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## Distinctive Features of Islamic Finance

Islamic finance ensures a closer linkage between real economy and finance, the former dictating and the latter following. The linkage is obvious in sharing-based modes of investment and financial services. When two parties, the financier and the entrepreneur, agree that an opportunity for creating additional value exists, they come together to realize the gain and share it. Since economic activities are, by definition, value-creating activities, sharing as a basis of finance is inconceivable without economic activity. In the uncertain world in which these activities have to be conducted, they do sometimes fail to create additional value. There is nothing to share. Sometimes part of the existing wealth may be destroyed—the losses borne by capital, the entrepreneurial efforts gone un-rewarded. This linkage between real economic activity directed toward creation of additional wealth and financial transactions continues in case of non-sharing Islamic modes of finance such as *murabaha* (cost-plus), *salam* and *istisna* (prepaid orders) and *ijara* (leasing). These deals, which are being used by contemporary Islamic banks to secure predetermined returns on their investments, are possible only when some real economic activity is involved. There have to be some goods and services to be objects of *murabaha*, *salam*, *istisna*, and *ijara*. The demand and supply of these goods and services whose exchange is “financed” through the above-mentioned contracts ensures that financial activity is the servant not the master of real economic activity.

Prohibition of “interest” has closed the door on exchange of more money for less money, even when a period of time intervenes. Stratagems (*Hiya*) securing the same goal by bringing in a commodity in a nominal way e.g. *ina*, *tawarruq* or *bay al-wafa* are rejected as impermissible. There remains the gray area of exchange between different monies, i.e. selling one currency for another. Islamic economic research in this area has yet to catch up with the times. I do not have any opinions to pronounce save noting that it is a necessary economic activity facilitating exchange of goods and services across borders. Fear of making financial transactions “profitable” without there being any link whatsoever with exchange of real goods and services makes many Muslim scholars opt for the strictest interpretation of the relevant rules. But that carries the danger of restricting what may be really necessary. The challenge of finding the golden mean remains.

It has been demonstrated that all market activities can be financed by using the various Islamic modes, such as *musharaka*, *mudaraba*, *murabaha*, *salam*, *istisna*, and *ijara*. No stratagems are needed. Financing consumption needs that fall outside the market (there being no prospective income to pay from out of) requires humanitarian solutions in the voluntary-cooperative sector or under a state sponsored safety net. Financing government deficits has also been shown to be quite feasible. How far it is desirable to run deficits, how long and what for, are however issues far beyond the scope of “finance”.

We have been arguing that interest-free Islamic modes of finance can replace the conventional interest based finance with certain added advantages. By synchronizing entrepreneurial payment obligations and accrual of revenues, sharing-based modes of finance remove a major source of instability from freely functioning markets. Also by linking financial intermediaries' returns to the actual revenue of the fund users, allocation of funds to invest is redirected to projects expected to produce more value than their alternatives. Even though the predominance of non-sharing modes of finance in the current practice of Islamic banking dilutes these advantages, the Islamic system would score far better than any system that permits exchange of more money for less money. Part of the reason is the vast opportunities of exchange that this permission opens by passing the real economy which is focussed on exchange of goods and services with one another, money serving as a means of such exchange. Exchange of money for money degenerates into a game of chance in which people indulge to try their luck, little benefit flowing to the production of goods and services which exchange is supposed to promote. Prohibition of interest is directed at restoring money to its essential functions, which certainly do not include a means for gambling.

Muhammad Nejatullah Siddiqi

### IBF Net to offer Islamic MBA course

Islamic Banking and Finance Network (IBF Net), is set to introduce an International Islamic MBA program. The program will offer a conventional MBA course as well as course electives such as Islamic banking, Islamic insurance, Islamic accounting, Zakah accounting, and Islamic worldview and ethics.

According to IBF Net director, Dr. Mohamed Obaidullah, this would be the first step towards establishing a Netversity that would be the driving force behind IBF Net. The Netversity, he said, was also aimed at becoming a one-stop resource center for students from the MA level to research scholars.

The MBA program will be a two-year course where distance learning will be supplemented with actual classroom teaching or personal-contact seminars at selected locations. Primarily aimed at students in the Indian subcontinent, Middle East and South-East Asia, the course fee would be about Rs 80,000.00 per student, including about Rs 30,000.00 for computers, CDs and Internet connection.

(*IslamiQ.com*)

### Lecture on the State of Islamic Finance in India

Mr. Shariq Nisar, Joint Editor of the *Islamic Economics Bulletin*, delivered a lecture on the state of Islamic finance in India at the Institute of Objective Studies, Aligarh. He traced the history of interest free institutions began in the country in 1890, when first such society was established in Hyderabad. Few other interest free societies, funds and finance companies also got the special mention.

A brief discussion on the theoretical development of Islamic economics in the country also took place, however, the main focus was the current state of the Islamic finance in the country. Mr. Shariq also highlighted the basic factors behind the failure of some of the most trusted Islamic finance companies during recent past partly because of government's tightened regulation toward non banking finance companies, lackluster attitude of the companies itself and also loose commitment of the public towards the cause of Islamic economics. Mr. Shariq's lecture followed by a question answer session by the audience. Dr. Javed Ahmad Khan (Senior Research Fellow, IOS) presided over the programme.

### Fifth Harvard University Forum (Revised Dates)

**Theme:** Islamic Finance: Dynamics and Development

**Place:** Science Center, Harvard University  
Cambridge, Massachusetts

**Dates:** April 6-7, 2002

This year will have a particular focus on the state of the industry, Islamic finance in the west, and Islamic banking as community banking. For more information and registration please see our previous issue of the Bulletin (Vol. 11 No. 3) or contact at: hifip@fas.harvard.edu

### The Second International Islamic Banking and Finance Conference

The Second International Islamic Banking and Finance Conference will be on: Securitisation & Capital Markets: Challenges and Opportunities for Islamic Financial Institutions 12-13 March, 2002, Beirut- Lebanon For further details, please visit website: [www.isbconferences.com](http://www.isbconferences.com) or contact at:

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### Bahrain Signs Deal to Set Up Islamic Money Market

Bahrain has signed a pact to establish an International Islamic Financial Market in the Gulf's financial and banking hub to help meet the needs of Islamic banks and financial institutions.

The Governor of the Bahrain Monetary Agency (BMA), Sheikh Ahmed bin Mohammed al-Khalifa, signed the deal in Paris with Malaysia, Indonesia, Sudan and the Islamic Development Bank (IDB).

"The agreement aims at the setting up of an international Islamic Financial Market with its headquarters in Bahrain," the BMA, the island state's central bank, said.

A council drawn from the four states and the Jeddah-based IDB as well as representatives of Islamic financial institutions would be formed to take the necessary steps to set up the money market, it said.

In June, regulators and bankers from Bahrain, Malaysia, Indonesia, Brunei, Sudan and the 53-member IDB met in Bahrain to review technical issues linked to establishing the Islamic inter-bank market.

Bahrain and Malaysia have since been discussing which of the two countries would host the IIFM, aimed at some 200 Islamic banks and financial houses serving 1.2 billion Muslims. (*New Horizon*).

### First Islamic index in India

The Parsoli-IBF Equity Index, the first Islamic index to screen Indian equities, has been launched. A joint venture between two Indian organizations, the Parsoli Finance & Investment Ltd. and IBF Net.

The Parsoli-IBF Equity Index will establish an Islamic Equity Research Cell and compile an index of *Shariah* approved stocks in India. Dr. Obaidullah of IBF Net, elaborated that the Parsoli-IBF Equity Index would "undertake research on acceptable stocks and highlight these as potential avenues for investments". It will also compile an "index of acceptable stocks on a periodic basis that could serve as a benchmark for investments."

The size of the domestic fund alone should be staggering, due to the sheer size of the Indian Muslim population - the second largest in the world, he said. He noted that the Parsoli-IBF Equity Index would fill the vacuum in the field of information-related services available in India and research and analysis, to encourage the inflow of Islamic investments. (*IslamiQ.com*).

### New Books And Articles

#### Books:

1. ANWAR, Muhammad, *Islamicity of Banking and Modes of Islamic banking*, Selengor, Malaysia: International Islamic University Malaysia, 2001, 28pp.
2. JARHI, Mabit Ali al- and IQBAL, Munwar, *Islamic banking: Answer to Some Frequently Asked Questions*, (Occasional Paper 4), Jeddah, Saudi Arabia: Islamic Research and Training Institute, Islamic Development Bank, 2001, 76pp.
3. KHAN, Tariqullah & AHMAD, Habib, *Risk Management: An Analysis of Issues in Islamic Financial Industry*, (Occasional Paper 5), Jeddah, Saudi Arabia: Islamic Research and Training Institute, Islamic Development Bank, 2001, 185pp.

#### Articles:

1. AHMAD, Habib, 'Determinants of Profit Sharing Ratio in Project Financing: A Note', *Islamic Economic Studies* (Jeddah, Saudi Arabia), Vol.9, No.1, September 2001, pp.41-45.
2. BURNETT, Malcolm, 'Emerging Trends and Opportunities in the Islamic Financial Industry', in: *Proceedings of the Third Harvard University Forum on Islamic Finance*, Cambridge, M.A.: Centre for Middle Eastern Studies, Harvard University, 2000, pp. 145-147.
3. CHAPRA, M.U., 'Islamic Economic Thought and the New Global Economy', *Islamic Economic Studies* (Jeddah, Saudi Arabia), Vol.9, No.1, September 2001, pp.1-16.
4. CHOUDHURY, M.A., 'Financial Globalization and Islamic Financial Institutions: The Topic Revisited', *Islamic Economic Studies* (Jeddah, Saudi Arabia), Vol.9, No.1, September 2001, pp.19-38.
5. CUNNINGHAM, Andrew, 'Analyzing the Creditworthiness of Islamic Financial Institutions', in: *Proceedings of the Third Harvard University Forum on Islamic Finance*, Cambridge, M.A.: Centre for Middle Eastern Studies, Harvard University, 2000, pp.149-153
6. KALLEK, Cengiz, 'Economic View of Ibn Ubaiyid', *IIUM Journal of Economic and Management* (Selengor, Malaysia), Vol.6, No.1, 1998, pp.1-21.
7. MAIDUGU, A. Asheikh, 'Malthusian Population Trap and Poverty in Third World Countries: The Islamic Synthesis', *Journal of Objective Studies* (New Delhi, India), Vol.12, Nos. 1&2, January/July 2000, pp 115-134.
8. SULAIMAN, Maliha & WILLETT, Roger, 'Islam, Economic Rationalism and Accounting', *The American Journal Of Islamic Social Sciences* (Herndon, VA), Vol.18, No.2, Spring 2001, pp.61-91.

### Book Review

#### **Social Sciences in Islamic Perspectives: A Bibliography of Contemporary Literature (1975-2000)**

**Compiled by: Javed Ahmad Khan.**

*With a 'Foreword' by Professor M. Nejatullah Siddiqi*

**Published by, Institute Of Objective Studies, New Delhi, India. 2001, 300pp.**

Since the last quarter of this century, the Muslim scholars are making some serious effort to build-up a social science paradigm based on Islamic value system. As a result, scholars from all over the world, both the critics and proponents, have produced a good numbers of academic works in the varies field of Social Sciences in Islamic perspectives covering the disciplines such as Political Science, Economics, Sociology, Psychology, Education, History and Law. Their researches provide an intellectual Islamic alternative in thoughts and knowledge and bring some fresh insights into the emerging disciplines now called as "Islamic Social Sciences" It has also inspired a numbers of Western academics whose critique of modern Muslim intellectual thoughts is now available in a good numbers of monographs, and research papers in various academic journals.

This bibliography aims to cover all these writings on the subject of Social Sciences in Islamic Perspectives and brings together some three thousands selected entries of contemporary literature in English language only, expanding a period of two and half a decade (1975-2000).

One can find that about one fourth of the literature in this volume are on the various aspects of Islamic economics covering the issues such as; nature and scope of Islamic economic, ethics of business and management, economic development, poverty alleviation, land, labour and population. Author has included the Islamic critique of other economic systems but his major focus is on the area of banking and finance, its theoretical and the empirical studies on Islamic financial institutions. There is an especial coverage on the Islamic financial market, all these focusing on the Islamic perspective. Although author's previous bibliography *Islamic Economics and Finance* (1995, Mansell), has the same sort of listing, but this one, as he notes, incorporate the literature that came out mainly in the 1990s.

In the view of reviewer, author has not been much successful in locating the works published in the western academic circles. For example, one does not find any reference of Harvard proceedings on Islamic finance published since mid 1990s. On the other hand, he has not even left the journalistic material published in the Indian sub-continent. Here, one would also agree with Prof. M.N. Siddiqi, who in his 'Foreword' has rightly pointed out that Islamic economics has now 'entered the realism of referred journals and university publications'.

Nonetheless, Dr. Khan has classified his material in a very systematic way and the selections of the items have been drawn from a wide range of published and unpublished material; the books, articles, conference proceedings and Doctoral Theses. There are however, numerous spelling errors, the most prominent one at the cover page itself – and that too in this computer age!

Keeping in view the recent development in Islamic economics, it is hoped that this bibliography would be an indispensable tool for the scholars and students of Islamic economics and finance.

**Shariq Nisar**

### Islamic banking set to expand

From a bare handful of financial institutions set up in the 1970s to provide services compatible with Shariah law, the number of Islamic banks have grown to more than 200 in some 50 countries. They manage assets of around \$120 billion in addition to investments of another \$150 billion. The great desire by Muslims everywhere to conduct their financial dealings in accordance with Islamic teachings by using banks that do not pay or charge interest, and thus avoiding riba or usury which is forbidden to them has propelled financiers to adjust and adapt Western-style services.

"Islamic banking is not a negligible or a temporary phenomenon. It is here to stay and there are strong signs that it will continue to grow and expand. Even those who do not subscribe to the injunction against interest may find innovative ideas in Islamic banking, which could add more variety to the existing financial network. Moreover, the speed with which Islamic banking has sprung up and the rate at which it has progressed has made it an academic discipline to be studied systematically," said Dr. Said Al-Shaikh, chief economist at the National Commercial Bank. He says that while Islamic banking derives its rationale from the prohibition of interest, it is widely believed that there is greater value to Islamic banking — such as contributing to a more equitable distribution of income and wider equity participation in the economy. The role of Islamic banks in stimulating economic development is underlined by the fact that they would be ready to finance acceptable projects, which might be turned down by conventional banks for lack of collateral. Islamic banks, on the other hand, might involve themselves in these projects on a profit-sharing basis.

Dr. Najatullah Siddiqi, an eminent economist and winner of the King Faisal Prize for Islamic Studies, shares the notion that Islamic banks are here to stay. He emphasized the viability and success of the system. According to him, the growing number of Islamic financial institutions and the opening of Islamic banking counters by major conventional banks are proof of its attraction and are themselves proving successful.

Local Islamic financial institutions are expanding abroad through shared capital and asset merger initiatives. The latest such deal was concluded between Dallah Al-Baraka Group of Saudi Arabia, which runs Al-Baraka banks in several Arab countries, and the International Investor of Kuwait. The two institutions heralded what Dallah officials described as "the beginning of an exciting new era in global finance" with the signing of a \$350 million asset-merger deal.

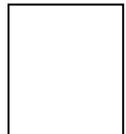
The new organization will provide clients in the Middle East and Africa with a full range of banking and investment services. "This agreement marked a turning point not only for clients, shareholders and business partners but for Islamic banking as a whole. We will work together to become the first full-fledged Islamic financial services network in the region," said Saleh Kamel, chairman of Dallah Al-Baraka Group.

While some analysts attribute the success of Islamic banking simply to clients' desires that these institutions comply with religious injunctions, most analysts predict expansion and growth well into the 21st century. "The development (of the Islamic banking experiment) may still be in its early stages but what has been achieved represents a great success," said Dr. Muhammad Al-Kari, former manager of the Islamic Economic Research Center at King Abdul Aziz University in Jeddah who is now in NCB's Shariah Control and Fatwa Committee. Making available the legitimate tools demanded by clients who want to invest has increased financial mediation, he said. "Studies in some Muslim countries have proved that the introduction of Islamic financing tools has had a direct effect leading to an increase in financial mediation."

Economists say Islamic banking is growing but the services offered by these institutions lack Shariah-compatible structured instruments to absorb liquidity. These banks and financial institutions need to establish a global, internationally accepted regulatory system to help ensure continued growth. Countries where these banks are located have also been advised to set up flexible rules and regulations, as well as instruments that can be traded according to Shariah to allow the industry to benefit their economies.

(Arab News)

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