

# ISLAMIC ECONOMICS

# BULLETIN

INDIAN ASSOCIATION FOR ISLAMIC ECONOMICS

VOLUME 12 No. 4

July - August 2002

Jumada I- Jumada II

1423 AH

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*Islamic Economics Bulletin* is published six times a year by the Indian Association for Islamic Economics (IAFIE). It aims to create awareness of the latest development in theory and practice of Islamic Economics.

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	Overseas	India
One year	US\$ 10	Rs. 50
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## ON ISLAMIC FINANCE

Samuel L. Hayes.III\*

I have been asked on a number of occasions about the relevance to or importance for the Islamic financial sector of current trends in the global financial services industry. A consideration of a number of interesting parallels as well as major differences can set the stage for a better treatment of various aspects of Islamic finance in the contemporary world. Enormous consolidation is taking place within the financial services sector--- not just among commercial and investment banks, but across the lines to other types of financial institutions. The arguments used to justify such consolidation in some cases have interesting parallels with and contrasts to Islamic banking.

For instance, it is pointed out that banks need to reduce costs, and a major vehicle for this is consolidation of expensive back-office activities and elimination of redundancies. This is critical to the renewal and reinvention of the mature banking industry of today. By contrast, Islamic banking is not a mature industry. We see a nascent industry, one that has been in existence for barely a quarter century. The typical S-curve for growth in the life cycle of a firm begins with a period in which the firm is getting its act together, and it then starts moving at an accelerated rate of growth before reaching a relative plateau of maturity. Unless the business finds a way to renew itself, it later slides back down the other side of that plateau. This is characteristic of the conventional banking system: commercial banks, both in the United States and in other nations, are finding that their customers are moving away from them, and so the banks, in addition to cutting costs, must reorient themselves to their customers' changing needs. Meanwhile, the Islamic banking sector is at the very outset of its S-curve life cycle. It is in the process of organizing and developing the necessary infrastructure and solid foundation that can precede rapid growth in the use of Islamic financial practices that solve problems for both investors and for Muslim businesspeople who wish to follow their faith in their commercial dealings. So on the one hand, Islamic finance is at the beginning of its career, while on the other the Western banking industry is at a mature phase in which it is trying to find a way to redefine itself to renew its growth. Given both the parallels and the differences between Islamic and Western financial services, several important issues are at the forefront as we contemplate an Islamic banking sector at the front end of the S-curve, posed for potentially rapid growth in the twenty-first century.

One critical issue is the need for additional variety of products for Islamic customers. This is a special problem for Islamic banks because of the religious constraints with which they must deal. Although many in the Muslim world hope for the elimination of the western capitalist system and its replacement by one based on Islamic principles that is not realistic. It is unlikely to come about during the lifetimes of many who are now present. Islamic capital users and investors will continue operating as a satellite around a global sun that represents the conventional international financial and commercial markets. Accordingly, we have to find accommodations for the legitimate needs of Islamic businesspeople, especially capital users. That must be emphasized because much of the attention paid by the Islamic world to Islamic finance has been directed at investors, not at users. If Islamic finance is to flourish and grow, Muslim vendors must broaden their interests and reach out to Islamic businesses that would like to practice their religious principles in the realm of corporate finance but must still compete in a non-Islamic world. A second important issue facing the industry is the need for liquidity. If anything, Islamic investors have a predisposition for liquidity, and yet the nature of many Islamic contracts is of long-term commitment. In fact, some have suggested that it is inaccurate to characterize Islamic institutions as banks because they are much more suited to the investors rather than lenders in the commercial banking sense. So, with Islamic contracts predisposed toward illiquidity and with an Islamic investor group that places a very high premium on liquidity, the establishment of a bona fide secondary market for Islamic instruments is an important goal.

Finally, there is a need for a stepped-up educational program to spread information about Islamic solutions for financial requirements. This need is almost as great for Muslims as it is for non-Muslims.

(\*Jacob Schiff Professor Emeritus, Harvard Business School, Cambridge, Mass. The extract of Hayes' Conference Chairman's Address at the Third Harvard University Forum on Islamic Finance).

### Al-Khair Registered

Al-Khair Cooperative Credit Society Ltd. of Bihar state has got registration from the Government of India. This is the second society of its kind under the Multi State Cooperative Act. in India after Aasra promulgated by Barkat Investment Group to have got the certificate of registration. Under the present banking regulation in the country where banking without interest is not possible, Muslims interested in Islamic principles are taking the route of cooperative credit society. The society will take the deposits from the public and give loans on actual service charge basis. The Chief Executive of the society is Mr. Arshad Ajmal and its head office will be based at Phulwari Sharif, Patna, Bihar.

### PhD Thesis Submitted

Mr. M. A. Pathan, a lecture at the Anjuman College of Arts & Commerce, Bijapur has submitted his thesis on "*The Economic Ideas of the Prophet Mohammad: A Study of Their Relevance and Significance*" to Karnataka University, Dharwad. Mr. Pathan completed his PhD work under the supervision of Dr. Syed Afzal Peerzade, the Principal of the same college and also the Director, Institute of Islamic Studies, Bijapur, and the writer of several books and research papers on Islamic public finance.

### Fifth Harvard University Forum on Islamic Finance April 6-7, 2002 - A Report:

Over 350 people, ranging from high-level executives in Islamic financial institutions to curious undergraduate students, attended the Fifth Harvard University Forum on Islamic Finance, held April 6-7 on the Harvard campus. Dr. Nazim Ali, Director of Operations of the Harvard Islamic Finance Information Program (HIFIP), explained, "The goal of the Forum is to attract a cross-section of the Islamic Finance industry, to bring together under one roof a diverse group of academics, practitioners, and consumers who can engage in meaningful dialogue about the industry—its past achievements, its current status, and the road ahead."

The Fifth Forum, titled "Islamic Finance: Dynamics and Development" came at a time of a significant upsurge in interest in Islamic finance by Muslims and non-Muslims alike. Increased awareness of the Islamic Finance industry, coupled with a widespread desire to better understand Middle Eastern financial systems, made this year's forum the best attended ever. The U. S. Treasury Department, impressed by the quality of the presentations at the Forum, has asked HIFIP to organize an "Islamic Finance 101" seminar in Washington, D. C. on April 26 for Treasury Department officials and congressional staff.

Thomas Mullins, Executive Director of the Harvard Islamic Finance Information Program, stressed the important role of the Islamic Finance industry in creating dialogue between Islam and the West. Forum Chairperson, Samuel Hayes, Jacob Schiff Professor Emeritus at Harvard Business School, commended the industry on the many strides it has taken in the past decade and outlined the areas where it still must improve. Saif Shah Mohammed, president of Harvard Islamic Society, suggested that the industry should provide relevant services to students such as *shari'ah*-compliant educational loans and young professional programs.

Address, delivered by Ahmad Mohamed Ali, President of Islamic Development Bank (IDB), was titled "The Emerging Islamic Financial Architecture: The Way Ahead." In his remarks Dr. Ali detailed the measures that IDB has taken to strengthen the international Islamic financial architecture by establishing the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the Islamic Financial Services Organization, an International Islamic financial market, and an Islamic rating agency.

In his address, Ahmed Bin Mohammed Al-Khalifa, Governor of the Bahrain Monetary Agency (BMA), discussed "The Progress of Islamic Banking and Finance in Bahrain." Frank Vogel, Adjunct Professor and Director of Islamic Legal Studies Program at Harvard Law School, delivered a keynote address entitled "*Ijtihad* in Islamic Finance."

Dr. M. Nejatullah Siddiqi discussed the emerging advantages of Islamic finance and banking.

Rushdi Siddiqui, Director of the Dow Jones Islamic Index, argued that developing 'Islamic windows' within conventional financial institutions constitutes the immediate future for Islamic banking in the West.

Shaykh Nizam Yaquby, an Independent *Shari'ah* Consultant from Bahrain, posed a number of questions, asking what are the social implications and larger economic benefits of an Islamic financial system? What are Islamic banks doing to eliminate poverty? Has Islamic finance become the roost of the few, or has it been able to address the needs and aspirations of the general populace? Shaykh Nizam's answers to these questions indicate that while the industry has made enormous progress in the last decade, it still has a long way to go.

For the second year, the Harvard Forum offered a free Workshop on Islamic Finance for Newcomers. The session aimed to introduce Islamic Finance to the members of the audience who had had little to no previous exposure to the field by describing Islamic finance from a theoretical, *shari'ah*, and practitioner's perspective.

The final session of the conference featured the unveiling of the New HIFIP Portal and *iDataBank*. Mr. Abdul-Basser, who is also the Coordinator of Software Development at HIFIP, described how the new remote Data Entry System (DES) would allow researchers from around the world to contribute to the *iDataBank*.

S. Nazim Ali, HIFIP Director of Operations mentioned that the 300-page Proceedings of the Fourth Harvard University Forum on Islamic Finance, widely recognized as the leading scholarly publication had just been published and are available for purchase.

For more details visit at: [www.hifip.harvard.edu](http://www.hifip.harvard.edu)

### Essay Writing Competition Date Extended to July 25<sup>th</sup>

The last date for the submission of paper for essay writing competition on '**Economic Development of Indian Muslims in Islamic perspective**' has been extended from June 30<sup>th</sup> to July 25<sup>th</sup> 2002.

The award is carrying prize of Indian Rs. 25000, announced by the Institute of Objective Studies, New Delhi in February this year. The competition is open to all Indian students and research scholars of below 45 years of age.

For more details contact at:

**The Convenor,**

IOS, Shah Waliullah Prize

Institute of Objective Studies

162, Joga Bai Extension, Jamia Nagar,

New Delhi, 110025, website: [www.iosworld.org](http://www.iosworld.org)

## New Books and Articles

## Research in Progress

## Books:

1. BILLAH, M. Masum, *Shariah Model of Quantum of Damages in Takaful and Re-Takaful*, Kuala Lumpur, Malaysia: International Islamic University, 2001, 40pp.
2. KHAN, Zafar Ahmad, *Islamic Banking and its Operation*, London: Institute Of Islamic Banking and Insurance, 2001, 160pp.
3. SABRA, Adam, *Poverty and Charity in Medieval Islam: Mamluk Egypt 1250-1517*, Cambridge, Cambridge University Press, 2000, 192pp.
4. SIDDIQI, M. Nejatullah, *Economics: An Islamic Approach*, Islamabad, Pakistan: Institute Of Policy Studies, 2001, 99pp.
5. STEWART, John A., *Economic Justice: An Enduring Quest*, London: Shepherd-Walwyn, 2001, 208pp.

## Articles:

1. CHOUDHURY, M.A., 'The Nature of Money and Monetary Policy for Economic Integration', *Thoughts On Economics* (Dhaka, Bangladesh), Vol.11, Nos.3&4, July-December 2001, pp.7-30.
2. CUNNINGAM, Andrew, 'Culture or Accounting: What are the real Constraints for Islamic Finance in a Riba-based Global Economy', *Middle East Economic Survey* (Cyprus, Nikosia), Vol.44, No.7, 12 February 2001, D3-8.
3. FRINGES-HESSAMI, Khachija V., 'The Islamic Debate about Land Reform in the Iranian Parliament, 1981-86', *Middle Eastern Studies* (London), Vol.37, No.4, 2001, pp.136-81.
4. HABIBUR-RAHMAN, S.M., 'Islamic Banking Revisited', *Thoughts On Economics* (Dhaka, Bangladesh), Vol.11, Nos.3&4, July-December 2001, pp.51-74.
5. HANEEF, M. Aslam, 'Islam and Economic Development in Malaysia – A Reappraisal', *Journal Of Islamic Studies* (Oxford, UK), Vol.12, No.3, 2001, pp.269-90.
6. OMOTOSHO, A.O., 'Begging, Idleness and the Economic Doctrine of Islam', *Hamdard Islamicus* (Karachi, Pakistan), Vol.24, No.4, October-December 2001, pp.67-72.
7. SALEH, Nabil, 'How Will Shariah Influence Middle East Contract Law', *Middle East Executive Report* (Washington, DC), Vol.24, No.7, July 2001, pp.13-18.
8. SHABBIR, Muhammad, 'Securitization of Islamic Financing Receivables', *New Horizon* (London), No.118, April 2002, pp.3-7.

## Contributions of Indian Scholars To Islamic Economic Thought:

Dr. Masood Hasan\*

Islamic economic ideas are distinguished from the conventional economic thinking in the sense that the latter are merely the Philosophical presentation depending upon different ideological pursuits. They are devoid of moral values and spiritual developments, which guide the human beings towards altruistic objectives. On the contrary, Islamic economic thoughts have their roots in divine laws revealed through *Qu'ran* for human welfare (*falah*) and codified in *Sunnah*-life and sayings of the Prophet Mohammad (PBUH).

Researches in Islamic Economic Thought like other dimensions of Islamic code of life are based on the primary sources of Islam – Qur'an and the Sunnah. Other sources of Islam known as secondary sources are *Ijma* (consensus of the *Ulama*) and *qiyas* (analogy), which are resorted for the explanation of newly emerging economic issues within Islamic framework where answer has no reference in Quran and Sunnah.

Indian scholars have made significant contribution to Islamic Economic Thought. They have not only maintained continuity of the economic ideas developed by the eminent Muslim Jurists, Sufis and Philosophers but also carried out some pioneering works in applied form such as Islamic Banking and Finance providing solutions to the contemporary economic problems along with moral values and spiritual development. Out of the two set patterns for discussing the Islamic economic thought either by ideas or by personalities, we examined the contributions of Indian scholars to Islamic economic thought in terms of personalities. However, the former approach has been selected for reporting briefly the economic ideas of Muslim thinkers up to 14<sup>th</sup> century.

The monograph has five sections. The first section deals with the conceptual framework of Islamic Economic thought based on revealed norms for human welfare. It will highlight the basic issues involved guiding the writings on Islamic economic ideas taking into account the Islamic worldview and its application to the complex problems arising from time to time. This section also briefly covers the contribution of Muslim Scholars up to 14<sup>th</sup> century. The second section will discuss the contributions of Indian scholars to Islamic economic thought during pre-independent period. It will include the contribution made by Shah Wali Allah Dahlawi, Sir Syed Ahmad Khan, Mohammad Iqbal, Syed Abul Ala Mawdudi, Maulana Mohammad Hifzurr Rehman Seoharwi, Anwar Iqbal Qureshi and Manazir Ahsan Gilani. Some other Indian scholars who have contributed to Islamic economic thought in way or the other will also be discussed. They are Muhammad Hamidullah, Muhammad Yusufuddin, Muhammad Abdul Qadir and Syed Sulaiman Nadvi. The third section will examine the writings of Indian scholars during the post independent period. The important scholars are Mohammad Nejatullah Siddiqi, Fazlur Rahman Faridi, Maulana Muhammad Taqi Amini and Abdul Azim Islahi. Some other Muslim writers will also be discussed such as Fazlur Rahman Gunnauri, Haroon Khan Sherwani, Hamid Ali Khan, Mujibullah Nadvi, Ausaf Ahmad, Masood Hasan, Muhammad Manzoor Alam, Sabahuddin Azmi and Syed Afzal Peerzade. The Fourth section will deal with the problems associated with the research in Islamic Economics. The last section is concerned with the conclusion and the suggestions and future directions needed conducting scientific research in Islamic Economic Thought.

(\*Reader, Department of Economics Aligarh Muslim University, Aligarh)

**EXCLUSIVE:****Islamic Banking at the Cross-roads: Zamir Iqbal**

Dr. Zamir Iqbal works as a Senior Information Officer with the Quantitative Strategies, Risk and Analytics department of the World Bank in Washington, D.C. He is currently also serving as visiting faculty of international finance at the George Washington University. He has published articles on Islamic finance in various international journals. He has presented papers on Islamic finance in international conferences in Egypt, Iran, Lebanon, Pakistan, UK and USA. His research interest includes Islamic Securitization, Financial Engineering, Structured Finance and Risk Management. Dr. Zamir shares his views with Shariq Nisar Joint Editor, *Islamic Economics Bulletin* (Editor.)

*You are at the top most banking institution in the world. How people at the World Bank look at Islamic banks. Do they see any material differences between both the banking systems?*

The Bank recognizes and respects the wishes of its member countries to develop their financial system according to their cultural, ethical and moral principles. IFC, private sector arm of the World Bank Group has successfully participated in several Islamic financial deals and has played significant role in others. The Bank has started to evaluate the areas such as regulations, standards, supervision, asset management and treasury management where it may be able to offer technical assistance to its client members.

*You have been writing at different aspects of Islamic banking in the past. In one of your such paper you have written that equity based banking is not new to the world and in fact it was Jews who established first equity based bank much before the advent of Islamic banks. Any comment?*

Equity financing has been in practice for ages but there are few examples where a financial institution such as a commercial bank functions based on the principle of equity participation with its clients and depositors. In more recent history, a French institution by the name of Credit Mobilier is an example where a financial institution on the basis of equity was successful in mobilizing funds for economic development.

Also, recent trends in global equity markets and emergence of diversified mutual funds are another positive sign that a banking institution can operate on equity-basis provided risks are understood by the investors. A bank which is designed to act as an intermediary who invests through instruments of trade and equity finance, and shares the profits with its depositors instead of paying predetermined interest rate would be fully compatible with Islamic principles. Given advancement in financial markets and enhanced portfolio and risk management tools, such financial institution is not inconceivable.

*How do you look at the future of Islamic banking? Where it is heading?*

Islamic banking is at cross-roads where they have demonstrated that there is enough demand in the market to justify specialized banking institutions but need serious thinking about going forward in terms of lack of products, lack of liquidity and lack of risk and portfolio management practices. Financial engineering does not exist, asset base is small which does not let Islamic banks enjoy economies of scale, and there is deficiency in the area of standards. Unless these problem areas are addressed, it may face tough competition from conventional banks who can offer similar services in more efficient fashion.

*It is said that Islamic banks rely more on propaganda than on actual work. A case in cites is the announcing of Islamization of few economies, while the ground realities in those countries still remains the same. Pakistan for example spends more than 60% of its tax receipts on debt servicing alone and it also claims to be the first country to Islamise its economy; Please comment?*

State-sponsored implementation of Islamic banking has been troublesome mainly because of significant fiscal deficits and balance of payment disequilibrium, which does not leave much option for the govt. whose citizen, may wish to practice Islamic banking but the economic realities are not very favorable.

However, things are different in the private sector where there are sincere depositors, entrepreneur and bankers who wish to bank on the basis of principles of Islam. That is one of the reasons that growth in Islamic banking is mostly taking place in the private sector.

*Islamic banking is said to be passing through identity crisis. What reforms do you think are needed to make the Islamic banking realize its goal?*

Areas of financial engineering, risk management and sound regulatory and supervision including transparency are the most critical areas in the near future. World-class research is a must, which must take place to make further progress.

*Which area should have the highest priority in research in Islamic economics and banking?*

Areas of public finance and monetary policy matters should be critical so that countries wishing to implement Islamic system can make some progress. For the private sector, financial engineering for new products in addition to addressing regulatory and supervision issues.

*Any message to our readers?*

I would like to thank the *Islamic Economic Bulletin* for giving me this opportunity to share my thoughts with the readers. The area of Islamic economics is very fascinating and needs dedicated researchers who are committed to produce high quality of research. There are several areas of research, which are being neglected mainly due to shortage of researchers in the field.

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