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Address for Correspondence:

The Editor,

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E-mail: iebulletin@yahoo.com

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Islamic Banks: Challenges & Opportunities

In 15 years, the Islamic banking has grown to approximately \$100 billion. This market is growing today at between 10% and 15% a year. During this period major improvement occurred in the business practices of Islamic banks both in the quality of provided service and investment activities. It is evident to economists and bankers that these banks were able achieve a prominent status among international banks. This achievement should prompt Islamic banks to accelerate their efforts for the development and improvement and the observation standards of quality in response to the dynamic, rapidly evolving investment and finance environment. Islamic banks should consider certain approaches to meet the global and technological challenges of the future in order to benefit from the substantial opportunities that exist there for them.

It is fitting that Islamic banks develop not only on retail banking but also diversify their banking and financial products into the areas of wholesale and investment. The challenge here is the lack of Islamic instruments in the market. Cooperation and coordination among *Shariah* authorities and Islamic bankers should thus be strengthened and a common scientific base for collective cooperation (*ijtihad*) established in order to develop Islamic banking products and investment instruments and the Islamization of instruments used in the international financial markets. For instance, Islamic banks will need to acquire and develop the necessary investment banking and fund management skills. They will also need to search out longer term investment projects such as Islamic equity, bonds and leases to achieve the Islamic investor's liquidity needs and the longer-term financing needs of borrowers.

Recently, conventional banks have introduced an increasing number of Islamic products. This is, of course, due to the increasing demand for these products. Some conventional banks find it profitable to deal with Islamic investment funds such as asset-leasing funds and share-dealing funds. This trend supports our view that we will see continuing expansion and growth in the relationship between Islamic and conventional banks.

There are many challenges that are imposed by globalization on the banking industry, some of which relate to institutional capacity for self-development in methods and organizations and in providing banking and financial services that can compete and survive. The globalization also imposes a challenge on the *Shariah* authorities in Islamic banks in the issuing of *fatawa* required in the rapidly evolving international financial market.

There are great opportunities for Islamic banks to play an important role in financing development projects on the private and public sectors in the developing countries in cooperation with development organizations such as the World Bank, Islamic Development Bank, IMF, and IFC, especially in situations where these organizations need to develop specific Islamic financial instruments for selected development projects. A good example is the IFC's experiences with Islamic funds and leasing instruments in project financing through *Mudarabah* for private sector projects. In fact, the IFC's successful experiences illustrate the fact that there is great potential for the accessibility and employment of Islamic instruments by international organizations to finance private or public projects. The participation of IFC and other international organization, World Bank, IDB, and IMF will also serve to boost confidence in Islamic products.

Abdullah Sulaiman Al Rajhi

(Director & General Manager, Al Rajhi Banking and Investment Corporation, Riyadh, Saudi Arabia.)

I.O.S. Announces Essay Competition on Islamic Economics

To commemorate the outstanding services of Hazrat Shah Waliullah in promoting Islamic values, the Institute of Objective Studies (IOS) is organizing an essay competition for the junior category on the topic "*Economic Development of Indian Muslims in Islamic Perspective*". Interested young scholars and researchers of below 45 years of age may submit their paper by 30th June 2002 at the institutes' head quarter, New Delhi. The length of the paper should not increase more than 10,000 words. The best paper will be awarded Rs. 25,000 on the occasion of Shah Waliullah award ceremony in September this year.

This year's Shah Waliullah prize will be given in the field of "Islamic Economics" for which the Institute of Objective Studies has sought nominations. The last date of receiving nominations is May 15, 2002. The award carries Rs. 100,000 cash and a citation.

Details of both can be had from the following address:
Institute of Objective Studies (IOS)
Post Box No. 9725, Jamia Nagar,
New Delhi, 110025. Website: www.iosworld.org

Two Indian Scholars Join King Abdul Aziz University

Two young Indian economists Dr. Abdul Azim Islahi, the present Honorary Secretary of the Indian Association for Islamic Economic and Dr. Mohammad Obaidullah, the Director, IBF,Net and also the member of the advisory board *Islamic Economics Bulletin* have joined the prestigious Center for Research in Islamic Economics at the King Abdul Aziz University, Jeddah. Prior to this, Dr. Islahi was Associate Professor of Islamic Economics at Aligarh Muslim University while Dr. Obaidullah was Professor at Xavier Institute of Management.

A new Ph.D. Student enrolled at A.M.U.

The numbers of research scholars in the field of Islamic economics are now increasing in the Indian universities. At the Aligarh Muslim University (A.M.U.) alone, more than half a dozen students are enrolled to pursue their Ph.D. programme in Islamic economics at its various departments; Economics, Commerce and Management.

Recently, a new research scholar Syed Nisar Hussain has got admission for his Ph.D. work on "The Economic Thought of Baqir al- Sadr", at the Center of West Asian studies, A.M.U., His supervisor, Dr. Arif Husain Rizvi, is an Associate Professor in Economics at the Center.

A.M.U. Held Essay Competition on Islamic Economics

Department of Economics, Aligarh Muslim University, has recently organized an essay competition on "*Literature Trend on Islamic Economics at the end of Twentieth Century*". This competition was meant for Postgraduate students only.

IAFIE Executive Meets

A consultative meeting of IAFIE was held on March 13, 2002 at the residence of President of IAFIE, Dr. F.R. Faridi. Some important decisions taken at the meeting were:

The following new members (subject to their concern) be included as the member of the association:

- Dr. M.Y Khan, Senior Economic Advisor, Security and Exchange Board of India (SEBI).
- Prof. Shah Mohd. Waseem, Former Dean & Chairman, Faculty of Commerce, A.M.U., Aligarh.
- Dr. Masood Hasan, Reader, Department of Economics, A.M.U., Aligarh.
- Dr. Javed Akhtar, Reader, Faculty of Management Studies & Research Aligarh Muslim University.
- Dr. Ghalib Husain, Head, Corporate Secretaryship, Islamiya College, Vaniyambadi.

Since Dr. Abdul Azim Islahi, the present Honorary Secretary and Treasurer, of IAFIE has decided to join King Abdul Aziz University, Jeddah, he requested the executive to relieve him of his responsibilities to which President Dr. F.R. Faridi agreed and it was decided that Dr. Javed Ahmad Khan will perform the duty of Honorary Secretary as well as treasurer of the Indian Association for Islamic Economics. He would, however, continue the editorial responsibilities of the *Islamic Economics Bulletin*.

Dr. Islahi was assigned to make effort for the establishment of a permanent library for IAFIE.

IAFIE executive expresses its deepest sense of gratitude to Dr. A.A. Islahi for his invaluable services as the Honorary Secretary of the IAFIE and wish him all success in his future endeavours.

Lecture on Islamic Banking

The Indian Association for Islamic Economics, Tamil Nadu, organized a lecture on "Islamic Banking – The Viable Alternative to Conventional Banking & Finance" by Mohammad Ismail Bin Mohamed Shariff, the Director of Bank Muamalat Malaysia Berhad on March 9, 2001 at Hotel President in Chennai.

Mohammad Ismail in his lecture said India is a birthplace of the leading Islamic economists and *Ulama* and their contributions in the field of Islamic economics is acknowledged worldwide. In the lecture he focused on the potential market of Islamic banking in India and stressed that this system based on equity financing is not only for Muslim but even our non-Muslim brothers must be exposed its merits and its viability in the secular environment for which, he said, India is the most ideal place. He also cited the example of Malaysia where both Islamic and conventional bank functions side by side and where both Muslim and non-Muslim avail the Islamic banking services. Mr. Ismail explained that Islamic banking and insurance should be promoted as an alternative system in India on the Malaysian model.

At the beginning of the programme Brother Av. M. Jaffardeen, Managing Trustee, Av.M. Jaffardeen & Noorjahan Trust introduced the speakers and brother N. Shafeeq Ahmad, Managing Director, Bonaventure Shoes Pvt. Ltd. & President, Indian Shoes Federation, presided over the meeting.

New Books and Articles

Book Review

Books:

1. HANNA, N., (ed.), *Money, Land and Trade: An Economic History of the Muslim Mediterraneans*, London: I.B. Tauris, 2001, 288pp.
2. HENRY, Clement Moore (ed.), *Islamic Banking (Special Issue of Thinderbird International Business Review, Vol.41, Nos.4-5, 1999)*, Gelendate, AZ, USA: Thinderbird Graduate School of Islamic Management, 1999, 609pp.
3. MAJID, Mohammad Gholi, *Resistance to the Shah: Landowners and Ulama in Iran*, Gainesville: University Press of Florida, 2000, 415pp.
4. PEERZADE, S. Afzal, (Tr.), 'Islamic Public Economics', by M.N. Siddiqi, New Delhi, India: Idarah-i-Adbiyat-i-Delhi Publishers, 2001, pp.

Articles:

1. BILAL, Gohar, 'Business Organization Under Islamic Law: A Brief Overview', in *Proceedings of the Third Harvard University Forum on Islamic Finance*, Cambridge: Centre for Middle Eastern Studies, Harvard University, 2000, pp.83-90.
2. YAVAS, Abdullah, 'Experimental Test of the *Homo Economicus*: The Implications for the Research on Islamic Economics', in *Proceedings of the Third Harvard University Forum on Islamic Finance*, Cambridge: Centre for Middle Eastern Studies, Harvard University, 2000, pp.55-64.
3. 'Ahkam on Riba (Report), *Journal of Islamic Banking and Finance, (Special Issue)* (Karachi, Pakistan), Vol.18, Nos.3-4, 2001, pp.151-62.
4. HASSAN, M., Kabir & ISLAM, Faridul, 'Propsects and Problems of a Common Market: An Empirical Examination of the OIC Countries', *The American Journal Of Islamic Social Sciences* (Herendon, VA), Vol.18, No.3, 2001, pp.19-64.
5. JASIMUDDIN, Sajjad, M., 'The Stock Exchange and Islamic Finance: Some Thoughts for Reconsideration', *The Islamic Quarterly* (London), Vol.45, No.2, 2001, pp.105-18.
6. KHAN, M.Y., 'Banking Regulations and Islamic Banks in India: Status and Issues', *International Journal of Islamic Financial Services* Vol. 2. No. 4, 2001, pp, 12-23
7. VALERIAN, D., 'Ifriqiayan Muslim Merchants in the Mediterranean at the End of the Middle Ages', *Mediterranean Historical Review* (London), Vol.14, No.2, 1999, pp.47-66.

Islamicity of Banking and Modes of Islamic Banking:**By: Mohd. Anwar****Selangor, Malaysia: International Islamic University Malaysia, 28 pp. n.d.**

This monograph is basically the inaugural lecture delivered by the author in October 2000 at the International Islamic University, Malaysia. It contains a number of vital issues relating to Islamic banking and economics. The heavy reliance of Islamic banks on *Murabahah* financing along with the practices of seignorage by Islamic commercial banks have been given special attention with critical analysis. The author is quite convincing in his attempt to examine the Islamicity of the functions of central and commercial banking system.

The book has been divided into 5 sections with each covering a separate subject of study.

In section one, the author has rightly argued that in the process of Islamization of banks, operational technicalities have taken precedence over other concern and therefore the change of name from banking to Islamic banking is nothing but merely a psychological achievement. To prove his point Prof. Anwar gives a statistical account of the financial instrument adopted by the leading Islamic banks. Followed by this is the spatial account of Islamic Banks, which are compared with the conventional bank. Author has tried to prove that Islamic banks have performed better than the conventional banks. One wonders that if there is no difference between Islamic and conventional bank as he has argued, then how these Islamic bank could be better than the conventional banks?

Next section deals with the Islamicity of the modes used by Islamic banks. This section discusses the time value of money, which according to author is *Riba* and therefore stands prohibited. Whereas it is the time value of money, which is a part and parcel of all financial transactions of Islamic banks. Islamic banks have relied on certain trading modes like *Murabahah* and *Bai Bitaman ajil* because it is convenient to charge time value of money in the name of profit margin. The author also criticized the two-tier *Mudarabah* on the ground that it is nothing but exchange of money in different amount. This needed some more elaboration, which unfortunately is missing. The legitimacy of *Qardul-Hasan* as zero interest loans is also questioned.

In his entire study author has diagnosed three broad areas where improvement are required. Creation of fiat money by the central bank, creation of money supply by the commercial bank and elimination of *riba* component from the Islamic banking transactions. Measures suggested include, the replacement of fiat money with the commodity money by the central bank and splitting of banking activities into two sub groups i.e. investment and social banks.

Author has no objection in circulation of paper money but he calls for 100% reserve requirement, which to him is necessary to stop seignorage. Banking activities shall be divided into two specialized forms, the investment banks can solicit deposit on the basis of *Mudarabah* and *Musharkah*, which shall be employed by the bank itself, while social banks shall be managed by a trust. This shall be like a depository where depositors will not receive any return, however, interest free loans shall be issued to serve the identified individual and social needs. Seignorage created in the process shall be utilized for the development of the society. Here one may ask if seignorage can be allowed for communities benefit, why not interest?

Shariq Nisar

Islamic Economics & Finance Have a Great Future: Prof. Rodney Wilson

From this issue of Islamic Economics Bulletin, we are starting the interviews with the leading scholars of Islamic economics. In the first of this series, Prof. Rodney Wilson of the University of Durham, United Kingdom, shares his views with Shariq Nisar, the joint editor of this bulletin.

Prof Wilson is a highly respected scholar of Islamic finance in the Muslim world. His research papers on Islamic Economics and Middle Eastern Economics are published in the reputed journals. He has supervised several PhD scholars. Among his notable works include: *'Economics, Ethics and Religion: Jewish, Christian and Muslim Economic Thought'*, Palgrave, 1997 and *'Islamic Financial Markets'* (ed.) Routledge 1998, (Editor).

What are the main messages of Islamic economics to humanity? How it is different from conventional economics?

Islamic economics is concerned with justice in all transactions, whether buying and selling activities or financing or labour recruitment and retention. The Shariah law provides the framework for the economic system to operate in accordance with Islamic teaching, and hence there is a moral filter. Conventional economics is concerned to explain human economic behaviour merely in material terms, and specifically in the balance between utility and disutility. It disregards the spiritual realm, the emphasis being on material reward in this life. Islamic economics does not reject conventional theory, but rather provides a normative dimension.

What are the prospects and opportunities for research in Islamic economics, particularly for the students of Indian subcontinent, at western universities especially yours?

We offer an M. Sc. in Islamic Finance for students with mathematical ability who are capable of taking courses in financial theory and econometrics and an MA in Islamic Political Economy where there is an opportunity to combine Islamic economics and finance with Economic Development and Contemporary Islamic Thought. These one-year taught Master's Programmes include modules in research methods which makes them a suitable prerequisite for further study to PhD level. Unfortunately we have little scholarship funding. Details can be found on our Website.

What paper / book of yours you regard to be your most significant contribution to the subject?

My book on "Economics, Ethics and Religion: Jewish, Christian and Muslim Economic Thought", Palgrave, 1997.

You have been associated with teaching and research in Islamic economics at various levels, what do you think should have the highest priority in research in Islamic economics?

Relationship between Islamic economics and social economics and institutional economics. Working out the implications of Islamic economics for economic policy making at the national (macroeconomic) level and for corporate governance and strategy at the level of the firm.

(Microeconomic) Exploring how Islamic economics relates to the trends towards globalization.

What would be your critique (if any) on Islamic economics and finance?

Basic premises well established and accepted, but need for clarity in exposition. Islamic economics and finance should not simply involve taking conventional theories and modifying them slightly, but rather implies constructing a distinctive moral paradigm.

Where do Islamic banks stand now as compared to 27 years ago when the first Islamic bank, Islamic Development Bank was established?

Islamic banking has become a worldwide industry with Islamic banks operating in most Muslim countries and many countries in the West. Much has been achieved in the creation of Islamic financial products that have proved viable and robust, and most recently Islamic securities markets have been developed. The majority of Islamic bank clients are satisfied with the services they receive, and Islamic banking is treated seriously by leading international banks, many of whom provide Islamic services.

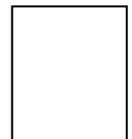
Critics say that Islamic banks are losing the ground and credibility, which they had succeeded in generating in the past. What do you think is the reason for that?

This is not the case, although in mature markets where Islamic and conventional banks compete it has been difficult for Islamic banks to increase their share of the market beyond 20 percent. In the West Islamic banking has great potential if large international banks with proven brand strength marketed their Islamic services to the general public rather than simply concentrating their efforts on a few individuals of high net worth.

Any message to the readers of Islamic economics?

Islamic economics and finance have a great future. Those working in the field are motivated by faith rather than simply material reward. They genuinely believe in what they are doing, and see their subject as distinctive and worthwhile.

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