and which justify its Islamicity can be handled by the bank, virtually instantaneously, acting as agent for both dealer and customer. However, the upshot is that the customer has obtained cash, in this roundabout way, in the form of an unsecured loan.

Success or failure?

Opinions on these new products differ markedly. El Qorchi (2005), viewing them from a multilateral bank perspective, recognizes the competitiveness of many of the products in attracting both Muslim and non-Muslim investors, while the asset-based bonds (*sukuks*) are seen as a particularly innovative, rapidly growing market sector tapped by sovereign and corporate borrowers alike. In the Islamic financial industry itself, such innovations are hailed for allowing vast sums of money (reportedly US $40 billion in the last three years) to be raised from Islamic investors. A press report in 2006 says 'a construction frenzy in the oil-rich Gulf region has triggered a boom in the market for *sukuks*, or Islamic bonds, as devout Muslims increasingly demand financing instruments that comply with their religion' (*The Australian,* July 12, 2006, p23). A less flattering assessment comes from academics such as Hamoudi (2006) and El-Gamal (2007). Hamoudi speaks of 'the failures of Islamic finance' which have led to the creation of 'a bizarre and highly artificial construct that does nothing to address the social concerns that are the central reason for the creation of Islamic banking and finance' (p8). El-Gamal decries the practice of what he calls '*shari'a* arbitrage', when conventional lending practices are replicated in Islamically-acceptable ways in the balance sheets of

Islamic financial institutions. To him, the Islamic finance industry has degenerated into one that is dominated by form over substance, the chief aim of which is to circumvent, rather than comply in any meaningful way, with the Qur'anic injunctions against *riba* (interest) and *gharar* (excessive uncertainty).

Certainly, one can discern unease in some circles as to the pace of innovation and the direction of change in Islamic banking, leading some observers to ask what remains distinctive about the Islamic system if it merely modifies conventional financing in such a way as to satisfy the *shari'a* advisers (Hassan and Lewis, 2007). One interpretation of this development is that there has been a failure of the special system of governance that an Islamic financial institution must put in place, in which all contracts must be vetted, and all new products approved, by a supervisory board of Islamic jurists or religious scholars (Algaoud and Lewis, 1999). The discipline provided by Islamic religious auditing is a device to solicit juristic advice, monitor compliance with Islamic precepts and collect *zakat*. This extra layer of auditing and accountability for resource use is designed to ensure that the enterprise operates as an Islamic concern, while assuring both insiders and outsiders that God's laws are being followed in financial transactions.

Here, again, there may be a gap between theory and reality. Volker Nienhaus (2007), in particular, argues that the behaviour of the *shari'a* supervisory boards, that monitor adherence to Islamic principles, has altered markedly over the years. In the past, they were somewhat conservative. Now he wonders whether in recent years the boards have become rather too permissive, and accommodating to the bankers. One only has to recall the 'capture' theory of regulation (Stigler, 1971) to think of reasons why the *shari'a* board members might be inclined to give bank managers the benefit of the doubt when approving new product innovations, so blurring the ideological purity of the Islamic system.

However, this may not be a new problem. In his commentary on the activities of the Religious Supervisory Boards (RSBs), Abdullah Saeed (1996) reached the following conclusion:

> 'At times it appears that thee is a tendency on the part of RSBs to solve practical problems by resorting to *hiyal* (legal fiction). Even though the RSBs sometimes appear to be averse to *hiyal* in their problem solving function, some *fatwas* pronounced by the RSBs are akin to *hiyal.* Utilisation of *hiyal* seemingly comes from the RSBs' preoccupation with moulding the solutions which are suggested by the management of the banks, or by the RSBs themselves, into legal forms which are acceptable to various forms of contracts developed in *fiqh*. A solution to a particular problem can he made acceptable if it is in a certain form, while the same solution cannot be acceptable in another form. The RSBs, at times, after declaring a particular transaction unlawful, go on to declare the same transaction lawful if it is presented in a different form even though no modification was made to any of its constituent elements' (p116).

Nienhaus's suggestion to remove this temptation is the establishment of a national *shari'a* board for each country that would be independent of bank management. Another possibility would be for the *fiqh* academies to engage more with Islamic bankers and their *shari'a* scholars, on the one hand, and the general public, on the other, with the aim of encouraging decision-making and governance procedures more in line with the Islamic principle of *shura*. Under *shura*, a consensus-seeking consultative process would be applied within the firm and across shareholders, employees, suppliers, customers and other interested parties and commentators (Askari and Taghavi, 2005; Lewis, 2005).

For such reasons the system of Islamic banking, despite all outward signs of success, may be at a crossroads of sorts. The continued encroachment of the conventional banks into what used to be the exclusive domain of dedicated Islamic financial institutions and the associated blurring of the lines between Islamic and conventional banking instruments and services may mean that the system will succeed only by abandoning, or at least watering down, the principles that led to its inception. If Islamic banking merely modifies conventional financing in such a way as to satisfy the *shari'a* scholars, what is there that remains distinctive about the Islamic system? There is the danger that Islamic banking looks like an issue of branding, like Mecca Cola instead of Coca Cola.

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Notes

1. When Muslims mention the Prophet Muhammad in speech or print, they usually follow the name with an expression in Arabic which can be translated, 'May the peace and blessings of Allah be upon him', sometimes written as 'pbuh', short for 'peace be upon him'. This is not dissimilar to those Christians in earlier times who, when referring to a revered forebear, would say 'may his or her soul rest in peace'.
2. *Sura* (pl. *surat*) is a chapter of the Holy Qur'an. There are 114 *suras* of varying length that constitutes the Holy Qur’an. In all references to the Holy Qur'an (eg 30:39) the first number refers to the *sura* and the second to the *aya* or verse.
3. Sunni legal doctrine has four main schools, each with its own system of theory and applications of law, although each recognizes the legitimacy of all of the others. The four orthodox schools are the Hanafi (rationalist), the Maliki (traditionalist), the Hanbali (fundamentalist) and the Shafii (moderate). However, there are considerable doctrinal differences between the Shia and the four Sunni schools of Islamic law, in terms of who is permitted to interpret *shari'a* law. Broadly speaking, Shi'ites believe that living religious scholars, known as *mujtahids*, have an equal right to interpret Divine Law as eminent jurists of the past, and their judgements replace the Sunni source of deduction by analogy from established law (*qiyas*). Shi'ism, which has various sub-sects, is predominant in Iran, and has significant numbers of followers in Iraq, India and many of the Gulf States. Sunnis predominate elsewhere in the Muslim world and constitute over 90 per cent of all Muslims.