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ISLAMIC FINANCE : A WESTERN PERSPECTIVE

Humayun Dar and John R. Presley

The new Islamic Economics paradigm has developed almost in isolation of contemporary Western economic literature. Islamic economics and finance has no far failed to Capture the interest of Western writers. Unfortunately also Islamic writers have focused upon the Koran and mainly Asian literature without utilizing a wide body of literature in the West which would assist with the development of the Islamic paradigm.

The Islamic literature employs a number of arguments to justify prohibition of interest, some of which are also a feature of Western literature. First, interest as a reward for saving is not considered to have any moral foundation or justification. Second, abstinence from consuming out of present income is not regarded as being sufficient reason to merit a finance reward. Third, a distinction is made between money and capital, money in essence becomes potential capital; to transform money to capital requires the application of enterprise, that is the risk taking and the knowledge required to bring factors of production together in order to create profit (or loss).

There are parallels between the development of Western and Islamic economic thought; modern Western economics has its foundation in classical economics. The classical economists argued on the basis of a perfect world, perfect knowledge in all markets, perfect mobility, perfectly competitive industries with wages reflecting marginal productivity and equilibrium achieved through the free interaction of supply and demand. However, western economies have progressed as a result of the recognition that the real world, as much as we might wish it to be, is not like this. Keynes in the *General Theory* (1936) was trying to explain how real people, as suppliers of labour or as consumers, behave in a real world. Neo-Classical macroeconomics is progressing by accepting uncertainty and imperfection and by analysing the behaviour of the rational economic agent and its implications for the achievement of economic objectives. The underlying basis of modern Western economic thought is that in reality man is selfish, groups act in self interest, indeed individual governments act in self interest, and even groups of countries (like the European Union) in the main act in their own interests - occasionally to the detriment of other countries.

This is the reality of the world, but it is not a feature of Islamic economic theory. The standpoint is totally different, Islamic theory describes how people, groups or governments should act in a perfect Islamic community, how the Koran expects them to behave. The reality is that they do not act in this way; though may be increasingly persuaded to do so.

The implicit recommendation of contemporary Western economics would be to search out a clearer understanding of how Moslems behave in the real world and how a marriage can be accommodated between theory and practice. One aspect of the work of the Islamic Economics and Finance project at Loughborough University has been to ascertain the behaviour of Moslems and particularly their attitudes to Islamic finance. An example will illustrate the difference between theory and reality in this area - the case of the United Kingdom.

Essentially, there are two points in this article : firstly there is a great deal in Western Marriage which focuses upon the major issues in the Islamic economic paradigm and, indeed, reaches similar conclusion. Here we have seen it in relation to the prohibition of interest and the causes of the business cycle. There is much to be gained from utilizing also the empirical approach of Western economic literature. Secondly, rather than develop in isolation from Western literature, Islamic scholars would do well to exploit the wealth of supportive argument to be found in Western literature. This would also encourage greater focus in the West upon the new Islamic paradigm as a topic research.

Source: Humayun Dar and John R. Presley, "Islamic finance : A Western Perspective", *International Journal of Islamic Financial Services*, (Bhubneswar, India), Vol. 1, No. 1, April - June 1999, pp. 1 - 8.

Scholars Visit IAFIE Headquarters

Mr. Rafeeqe Ahmad Pathan, d lecturer at Anjuman College of Science, Arts and Commerce, Bijapur and Mrs. Shawkat Ara Aslam, a lecturer at Justice Basheer Degree College, Chennai, visited the headquarter of Indian Association for Islamic Economics in search of materials for their Ph.D. works. They were impressed by the rich collection of IAFIE library. Mr. Pathan and Mrs. Shawkat Ara are doing research on "Economic Teaching of the Prophet" and "The Financial System of Islam" respectively.

UAE Islamic Banks look to India

Islamic banks of the Arabian Gulf are positioning themselves to tap expanding opportunities resulting from financial sector reforms in India. Abu Dhabi Islamic Bank (ADIB) is among the UAE institutions which has mapped out a new business strategy that wee it making forays into India and the Gulf.

According to the Economic Times report, 'ADIB is weighing various options in India. Quoting the managing director of ADIB, Abdul Rahman A Abdul Malik, the paper says the Islamic banking market has depth in India. There are plans to set up two subsidiaries, one an Islamic insurance company and other a real estate firm. Abu Dhabi Islamic Bank posted a healthy results last year, Mr. Malik said. The ADIB has also posted 20 percent growth in deposits in the past eight months.

Islamic Equity Funds in 2000

Several new Islamic Equity Funds (IEF) have been announced recently including two funds by conventional banks with Islamic products, the Banque Nationale de Paris and Barclays Private Banking. In the beginning of 2000, Commerz bank announced the launch of its Al-Sukoor European Equity Fund and also now TAIB Bank of Bahrain has announced its new product. The TAIB Crescent Global Fund, an open-ended fund is a triumph for the Dow Jones Islamic Markets Index since it will be issuing the DJIM index as its bench mark.

In the year 2000, there are more fund coming to beginning with Al-Taiyyat Fund by Bank Al-Jazira of Saudi Arabia. After successfully launching a global Islamic equity fund and a European equity fund. Bank al Jazira is now launching a third Islamic equity fund targeting the local market.

In Bahrain, Faisal Islamic Bank of Bahrain has partnered the Banque Nationale de Paris to launch a new Islamic Equity fund – the Raysal Shield Found with reed Capital of US \$ 25 million. Last but not least, Prime Corp. Investment Management of London is set to launch a new Islamic fund, the Khaled Ibn el-Waræed Fund, in association with Kuwait's Al-Mall Islamic Company in order to tap the oil-funded Kuwait market rimming with investment possibilities.

Conference on Monetray vs Exchange Policies

The Monetary & Banking Research Academy of the Central Bank of the Islamic Republic of Iran will be holding the 10th Annual Conference on 16th & 17th May 2000 "Appropriate Monetary and Exchange Policies for controlling inflation and reducing unemployment. Some of the topics to be discussed are

- (1) Exchange and monetary policies, inflations and unemployment.
- (2) Monetary and banking policies and their role in reducing unemployment and containing inflation.
- (3) Financial sector, capital market in Iran and the question of inflation and unemployment.

For further information please contact..

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Tehran, Islamic Republic of Iran

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IDB & IOS Jointly Organise Seminar at New Delhi

An International Seminars on 'Allocation, distribution and welfare economics in Islamic perspective is to be held at New Delhi in October 2000. The seminar will be jointly organized by the Islamic Development Bank, Jeddah, Saudi Arabia and the Institute of Objective Studies, New Delhi. A number of scholars and university academics are being invited to contribute papers for the seminar. Some of the themes to be discussed are: 1) Cost-Benefit Analysis in an Islamic Frame Work, 2) Social Welfare Function in an Islamic Economy, 3) The Theory of Economic Policy in Islam, 4) Economic Analysis of Islamic Laws on Resource use, pollution and other environmental consideration, 5) Economic Justice in Islamic Perspective 6) Allocation of Real Capital in a Riba-free Islamic Economy 7) Islamic view of Land tenancy practices, 8) Concept of "surplus value" and its evaluation from shariah point of view.

Deadline for Submission

- May 20, 2000 : Abstract with paper topic
- July 20, 2000 : Draft of the paper (for review)
- August 30, 2000: Final paper.

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Call for Paper

Islamic Society of North America (ISNA) Plainfield, Indiana invites papers for the 1st international conference on the economics of Zakah with the general theme "Reviving the Fiqha of Zakah and the Muslim minorities in the West".

Papers and panel programmes in all aspects of Zakah may be submitted to:

Dr. Abdul Hameed Basheer (Programme Chair)

Department of Economics

PO Box 867, Grambling State University

Grambling LA7245

e-mail: bashirah@alpha.gram.edu

New Books and Articles

BOOK REVIEW

Books:

1. Fleet, Kate,
European and Islamic Trade in the Early Ottoman State: The Merchants of Geneva and Turkey,
New York : University Press, 1999, pp. 204.
2. Mills, Paul and Johan R. Presley,
Islamic Finance : Theory and Practice,
New York, NY : St. Martin's Press, 1999, pp. 171.
3. Suhail, I.A. Khan,
What is Riba,
New Delhi, India : Pharos Media and Publishing Pvt. Ltd.
1999, p. 199.
4. Warde, Ibrahim,
Islamic Finance in the Global Economy,
Edinburgh : Edinburgh University Press, 2000, pp. 252.

Articles:

1. Ahsan, A.H.,
"A Historical Analysis Outlining the Attributes of the Islamic economic system and the fallacy of the dominant interest based capitalist order",
New Horizon (London), February 2000, pp. 3-4, 12..
2. Chapra, M. Umer,
"Islamic Banking and Finance : The Dreams and the Reality",
Hamdard Islamicus (Karachi, Pakistan), Vol. XXII, No. 4,
October – December 1999, pp. 69-87.
3. Gusau, Sule Ahmad,
"Problem that May Arise as Country Implements Zakat",
Hamdard Islamicus (Karachi, Pakistan), Vol. XXII, No. 2, April
– June 1999, pp. 13-18.
4. Karim, Rifat Abdel,
"Regulation of Islamic Banking"
New Horizon (London), No. 95m January 2000, pp. 3-4..
5. Kuwahara, N.,
"The Legal Aspects of Islamic Banking : A case Study of Bank of Malaysia",
Ajia Keizat (Tokyo, Japan), Vol. 39, No. 5, 1998, pp. 59-91.
6. "The Shariah Bench of the Supreme Court of Pakistan on Interest",
New Horizon (London), No. 95, January 2000, pp. 10-12.
7. Wohidul-Islam, M.,
"Dissolution of Contract in Islamic Law",
Arab Law Quarterly, (London), vol. 13, No. 4, 1998, pp. 336-

ISLAMIC FINANCE IN THE GLOBAL ECONOMY

By Warde Ibrahim

Published by: Edinburgh University Press, 2000, pp. 252
ISBN 0-7486 1216-5

This book, based on rigorous academic research as well as considerable empirical work, provide a fresh reading to all those with an interest in Islamic business and finance at the global level. The author, a lecturer, in the University of California, explains the paradox of a system rooted in the medieval era now thriving in the global economy. It traces the evolution of Islamic finance, explore its significance from historical and comparative perspective, and considers the strategic, marketing, managerial, political, economic regulatory and cultural challenges faced the Islamic financial institutions. The book has comprehensive coverage, defining Islamic finance in its broadest sense to include banks, mutual funds, securities firms and insurance companies. Islamic finance is presented in the context of the global political and economic system and cover core issues including the moral economy of Islam, differences between countries such as Pakistan, Iran, and Sudan, and Malaysia and religious issues and challenges.

Author rightly argues that although Islamic finance is successful attracting \$200 billion from all over the world, it is also a failure in so far as it did not fulfil its original promises of becoming an original and innovative system, based on a risk sharing, that would bring social and economic benefit of Islamic world. Indeed, profit-and loss-sharing (PLS) transactions, initially the *raison d'être* of the industry, only accounts for 5% of the operations of Islamic financial institutions. Most now prefer to engage in trade finance and mark-up activities. In the early phase of Islamic banking, these short-term low risk financing mechanism were seen as desirable only to the extent that they would ensure the financial viability of the first Islamic banks. The danger today is that mechanism that were once intended to be provisional have become institutionalized, raising serious ethical and religious issues.

He critically points out that even the promise of interest-free finance has not been fulfilled, since interest-like mechanism have been devised such as *murabaha* and since many Islamic institutions have been deriving substantial income interest bearing balances in foreign banks. One can also agree with his analysis that rather than learning from mistakes, Islamic finance houses decided to abandon such operation altogether. A more fruitful approach would of course have been to undertake on improvement of procedures. The author, however, concludes that the gap between promise and performance can be attributed to the youth of the industry. It would be unfair to judge it severely, since many venerable institution have not provided in today's financial jungle, to be exemplars either of probity or of financial success. From that perspective, many of the shortcoming of Islamic finance can be looked at as unavoidable because they are passing through a trail and error process that may led to the fulfilment of original goals.

Workshop on Islamic Economics. A Report:

Institute of Objective Studies, New Delhi organised a two-day workshop on Islamic Economics : A Challenge An Alternative at its premises on March 25-26, 2000. This workshop covered a wide areas for discussion such as Islamic economics as an alternative system, monetary and fiscal aspects of Islamic economic system. There were also much discussions on public expenditure, consumer behaviour in Islamic perspective.

But the main focus was on the causes and failure of a number of Islamic finance companies in India recently. For this purpose, Muslim economists, bankers as well as businessman gathered to work out some reviving methods for ailing Islamic finance companies which under the current Indian rules and regulations are finding it difficult to survive in the contemporary financial reform period in the country.

Speaking on the occasion, Mr. Abdul Hasib, former Executive Director, RBI, highlighted the financial reform process undergoing in India with new rules and regulation for the non-banking financial companies (NBFCs). He observed that in such a changing scenario, Islamic financial institutions in India need to evolve some mechanism of risk management, in order to strengthen the viability of these institutions in India. Participants examined the Islamic finance instruments, economic implications of equity and debt financing. Viability of Islamic banks in secular context, potential Islamic finance market in India. The major discussion centered around the stability of these Islamic financial institutions particularly at a time when the Reserve Bank of India does not permit Islamic bank to operate on the principles of profit and loss sharing, a basic tenet of Islamic finance.

The major problem according to the Managing Director of Bombay's leading Islamic finance house, Baitun Nasr Group, Mr. A. Dalvi, lies in the deposit mobilization, because of limited area of operations where these institutions can invest. Keeping in view this situation, the workshop stressed the need to review the reason of failure of Islamic banks in India, as the chairman of Institute of Objective Studies, Dr. Mohammad Manzoor, Alam proposed to form a federative of Islamic Banking and Finance, comprising

of economists, bankers, financial experts and chartered accountants as well the religious scholars to monitor the pinching problems these Islamic banks face in the country. However, regarding the recent collapse of some of Islamic finance companies, the prominent Muslim economist, Dr. F.R. Faridi was of the opinion that it is basically due to the lack of implementation of Islamic shariah in their business activities, which he said, should have been put into its proper perspective. But the failure of Islamic bank, he said, does not means that the very concept of Islamic bank is inefficient. He cited the cases of a numbers of such institutions successfully operating in the Muslim world. Even in the Western financial circles, Islamic banks are making their presence, he said.

The participants in the workshop however agreed that the recent down fall of Islamic finance house in India is mainly related to the governments new financial reform policy, the RBI's new rules now making it difficult for low capital based finance companies to survive. Its major impact can be seen in shaking confidence of depositors in these institutions – both Islamic as well as interest based. How to come out of this hurdle? Prof. Bagsiraj and Dr. A.A. Islahi explained the practical difficulties in implementing the Islamic financial instruments in contemporary Islamic banks in India. Both Prof. Rahmet Ali and Prof. Naushad A. Azad felt that Islamic banks are still at their infancy stage, they have yet to evolve the mechanisms, new finance products, transparency in their operations, and form a monitory body to make these banks competitive.

FOLLOWINGS ARE THE RESOLUTIONS OF THE WORKSHOP

1. Literature & text books should be printed for the general awareness of Islamic economic system, and focus its emphasis on the human welfare.
2. A Federation of Islamic financial institutions should be formed to cooperate in resolving their problems.
3. A monitoring and supervisory board should be established to monitor the activities of Islamic banks in India. The board may consist of economists, bankers, finance experts and *Shariah* advisor.
4. Islamic banks should incorporate the services of technical experts in addition of financial exerts.
5. A Credit Rating Agency should be formed to assess the performance of Islamic banks in the country.

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