

## FATWA AND THE DEVELOPMENT OF SHARIA FINANCIAL INDUSTRY: A LESSON FROM INDONESIA

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**Abstract. *Fatwa and The Development of Sharia Financial Industry: A Lesson From Indonesia.*** This article is a critical study to analyze the impact of the Fatwa issued by Ulema of the Indonesian Ulema Council (MUI) against the Development of Sharia Financial Industry in Indonesia. The development of Sharia financial industry in Indonesia has been started since the early 1990s. But the most improved level of development was since 2003, when MUI issued a fatwa on the illegitimate Bank's Interest. It was a necessity for the Ulema to perform *ijtihad* or *istinbat* laws in order to give a fatwa on his people. Ulema as the agents of social change oriented to make continuous improvements (*islahiyyah*) in the social -economic order, especially in the financial industry. Considering that the circulation of money in the community is a reflection of society, if the financial flows controlled by virtuous people then so the community. Conversely if the flows of finance are controlled by people who are not good, then the community became devastated.

**Keywords:** *fatwa, sharia financial industry, ulema, descriptive*

**Abstrak. *Fatwa dan Perkembangan Industri Keuangan Syariah: Pembelajaran dari Indonesia.*** Artikel ini merupakan kajian kritis untuk menganalisis dampak dari Fatwa Ulama Majelis Ulama Indonesia (MUI) terhadap perkembangan industri keuangan syariah di Indonesia. Perkembangan industri keuangan syariah di Indonesia sebenarnya sudah dimulai sejak awal tahun 1990-an. Namun tingkat perkembangannya yang paling meningkat adalah sejak tahun 2003, ketika itu setelah MUI mengeluarkan fatwa MUI tentang Haramnya Bunga Bank. Suatu keniscayaan bagi ulama untuk melakukan *ijtihad* atau *istinbat* hukum agar dapat memberikan fatwa pada umatnya. Karena fatwa pada hakikatnya merupakan jawaban keagamaan terhadap problem dan permasalahan yang terjadi dalam masyarakat. Ulama sebagai agen perubahan sosial yang berorientasi secara kontinuitas untuk mengadakan perbaikan (*islahiyyah*) dalam tatanan sosial ekonomi terutama di bidang industri keuangan. Karena peredaran uang di masyarakat adalah suatu cerminan dalam masyarakat, kalau arus keuangan dikuasai umat yang soleh maka solehlah masyarakat tersebut. Sebaliknya kalau keuangan yang beredar dikuasai orang-orang yang tidak baik, maka rusaklah masyarakat tersebut.

**Kata kunci:** *fatwa, industri keuangan syariah, ulama, deskriptif*

## Introduction

The occurrence of the various waves of economic and financial crisis that hit many parts of the world was a very valuable lesson for the Ulema. Due to the occurrence of the financial crisis, especially when we examine the global financial crisis that struck the United States in 2008, because of the element of *gharar*. Indonesia also has experienced the financial crisis ten years earlier, namely in 1998. There are lessons that we can take in many cases related to the financial crisis, the emergence onto the surface of an Islamic economic system as a way out of the crisis. Therefore, the Islamic economic system becomes an alternative system that emerges from mistakes done by the capitalist system and the socialist system. That the economy is driven by the usurious system definitely will ultimately lead to a crisis in the economy, especially the financial crisis.

Abdullah and Chee (2010) confirmed that the Islamic financial system is now increasingly becoming the mainstream and alternative to the conventional financial system. Considering that the Islamic financial system proved to have endurance in to face the wave of economic crisis. At least three waves of the global crisis, the oil crisis of 1973, the terrorist attacks of 11 September 2001 and the global financial crisis, known as the “subprime crisis” in 2008. Especially in the latter case that was the global financial crisis that began in the US but worldwide impact, reflected in the variety of the trading floor of the world, all affected by the crisis, only those indexed by sharia alone that have endurance to the crisis.

Similar recognition comes from Moody Rating Agency (2008) that one of the advantages of Islamic financial system is the immune to shock the power of the global financial crisis. As has been known, the cause of the crisis is because of the element of speculation in the conventional financial system. Islamic economic system has the spirit of eliminating the elements of *gharar* / speculation in economic practice. In the consideration of fatwa issued by Ulema, one that becomes our concern is to remove the practice of *gharar* (*adamul gharar*) in economic activity of society. Because *gharar* will eventually trapping people in deceptive action stratagem in the economy. Ulema issued a fatwa unequivocally that every economic transaction containing fraudulent (*gharar fahisy*) shall be declared not valid in terms of Islam law (Daradika, and al-Dharir, 1990).

The system that put forward in the sharia financial industry is a system that brings *maslahah* for the community. In other words, economic activity must be conducted on the principles of Sharia that bring benefits for the good of society such as improving welfare and other virtues. In addition, the Islamic financial system should avoid any harm or damage in the community. In *usul fiqh* Qaeda, it

is known as the principle of “*Jalb al-mashalih wa dar’u al-mafasid*”, means bringing benefit and avoiding any damage. This principle contains a consequence, that the Islamic economic system did not justify their economic practices that may damage or disrupt the lives of people such as gambling, drug sales, prostitution and so on (Zaid, 1964 and al-Qaradawi, 2001).

El-Komi’s study (2010) showed that the cause of poverty in the world mainly that affecting the third world countries that are predominantly Muslim, is their belief that the bank interest is the unlawful usury. The poor people were not able to access to micro-finance credit because it conflicts with their religious beliefs, that the micro-credit-based interest is forbidden. As generally known, the role of microfinance is very significant in poverty alleviation.

The findings of this study show us that interest-based financial system will create a widening social inequality and will extend the row number of poverty population. In fact, one third of the poor society is on the third world countries whose population is majority the Muslim.

Ideal financial system should be able to accommodate and commit to engage in poverty alleviation. Because, the increase levels of the welfare of poor people will boost purchasing power. One of the goals of the Islamic financial system is *Khidmah* principle, which is a commitment of the Islamic financial system that encourages the sharia economic activity in order to realize social services (*tabbiq al-khidmah al-ijtima’iyah*). Of course, the orientation is towards the creation of the social services that can alleviate the burdens of the weak economy. This principle is inherent in all activities of Islamic economics, because the sharia economic system in addition to allow the increase of profits and wealth, there must be concern for the social conditions of the surrounding community.

Conventional financial system, as revealed in Al-Harran (1996), closes access to the small farmers, small businessmen and small craftsmen, because they are considered not worthy to get credit by the conventional financial institutions. In addition, they mostly do not have collateral, as well as those deemed unworthy venture business. Obstruction of access to sources of funding from the conventional financial system creates injustice and imbalance between small and large businesses that will cause social jealousy. If these conditions cannot be overcome, it will create instability, which in turn would disrupt the economy of the community itself.

That is why the sharia financial system committed to promote justice in the economy. Fair principle that is intended to encourage every economic activity should be oriented towards the creation of fairness and balance (*al-’adlu wa al-tawazun*). Islamic economic system is intended to maintain the values of justice

and avoid the element of injustice. In terms of economy, there should not be any elements of oppression, exploitation and so on. It should be considered an element of proportional balance. For example, if we want a big advantage, then it should also consider the risks that would arise.

Islamic economic system should also accommodate the values of pleasure (al-Zarqa, 1968), that in any economic activity there should be a process of mutual give up (*taradhi*), there should be no element of coercion (*ikrah*). Element of *ridha* among people that conduct economic activity is a fundamental aspect, so that the activity runs healthy, there is a spirit of honesty and mutual *Ihlas* and must not be under-pressure.

Nevertheless, the *ridha* principle is not necessarily make the transaction is valid in terms of *syar'i*. It is true that each element of the pleasure is the principle in economic activity, but it is not the cause of the permissibility of something forbidden (*ar-ridha ruknun li al-aqdi wa laisa sababan li al-hilli*). In addition the economic transaction should be based on the attitude of non-pressure (*ghaira ikrah*). This principle is a basic principle in jurisprudence of *mu'amalat* and as the basic principle as well in the agreement (contract). There must be freedom among the parties involved in the contract either in determining the terms of the agreement and the object being agreed (object of the agreement), including methods for the settlement of disputes. Freedom in determining these terms shall be allowed, as long as no conflict with other provisions of sharia.

Furthermore, Islamic economic system emphasizes the principle of *Mubah* (Buzed, 2004). The principle of *Mubah* is in accordance with the rule that any form of economic activity or the *mu'amalat* activity basically in under *mubah* law, unless otherwise determined by a proposition. This principle is usually used as a basis in determining the law of economic transactions. This principle also shows that Islamic law would not be difficult for the transaction actors of sharia system. It is precisely that this principle provides convenience and vast opportunities for growth and development of the economy in accordance with the needs of the era and the needs of the livelihood of the people.

Ulema in determining the legal fatwa regarding Islamic economics is usually also consider the principle of *Istirbah* (al-Mansur, 2007). This principle is intended that the sharia economic activity must consider the principles of profitable or profitability in the business. Actually this has become a common formula, that people who do business certainly expect their profits. Be illogical, if there are people who do business bit do not expect any profit.

Formulation of a fatwa is not only based on *nushush syar'iyyah*, but also to adjust the same with the economic changes and needs in the community, so that

the output applied and encourages the economic growth that exists. Fatwa issued by MUI is indeed departed from the fatwa that is requested by the community businesses, government officials and those of other interested parties. Therefore such fatwa is issued directly functional and can trigger the growth of national economic.

## Literature Review

### Reform of Islamic Law and the Demand of Islamic Economic Fatwa

Reform of Islamic Law is a necessity, because it is in accordance with the guidance of *nash* and also in accordance with the changing demands in the field of economy. Various changes in the society because of the change of era raise new issues, which are sometimes difficult to find the answers in the existing texts. This fact requires the effort of *ijtihad* or law *istinbat* to accommodate the change in the order of economic life in the community.

In accordance with the *Hadiths* (al-Hakim, at-Thabrani, al-Baihaqi, Abu Daud, Sunan Abi Daud in Maktabah Syamilah, t.thn) which reads: “ *Truthfully Allah sent to this people at the end of every hundred years, a person that reforming the religion of such people* “. This *hadits* explicitly mentioned the need to reform the Islamic law at the end of every century or hundred years.

In relation to such *hadits*, it also reveals the provision in the Qaeda (al-Jawziyyah, t.th, al-Nadawi, 1999): “ *the change of fatwa of the law is because the change era, place, condition, intentions and customs* ”. This rule gives the explanation that the characteristics of Islamic law are flexible and contextual in line with the dynamics and development of the era, especially in the new and renewable matters (*al-masail al-jadidah wa al-mustajaddah*). Simultaneously, it negates the notion that Islamic law is sacred and cannot be changed.

The assumption that Islamic law is standard and cannot be changed is from an idea that Islamic law or jurisprudence originated from the *ijtihad* result of the previous Ulema is standard and is sacred. They assume that the forces of law and the sanctity of Islamic law as strong as *nushush syar'iyah* contained in the Qur'an and Hadits. This does not correspond to historical facts, because of the fact that the text of the Qur'an and al-hadith has been stopped, while society continues to change and evolve with different problems.

The idea that Islamic legal reform is the inevitability that is in accordance with the formulation of Ulema (al-Syahrستاني, t.th): “ *Truthfully nash was limited, while the problems that arise are not limited, or because truthfully nash has been stopped while the problems continue to arise and never stop* ”.

In order to reform the Islamic law (*fiqh*), the Ulema have already provided the basis of methodology or *manhaj*. Understanding the *fiqh* limited only to the existing compilation of Islamic law is not enough to answer the challenges of the era, because it is the inevitability to *jihad* conducting Islamic law reform.

There are several factors that need to be observed, with respect to the need to reform the Islamic law, namely the changing of era as a result of progress in the fields of industry, trade, services, contract, technology, communication and others. Among the urgent factors to reform the Islamic law (read al-Qaradhawi, 1989), shall be as follows:

Firstly, social changes, which including the changes in culture, economy and politics which today requires the *fuqoha* (Islamic law experts) for rethinking the opinions of previous Ulema that are no longer appropriate to the current social context. Secondly, the development of science technology is very influential on the quest for a stronger opinion (*rajih*) among the opinions that developed in classical *fiqh* in which the classical period of science and technology has not yet developed rapidly, particularly the exact sciences. With the help of science and technology, the Islamic law expert can re-examine the provisions of the previous laws that have been topics of discussion in the Middle Ages to contextualize the contemporary conditions that are certainly much more complex. Now, the more powerful determination (*rajih*) is not only based on the textual argument with a deductive approach, or even just approach of the school of thought of Islamic jurisprudence, but also the relevance of the changes taking place in society.

Thirdly, the demands of the changing era requires the contemporary Islamic law expert to look at the complexity of the contemporary problems and choosing the views and legal fatwa which makes it easier (*taisir*) and avoid trouble (*al-haraj*) under the laws of *furu'*, both pertaining to the worship and in *mu'amalat* matters. The emergence of new and renewable cases necessitated a new *ijtihad* because these issues have never been answered by the classic *fuqoha* (Ismail, 1985).

The reform of Islamic law conducted by the National Islamic Council of Indonesian Ulama Council (the "DSN-MUI") is not a new legal product of all. However, the reform of Islamic Law conducted by the DSN-MUI is a legal reform that is still associated with the opinions of the previous ulama codified in the *mu'tabarab* books. DSN-MUI conducted a review with a certain method or *manhajiul hukmi*, that is by re-analyzing the '*illat* / legal consideration against the legal opinion of the previous ulama (*masalik al-'illah*). The present case is linked

to the opinion of the previous ulama, and thereafter an analysis against their *'illat* was conducted, if the opinion of the ulama is still strong and still relevant to answer the contextual problem, then such opinion is maintained. However after the *'illat* being analyzed, it turns out that the opinion or *qaul* of ulama is no longer adequate to answer the contextual problem, then the *qaul* or legal opinion is abandoned, however the *manhaj istinbatul hukmi* of the said ulama is still used by DSN-MUI.

DSN-MUI has made a standard way of doing *istinbath* or *ijtihad* against the law, whether done by individual ulama or collectively, then said ulama must understand the methodology or guidance of *manhajul hukmi* in doing the *ijtihad* (read Mudzhar in Amin, 2013 and Amin, 2008). The standard method commonly used by DSN-MUI is analytical procedure by checking and rechecking frequently against the sources of Islamic law, such as the Al-Qur'an, *Al-Hadith*, *Ijma'* and *Qiyas*. The first stage, the ulama who conducted *ijtihad* should check on the Al-Qur'an. They should seek sources of proposition in the Al-Qur'an against the related verses to find explicit explanations or answers to the matters being questioned. If in the search of the answer, it is found the answer as well as the explicit explanation, then search effort for the answer is complete.

If the explicitly answer based on Al-Qur'an on the search has not been found, it must proceed to the next stage, that is the second stage in which the search for answer or the explanation shall be based on Al-Hadith. Of course the answer or explanation found in the Hadith should be considered strong enough to be the argument of the legal problem. If there is any explanation or explicit answer in the Hadith, then the search effort for the answer is complete. However, if there is no explanation or legal answer to the proposed issue, then it should proceed to the next stage. The third stage, which conducting verification whether in *ijma'* of ulama, legal opinion or *qaul* agreed by ulama as stated in the book of Fiqh Mu'tabarah there is answer or explanation for the relevant problem. If it is found the legal opinion of the previous ulama related to a disputed legal matter, then the search for the answer is complete. However, if it is not found in the *qaul* of the previous ulama, then it continues to the next stage. The fourth stage is conducting verification by *qiyas* (legal analogy), that is by comparing and searching the equation on *'illat* in the form of reason or legal consideration between those stated in the *nash* Al-Qur'an-Hadith with the new problem in question.

In the context of the reform of Islamic law, DSN-MUI continues to hold contextualization with the dynamics of changing times and social developments, especially the trends that occur in the economic world. In addition of performing a

verification analysis of the four stages, the DSN-MUI also sets the standard of legal reform methodology at least by implementing three methods. First, the DSN-MUI revitalizes *tahqiqul manath* (see Al-Amidi, t.th), namely the step to acknowledge the existence of a legal reason (*'illat*) on a new case after *'illat* itself is known beforehand, both in the nash Al-Qur'an-Hadits, *ijma'* or result of *istinbath* law. The difference with *qiyas* is that *qiyas* limits the equation of *'illat* only to the nash of Al-Qur'an-Hadith, while in terms of *tahqiqul manath*, the search for the equation of *'illat* extends to *ijma'* and *qiyas* in the previous of *qaul* of ulama. In NU this method is known as *ilhaqi* method that is comparing *'illat* of law of a new problem with the *'illat* of law which stated the opinion of the previous ulama.

The second stage, DSN MUI performs the method of *I'adah al-Nadhar l* re-examination (see Amin, 2008) by re-examining the legal consideration (*'illat*) of the opinion of the previous ulama relating to the problem. The study of law shall be done since the legal perspective of *'illat* has changed or because some opinions of the previous ulama considered not applicative and inadequate with contemporary conditions. The opinion is considered to be no longer suitable for legal guidance, because its implementation is difficult to be done (*ta'assur, ta'adzdzur aw shu'ubah al-amal*).

One of the ways used in this re-examination is to re-examine the *mu'tamad* opinion (which has been made by law all this time) taking into consideration the legal opinion which has been regarded as weak opinion (*marjuh* even *mahjur*), due to the existence of a new legal *'illat* and or the said opinion is more beneficial. Furthermore the opinion is used as guidance (*mu'tamad*) in establishing the law.

The third method commonly done by DSN-MUI with answering the problems posed by the community, namely *Tafriqul halal min al-haram* (separating something *halal* from the *haram*) that is usually done in the economic field. The sample case is when the conventional bank wants to establish a Sharia unit (the UUS). Though its conventional business is based on interest that is expressed as usury and is forbidden. It is not allowed to establish sharia business with capital from illicit funds. According *Tafriqul Halal min al-haram* is used, namely by identifying the separation between *haram* funds and *halal* funds. Once known, the unlawful funds are taken out so that the rest of it is really the *halal* fund. Therefore the fund that is declared *halal* through the method of *Tafriqul halal min al-haram* is used as capital to establish the UUS (read Amin, 2013).

## **Demands of Islamic Economic Fatwa**

Fatwa (Amin, 2013) is a religious answer for all problems and the problems faced by Muslims contextually. Fatwa processes not only based on the existing text

in texts or *nushush syar'iyah*, but also articulate or reflect the social conditions that surrounded him. In the early era of Islam, when the Prophet Muhammad was alive, al-Quran and as-Sunnah explicitly can answer the problems of the day. After the death of Prophet Muhammad, the source of Islamic law in order to answer the problem are extended which is *ijma'* and *qiyas*. Qoul of Ulema who has become a compilation of Islamic law in the books of Islamic jurisprudence emerged in medieval times, so as to address the contemporary problems it is inadequate if simply only rely on the resources of existing law. Facing problems of the present and replied to this contemporary issue, Ulema must do the *ijtihad* in order to conduct the reform of Islamic law which out-put is in the form of a fatwa.

Fatwa cannot be done by just anyone; authority to issue the fatwa is in the hands of Ulema that have depth religious knowledge, usually called a *mufti*. Historically, there is mufti appointed by government and the independent mufti because of his expertise to become *imam*. Mufti who has authored several books pronounced ability to open several legal *ijtihad* results in books of *mu'tabarab*. The works of earlier Ulema in the books of Islamic jurisprudence is also referenced as a source of lawmakers to make the fatwa, lately.

Although Indonesia is an Islamic majority, but Indonesia does not recognize the country's official mufti. Fatwa in Indonesia is *jama'i* which is usually done by the fatwa section of each Islamic organization, if in NU, it is carried out by the Institute of *Bahsul Masail*, in Muhammadiyah by the Legal Affairs Committee and in MUI, and it is implemented by the Division of fatwa. Because Indonesia is not a religious state, the nature of the fatwa is not binding. The Constitution states that Indonesia is not a religious state, nor a secular state, but the state upholding the religion. Therefore, religion can be a source of law, sources of inspiration, the cornerstone of thinking, and rules guiding the system of national and state in Indonesia. Constitution opens the opportunities for the accommodation of principles of religious into laws.

In this context fatwa of Ulema of the Indonesian Ulema Council may become a source of law and the foundation of thinking the formation of legislation in this country, particularly the MUI fatwa related to the economic problems of sharia.

Currently the development of Islamic economics has become so advanced. Islamic economics is not only developed in the countries that are predominantly with Muslim, but also in developed countries that are in daily applying secular system. The more rapid development of Islamic economy, their will the greater challenge. Especially to be more competitive than the conventional economy, especially in realizing the goal of Islamic economics, which is the benefit for the people.

It must however be recognized that Islamic economics is a merger of the two disciplines, namely; economic and Islam. Therefore, Islamic economics should consider the principles that exist in both the economic principles and the principles of Islam. Economic practices that do not pay attention to the principles of Islam are potentially causing an imbalance in the economy. The impact of usury economic practice is indicated by the capitalist and socialist economic system.

In contrast, the economic practices that simply forward the principles of sharia by ignoring the economic principles would tend potentially trapped in the area philanthropic that consider the efforts of profit withdrawal is taboo (*al-istirbah*), which in the long term potentially lead to bankruptcy. Therefore, the combination of economic principles and doctrine of Islam in economic practice becomes absolutely necessary.

The modern economy and the problems that arise in people's lives is a new issue in the discussion of Islamic Law. Therefore it requires a new fatwa of the ulama with the reform of Islamic Law. It can be assumed that the problems of the economy will continue to emerge which require a continuous legal response as well. In fact, *nash*, both Al-Qur'an and Al-Hadith have stopped. Herein exists the relevance of the fatwa of the ulama with the legal *ijtihad*, since it does not get explicit answers in the *nash* of Al-Qur'an-Hadith as well as *qoul* of ulama in the Book of Fiqh. *Ijtihad* of ulama is required to reform the Islamic law in order to answer these new questions.

The provision of fatwa (see Amin, 2011) is a form of guidance and counseling to the *ummah* (*ri'ayah wa himayat al-ummah*) as an explanation of the responsibilities of the ulama against the guidance of society (*mas'uliyah ummatiyah*). Communities should not be allowed to simply conduct their own *ijtihad* to find answers to religious law, because such actions are very risky and harmful to the life of the people. Performing *ijtihad* or *istinbath* of law requires scholarly qualifications, namely ulama that explore depth religious scholarship and also understand the development of community life so that the fatwa does not plunge people in error. This is the religious responsibility of the ulama (*mas'uliyah diniyah*) and the other responsibility is to guard the unity of the Unitary State of the Republic of Indonesia (*mas'uliyah wathoniyah*) by establishing a religious frame of mind in the context of nationality.

## Method

This study uses a qualitative approach that emphasizes the meaning, context, and perspective of the native point of view. The process of collecting research data is taken from the field through direct observation as the primary data. On

the other hand, researcher also uses secondary data by reviewing documented information in the form of books, leaflets, journals and scientific papers and research results. As a qualitative feature, this research seeks to find out a deeper understanding that is not enough by tracing the causal relationship of “social facts”. Researcher in understanding the problem not only sees the aspect of causal relationships, but strives to understand more deeply and comprehensively from some of the proposed variables. To that end, the researcher tried to explore the meaning, values, deeper understanding of the impact of the fatwa of the ulama of the Indonesian Ulama Council (the “MUI”) on the development of Islamic finance industry in Indonesia.

Data analysis is done through data collection, presentation and reduction of data to findings, propositions and conclusions. Collecting and analyzing data is done simultaneously; Prioritize observations and interviews and the researchers themselves as the main instrument. Through the process, researchers attempt to understand the data, categorize, and identify the characteristics of each category until clearly different from each other. Thus obtained a deep understanding, both in terms of depth, validity and reliability as supported by adequate data. With a theoretical approach, conclusions are drawn to obtain useful recommendations.

## **Result and Discussion**

### **The Influence of Fatwa that Bank Interest is Illegitimate**

Whether it is recognized or not, fatwa of MUI regarding the illegitimate of Bank Interest in 2003 had a strong influence on the development of the Islamic financial industry and laws and regulation related thereto. It can be proved by the fact of the existing statistics. In the span of 1990 to 1998 there was only one Islamic bank. In the span of 1998 to 2002, was born five Islamic banks. Whereas after 2003 in which the fatwa of MUI about the illegitimate of interest has been born, the more emerging Islamic banks, both in the form of Sharia or Islamic Banks. Something similar occurred in the non-bank sector. After the release of the fatwa of MUI regarding the illegitimate of bank interest, more Islamic insurance, sharia financial companies, Islamic capital markets, and other Islamic finance institutions were emerged.

Domino effect after the issuance of the fatwa of MUI on the prohibition of bank interest can also be seen from the improvements in the government accommodation to the development of Islamic financial institutions. This can be seen from the enactment of a special section on the regulatory agencies that deal with Islamic economics, both in Bank Indonesia through the Directorate of Islamic Banking which specifically deal with sharia banking, or in the Ministry of Finance

through the Directorate of Islamic Financing, Capital Market Supervisory Board-Financial Institution, Bureau of Islamic Insurance, Indonesian Stock Exchange (BEI) and so on.

This further indicates a strong correlation between the fatwa issued by MUI with the formation of laws and regulations in this country. By doing so, it reinforces the view of the possibility of absorption of formulated religious values.

In the perspective of Law Science (Rahardjo, 2000), fatwa falls under the category of legal norms among the three domains of law, namely; Law-making, law implementation, and law enforcement. The law that applies to both the state and the society concerned with Law Science in Indonesia (see Utrecht, 1959) are known as the written law and the unwritten law. MUI in the context of the unwritten law, has established two institutions, namely; (1) establishing the DSN-MUI by issuing a fatwa on Islamic economic law and overseeing its application, (2) establishing a National Sharia Arbitration Board (Basyarnas) with the authority to examine and dispute the sharia economic dispute outside the court.

While in the context of written law, MUI has been producing tens or even hundreds of which are being or have been processed into positive law either in the form of laws or government regulations or regulations in other forms. The pioneering norm of Islamic religious law into positive law especially in the field of Islamic economics has started in the early 1990s (Amin, 2013). Good and bad norms prevailing in society will encourage the practice of Islamic economics. That is the fatwa of ulama issued by the MUI, which is very influential in developing the Islamic economic practices in the business community. The development of Islamic economics in Indonesia is still dominated by the financial sector with the establishment of Sharia Financial Institutions (the "LKS"), which include: sharia banking, sharia insurance, sharia capital market, and Islamic finance. Each LKS has a Sharia Supervisory Board (the "DPS") within the LKS. The DPS has the task of overseeing the operation of the LKS and its products in accordance with the principles of sharia. DPS is usually placed at the board of commissioner level at each sharia financial institution. This is to ensure the effectiveness of any opinions given by DPS. Therefore, the determination of DPS members usually done by the General Meeting of Shareholders, after the Members of DPS get recommendations from the National Islamic Council (DSN MUI), then they are attested by the Financial Services Authorization.

The increase of activity of Islamic economic practice, which is reflected in the growth of Islamic financial institution continues to increase and parallel with the level of need for the fatwa of the ulema of DSN-MUI. As a concrete picture we can explain hereto that in 2001 for example, there were only two Sharia Banks with 84

branches (services). Nine years later, in 2010 the number of Sharia Bank increases sharply to 11 units with 1215 branches (service). The increase also occurred in the Sharia Business Unit which is based on conventional banks, in 2001 there were only 3 Sharia Business Unit with 12 branch offices, in 2010 the number of Sharia Business Unit increased to 23 units with 262 branches. Only two years later the number of LKS continues to move up, in 2012 the number of Sharia Bank has reached 11 units with 1435 offices (service) and the number of Sharia Business Unit increased to 24 units with 378 offices (service). Not only in the banking sector, sharia insurance sector has an upward movement, in 2003 the number of sharia insurance was only 11 units, in 2011 the number of sharia insurance has increased to 42 units. In the field of sharia capital market also develops, starting with the first publication of mutual funds of Sharia Funds in 1997, followed by the issuance of Islamic bonds in 2002 and it was recorded that there were 6 issuance of Islamic bonds in 2008, and presented the Jakarta Islamic Index (JII) in the year 2002 with a total membership of 30 companies in 2008. While in the field of Islamic financing in 2009 there are two Islamic finance companies and 16 units of Islamic financing from conventional finance companies.

The demand for a fatwa on Islamic economics by LKS to the DSN-MUI was initially voluntary and not legally binding. However, the fatwa was then processed into positive law through the adoption process by regulators such as Bank of Indonesia (BI) or the Ministry of Finance, especially the Directorate General of Financial Institutions, Directorate General of Debt Management and Capital Market and Financial Institution Supervisory Agency (the "Bapepam-LK") become the law and regulations, namely the binding positive law. Some even adopted by the State into Laws.

Based on data in the field, it indicates (see Barlinti, 2010) that the laws and regulations on Islamic economics in Indonesia, such as the Islamic Banking Law, Sharia Insurance, Sharia Capital Market and Sharia Financing give special position to the fatwa of DSN-MUI. This particular emphasis is seen in articles that mention both implicitly and explicitly of the fatwa of the DSN-MUI. Overall, the position of the fatwa of DSN-MUI in the Indonesian laws and regulations system can be seen in four components: (1) The Fatwa of DSN-MUI as the principles of Shariah which is the guideline for the implementation of Islamic economic activity which must be obeyed. (2) The fatwa of DSN-MUI serves as a guideline for DPS in supervising business activities of LKS (3) The contents of the fatwa of DSN-MUI are absorbed into the laws and regulations. (4) The fatwa of DSN-MUI becomes the legal basis for LKS in running its business activities.

The process of fatwa becoming law or regulation is more complete after

the accommodation of fatwa in judicial institution to accommodate problems that arise in engagement done by society, which is muamalah, based on sharia principle. These courts serve as a platform for dispute resolution based on sharia principles. Law Number 3 of 2006, which is an amendment to Law Number 7 of 1989 concerning Religious Courts, has included the duties and authority of the Religious Courts in deciding and solving the case in the field of Islamic economy. The explanation on the field of sharia economy in this Law covers all sectors of Islamic finance, namely sharia bank, sharia micro finance institution, insurance and reinsurance sharia, sharia mutual fund, sharia financing including sharia pension fund and sharia business.

### **Growth of Sharia Financial Industry**

The process of the accommodation of the fatwa into positive law does not just happen, but through a long process with a variety of strategies and tactical steps and systematic. Al-Hakim (2013) said that the fatwa that established had absorbed by the regulator. Wibowo (2008) found that there is no difference in asset, saving, and financing growth of Islamic banking between before and after the fatwa of interest. Latif (2016) found that sample banks are not fully in accordance with the fatwa of DSN-MUI on murabahah financing. Waluyo (2016) shows that the fatwa related to Islamic banks that has been transformed into positive law can be used as a legal basis to be obeyed. Besides that, the result showed that the Islamic bank commitment to implementation of fatwa has not been effective.

Until now, the Fatwa related to financial transactions and business arrangements issued by the National Sharia Board has reached 100 fatwa. In general, the fatwa was dominated by fatwa related the financial institutions, in particularly banks. Fatwa can be grouped into 9 groups; Firstly, the National Sharia Board Fatwa regarding Sharia Banking. Secondly, the National Sharia Board Fatwa regarding the Sharia Insurance. Thirdly, the National Sharia Board Fatwa regarding Sharia Capital Markets. Fourth, the National Sharia Board Fatwa regarding Sharia Pawnshop. Fifth, the National Sharia Board Fatwa regarding Sharia Financing. Sixth, the National Sharia Board Fatwa regarding Sharia Guarantee. Seventh, the National Sharia Board Fatwa regarding Sharia Accountancy. Eighth, Fatwa regarding Sharia MLM. Ninth, Fatwa regarding Sharia Commodity.

The grouping the fatwa are in fact not absolute. Because there are several fatwa coming from certain groups may actually be used for other groups. For example fatwa related to *murabaha* that includes in the Fatwa on banking group was also used in Sharia financial group. Another example, fatwa on *rahm tasjili* (that

includes in the sharia pawnshop group) and fatwa regarding factoring (that includes in the sharia financing group) could then be used by Sharia banking.

In the development of the sharia financial industry, the application of fatwa that have been issued by the DSN-MUI certainly will not run perfectly without any rules and regulations that govern them. Because it is necessary to have legislation that accommodates the fatwa of DSN-MUI fatwa in it, so that it can directly bind to the sharia financial industry.

Attempts to carry out the absorption of fatwa into actual legislation have been carried out by Muslim Ulema and scholars. MUI workshop on 22-25 March 1990 to establish a working group mandated the establishment of the Islamic Bank in Indonesia; the Working Group called MUI Banking Team. On 1 November 1991, the team signed the deed of establishment of the first banks using the system without applying bank interest. The business then received a positive response from the executive and legislature with the establishment of Law Number 7 of 1992 on Banking, which contains rules about the possibility of the operational of banking using sharia principles termed as profit sharing (Article 6 letter m, and Article 13 letter c).

In the same year, the Government issued Government Regulation of the Republic of Indonesia Number 7 of 1992 concerning Bank Based on Principles of Profit Sharing (State Gazette of 1992/119, and the Elucidation as set forth in the Supplement to the State Agency Number 3505). Based on Government Regulation Number 72 of 1992, Article 1, it is stated the Bank based on the principle of profit sharing is required to have Sharia Supervisory Board (paragraph 1) formed on the basis of consultations with the Ulema (paragraph 2), and the Ulema in question is MUI (elucidation of Article 5 paragraph 2).

The formation process of the regulation provides legal certainty on the application of the concept of *mu'amalah syar'iyah* kept continuing. Six years later, Law Number 10 of 1998 on the Amendment to Law Number 7 of 1992 on Banking, was published, which is clearly to accommodate the dual banking system in Indonesia, namely conventional banking and sharia banking. Attempts to include fatwa into positive legislation are getting rolled after the formation of the National Shari Board – Indonesia Ulema Council on 10 February 1999.

The good relationship that exists between Bank Indonesia and DSN-MUI has produced many Regulations of Bank Regulation (the "PBI") that are adopting and harmonizing fatwa of DSN-MUI. So it can be said that the absorption of fatwa into official regulation has been progressing well in the banking sector. Things like that happen not only in banking sector, but also occur in other sectors, such as insurance, finance, and capital markets. In the insurance sector, the Minister of

Finance issued the Regulation of the Minister of Finance (the “PMK”) Number 18/PMK.010/2010 on the Implementation of Basic Principles on the Establishment of Insurance Business and Reinsurance Business Using Sharia Principles.

Whereas the sector of financial institutions has also been issued 2 (two) Regulation of the Chairman of the Capital Market Supervisory Board-Financial Institution Number: PER-03/BL/2007 on the Activity Financing Company Based on Sharia Principles and Number: PER-04/BL/2007 on the Contracts Used in the Activity of Financing Company Based on Sharia Principle. Regulations that have been issued for the sector of sharia insurance and sharia financing are under the provisions outlined in the fatwa of DSN-MUI related to insurance and financing sectors.

In capital markets sector, fatwa of DSN-MUI has been well accommodated by the issuance of 3 (three) Capital Market Supervisory Board-Financial Institution’s regulations, namely Regulation Number IX.A.13 on the Issuance of sharia securities, and Regulation Number IX.A.14 on the Contracts Used in the Issuance of Sharia Securities in the Capital Market, both issued on 23 November 2006, and Regulation Number: IL.K.1 on List of Criteria and Issuance of Sharia Securities, issued on 31 August 2007. The three regulations issued by Capital Market Supervisory Board-Financial were clearly adopted two Fatwa of DSN-MUI, the Fatwa of DSN-MUI Number 20 on Guidelines for Sharia Mutual Fund Investments and Fatwa of DSN-MUI Number 40 of the Capital Markets and the General Guidelines for Application of Sharia in the Capital Market.

Consistency and hard struggle carried out by the Ulema in order that the legislation related to sharia economics increasingly absorbed and accommodated with fatwa was confirmed by Law Number: 19 of 2008 on SBSN and Law Number 21 of 2008 concerning Sharia Banking.

Article 25 of Law regarding SBSN states:

“In order to the issuance of SBSN, the Minister asked for a fatwa or statement of the compliance of SBSN against the sharia principles of the institution that has the authority in setting the fatwa in the field of sharia”.

The article then elucidated:

“What is meant by “an institution that has the authority to establish the fatwa in the field of sharia” is the Indonesian Ulema Council or any other institution appointed by the government”.

Article 26 of the Law of Sharia Banking, states:

“(1) The business activities referred to in Article 19, Article 20 and Article 21 and / or the products and services of sharia, must submit to Sharia Principle.

(2) Sharia Principle as referred to in paragraph (1) shall be made in fatwa by the Indonesian Ulema Council”.

After the formation of the Financial Services Authority (FSA), which brings together all financial sectors under it, the regulations originally a separate regulatory agencies, such as BI, Finance Minister, and Capital Market Supervisory Board-Financial Institution in the process is converted into the FSA regulation without altering its substance. In terms of the lack of regulations to replace the FSA that the previous regulation, the regulation is still valid and binding for the financial industry as before.

Supervision of the implementation of the fatwa that was adopted legislation in the Islamic financial institutions conducted by the Sharia Supervisory Board (DPS). Sharia Supervisory Board is a unique thing, because not all countries have institutions like this. In some countries, the Sharia Supervisory Board (DPS) on companies very independent because there is no institutional link between the DPS with other DPS. While in Indonesia, the Sharia Supervisory Board (DPS) is an arm (representative) of the National Islamic Council of Indonesian Ulama Council (DSN-MUI) placed in companies.

The relationship between the Sharia Supervisory Board with the National Sharia Council as described by Karnaen Perwataatmadja and Muhammad Shafi Antonio, is that the Sharia Supervisory Board are united by the Indonesian Ulema Council (MUI) and the authority of Bank Indonesia (now the Financial Services Authority [FSA]) in containers the form of the national Sharia Council (DSN-MUI) as a consortium of the Sharia Supervisory Board national level; Sharia Supervisory Board as a consortium of international level which is called The Higher Shariah Supervisory Council established by the International Association of Islamic Banks domiciled in Cairo (see Perwataatmadja and Antonio, 1992).

Islamic economic development model based on three links, issued of fatwa, adoption of fatwa and the supervision of the fatwa provisions proved to open up wide avenues for the development of Islamic economics which had an impact on the improvement of the welfare of the community and their participation in promoting national economic growth. It also shows that the economic potential of Islam as a buffer of the national economy and as an alternative national economic system is not “Dreams”.

In the ratio of Islamic economic development continues to increase, both in terms of institutional and asset. For example in terms of assets (see Barlinti, 2010) in 2003 the value of Sharia Commercial Banks (BUS) asset Rp 7.44 trillion, in 2008 has increased to Rp 47.18 trillion. The value of financing also increased from Rp 7.38 trillion in 2003, increasing to Rp 38.53 trillion in 2008. Third party funds

showing the level of public trust also continued to increase, in 2003 third party funds of Rp 5.96 trillion increased to Rp 34.42 trillion in 2008. In sharia insurance sector also increased, In 2003 the total number of individual policies sharia life insurance recorded 1,864,114 sheets, Increased to 2,792,913 shares in 2008, with a premium of Rp 92.7 billion in 2003 increased to Rp 1.1539 trillion in 2008. In 2003 the asset value of this sector was Rp 275.6 billion, increasing to Rp 1.1514 trillion in 2008.

## Conclusion

This paper brought forth to some conclusions as follows: First, lessons from the financial crisis in 2008; the Islamic financial system is increasingly becoming mainstream and alternatives of the conventional financial system. That is because the Islamic financial system has endurance to face the pressure of global financial crisis. Second, Islamic Law Reform is the inevitability to address the developments taking place in contemporary society. Reform of Islamic Law shall be in accordance with the guidance of *nash* and the demands from the changing era in society. Changing era give rise to new problems, which are sometimes difficult to find the answers in existing texts. This fact requires the effort of *ijtihad* or law *istinbat* to accommodate the change of the order of life in society. Third, fatwa is a religious answer for all problems and the problems faced by Muslims contextually. Fatwa process is not only based on the text existed in *nash* or *nushush syar'iyah*, but also articulate or reflect the surrounding social conditions. Demands of fatwa regarding Islamic economic is related to problems and issues to economic activities in the community.

Fatwa of MUI Fatwa on illegitimate Bank Interest in 2003 was very influential on the development of the Sharia financial industry as well as the legislation related thereto. It can be proved by the fact of the existing statistics. In a range of years 1990 -1998 there is only one Sharia bank. In the range of years 1998 – 2002, they were born five sharia banks. Whereas after 2003, more sharia banks were emerged, both in the form of Sharia Bank or Sharia Business Unit. Something similar occurred in the non-bank sector. After the release of the Fatwa of MUI regarding the illegitimate bank interest, more Islamic insurance, sharia multi-finance companies, sharia capital markets, and other sharia financial institutions were emerged.

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