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## Address for Correspondence:

### The Editor,

Islamic Economics Bulletin  
4331, Amir Nishan,  
Aligarh, 202002,  
U.P - India

Phone: 0571-503651

**E-mail: [iebulletin@yahoo.com](mailto:iebulletin@yahoo.com)**

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## Towards A Grass-Roots Based Islamic Finance For All

Professor M. N. Siddiqi

One of the lessons of recent history has been that governments tend to over-regulate. There are reasons to believe that a modern Islamic state will be over-zealous to do so. It may even overstep from regulation to full-scale management of the financial sector. One can already discern such a tendency in Sudan, Pakistan and the Islamic Republic of Iran. But neither the Law of Islam nor the *Maqasid* (goals) of *Shariah* or its *Masalih* (interests) require such a policy or even condone it. Such policies can only lead to disastrous results as the history of the socialist states has shown. Moreover, collective management does not and cannot have the flexibility and innovativeness that Islamic finance requires in a fast changing world.

A great blessing indeed, more than anything else, government patronage put Islamic finance visible and loud on the scene of world finance. But unfortunately, most of these official initiatives lacked a solid basis in a democratic polity. The beauty of democratic decision-making is that it is not hypocritical. Islamization of banking in the framework of democratic governance would have had the benefit of wide scale participation of those involved - bankers, businessmen, accountants, auditors and the common man (male & female) as depositor or borrower. The fact that they had a say in deciding where to begin, how to proceed, where to compromise and where to stay firm, etc. would have gone a long way in ensuring compliance. Decisions taken in this manner, and open to revision through dialogue and debate in the light of experience, would have been implemented at least as seriously and as sincerely as the other laws of the land and policies. But what we actually had was entirely different. The results are there for all to see.

The entry of conventional players into the field and the rapid growth of mutual funds have provided a new source of strength to Islamic finance in the private sector. This coincides with the greater interaction between Islamic scholars and conventional financial experts at various forums. This has heightened the realization that a search for ethical investment and cleaner, greener finance is not confined to any one community. Islamic financial movement can now be placed in the broader perspective of disenchantment with the excesses of capitalism and the uncaring financial system ensuing from it. The quest for socially responsible financial management that yields a fairer distribution of benefits tends to become a universal human endeavor.

Exactly what needs to be done to bring people around to Islamic banking and finance? In the first instance we need to reinforce credibility which has suffered in the recent past, both on account of politicians exploiting the idea for promoting their hidden agendas and unscrupulous profit seekers preying on people's gullibility and using religion as a tool to do so. Credibility requires visible operation within a framework of rules everyone can know and understand. Islamic finance has to be transparent, open to inspection by anyone and everyone. It should not be perceived to be operating in the framework of rules largely unavailable in writing, understandable only to the select who can make sense of archaic terminology subject to varying interpretations. It should not be projected as something above the layman's scrutiny, tolerating no dissent, leaving room for no debate, immune to learning by doing and allowing no flexibility in application. We should never lose sight of the reality that the divine part of modern Islamic finance, though crucial, is very small. The rest is man-made, resulting from *Ijtihad* (efforts in understanding and application). More than in any other walk of life, *Muamalat* (worldly transactions) in general and finance in particular require continuous interaction between scholars and practitioners for arriving at laws that really ensure the goals of *Shariah* in a particular time and place and rules of the game that are fair and perceived to be so by all concerned. It was so in the heyday of Islamic jurisprudence. It requires a similar environment today. But that environment does not exist at the present. We have to work for it.

(Excerpt from Keynote Address read at the 8<sup>th</sup> Annual International Conference on Lariba Islamic Banking in Los Angeles, USA, 16<sup>th</sup> June 2001).

### Pakistan Supreme Court lowers interest in Islamic banking

The photo finish landmark judgment by which the Supreme Court of Pakistan has canceled the mandatory order banning interest-based banking in Pakistan has deep implications for banks and financial institutions.

The ban on all interest-based banking or '*Riba*' was to come into force from June 30, 2002 under a judgment of Federal Shariah Court (FSC) of Pakistan. The Federal Shariah Court that rules on what is un-Islamic had, in its November 14, 1999 judgment, declared "all forms of interest based banking un-Islamic." The Shariah Appellate Bench (SAB) of the Supreme Court of Pakistan that can overrule or confirm Federal Shariah Court judgments had, on December 23, 1999 upheld the Federal Shariah Court judgment. By doing so, it mandated the government of Pakistan to ban all interest-based banking and to transform the economy according to Shariah laws and principles. United Bank Ltd. (UBL), a state-owned bank, filed a review petition against this Federal Shariah Court - SAB ruling in the Supreme Court of Pakistan (SCP), the highest judicial organ of the country. The government of Pakistan supported the UBL review petition against the ban on interest-based banking. The government maintained that implementation of the Federal Shariah Court-SAB judgment will create enormous problems for the domestic, Western-style banking and the economy, as well as Pakistan's official and private business and financial dealings with the outside world.

The SCP has now ruled on the UBL and government review petitions against December 23, 1999, judgment and has now sent the case back to the Federal Shariah Court and directed review all matters of the present banking and financial system, keeping in view the legal, religious and business practices in other Islamic countries. Meanwhile, it revoked the proposed ban that was to become effective June 30, 2002.

Setting aside the 1991 and 1999 rulings it said, case has been made by UBL, the government and those appealing against these orders because "there are errors floating on the surface of record."

"We are of the considered view that the issues involved in the matter require to be determined after thorough and elaborate research and comparative study of the financial systems which are prevalent in the contemporary Muslim countries of the world." The previous rulings, it said, did not give a definite finding on all the issues for resolution of the controversy — interest-free banking and ban on '*Riba*' — involved in these cases.

The Federal Shariah Court, under the Constitution of Pakistan, it said, is "enjoined upon to give a definite finding on all the issues falling within its jurisdiction." The Supreme Court also said that Justice Dr. Tanzilur Rehman, the then chief justice of Federal Shariah Court that gave the 1991 ruling had "delivered the judgment with a pre-determined mind, and had relied on views he himself had expressed in his own books and writings on interest-based banking and economy. Justice Rehman had also ignored opinions of globally known Islamic scholars and jurists including Shaikh Mohammad Abduhu, Shaikh Rashid Rida, Abdul Razzak Sanhuri, Shaikh Mahmood Shaltut the former rector of Al-Azhar University at Cairo, and the present rector of the university Dr. Muhammad Sayyid Tantawi, etc.

(Source: *Arab News*)

### A.M.U. Cancels Teaching Islamic Economics Course

The Department of Economics of Aligarh Muslim University has canceled teaching course on Islamic economics from the academic session 2002-2003. This course was taught as an elective at the Postgraduate level since last twelve years. When contacted, the Chairman Department of Economics, Professor Nasim Ahmad Zaidi said that we were forced to stop the course due to lack of appropriate teaching staff as well as incentives for the students offering this course. He also said that, students offering this course loose the opportunity of being employed by the Indian universities, as this course cannot be offered for lectureship conducted by the University Grant Commission. This course was also marred by low response after the Barkat Investment Group stopped scholarships to the students offering Islamic economics.

In another development, a diploma course in Islamic Banking and Finance, which was earlier passed by the Board of Studies, at the Department of Economics with the active intervention of the former Vice Chancellor Mr. Hamid Ansari, is yet to get clearance from the higher academic bodies of the university.

### Arab Development Report

The United Nations Development Programme in its report on Arab Development observes that the region, which has provided political, intellectual, cultural and scientific leadership to the world for hundreds of years is at the cross roads in spite of a strategic place on the world map, immense oil wealth, and unifying factors such as one religion, one language and one culture. It further says that the lack of political will has kept the region underdeveloped over the years. The whole report can be downloaded from <http://www.undp.org/rbas/ahdr>

For the sake of information of our reader, we reproduce here some economy related facts and figures from the Arab Development Report.

- GDP of all Arab countries combined was US\$ 531.2 billion in 1999. This is less than that of a single medium sized European country, Spain (US\$ 595.5 billion)!
- Annual growth rate is just 3.3%
- Annual growth rate of per capita income is just 0.5%
- Oil comprises 70% of export
- Inter-Arab trade accounts for only 7 to 10% of total Arab foreign trade (This has remained same since the 1950s.)
- Arab investment capital flows more to the industrial countries, rather than to inter-Arab destinations.
- There is much disparity in different Arab countries, with countries like Kuwait, Bahrain, Qatar and UAE forming the higher strata.
- Unemployment is 15% (the highest in the developing world)
- Half of young Arabs polled want to immigrate
- There is less dire poverty in Arab countries, and disparity between rich and poor is not as marked as in some other regions. This is because of the solidarity inherent in Arab culture and the tradition of aid for the poor!
- Still, one out of every five Arabs lives on less than \$2 per day.
- Main obstacles to economic growth: Lack of skilled human resources and lack of democratic and efficient governance.

## New Books and Articles

## Books:

1. AHMAD, Habib, *Theoretical Foundations of Islamic Economics* (Book of Reading No.3), Jeddah, Saudi Arabia: Islamic Research and Training Institute, Islamic Development Bank, 2002, 192pp.
2. RASHID, S. Khalid (ed.), *Awqaf Experiences in South Asia*, New Delhi, India: Institute Of Objective Studies, 2002. 634pp.
3. YOHANNES, Okbazghi, *Political Economy of an Authoritarian Modern State and Religious Nationalism in Egypt*, Lampeter, Dyfed, UK: Edwin Mellen Press, 2001, 364pp.

## Articles:

1. ABDUR-RAHMAN, Hasbullah Haji, 'Concept of Contract (*Aqd*) in Islamic Law', *Hamdard Islamicus* (Karachi Pakistan), Vol.25, No.1, January-March 2002, pp.55-62.
2. AHMED, Habib, 'Financing Micro enterprises: An Analytical Study of Islamic Micro finance Institutions', *Islamic Economic Studies* (Jeddah, Saudi Arabia), Vol.9, No.2, March 2002, pp.27-64.
3. ALIERO, Ibrahim Hussaini, 'Islamic Banking and the Problems of Financing Small-Scale Enterprises: A Critical Review', *Islamic Culture* (Hyderabad, India), Vol. LXXVI, No.3, July 2002, pp.27-44.
4. BUGRA Ayse, 'Labour, Capital and Religion: Harmony and Conflict Among the Constituency of Political Islam in Turkey', *Middle Eastern Studies* (London), Vol.38, No.2, April 2002, pp.187-204.
5. HAQUE, M. Rizwanul, 'Waqf Experience in India', In: Syed Khalid Rashid, (ed.), *Awqaf Experiences in South Asia*, New Delhi, India: Institute of Objective Studies, 2002, pp.125-140.
6. HASAN, Zubair, 'The 1997-98 Financial Crisis in Malaysia: Causes, Response, and Results', *Islamic Economic Studies* (Jeddah, Saudi Arabia), Vol.9, No.2, March 2002, pp.1-16.
7. MANSOORI, M. Tahir, 'Supreme Court's Judgment on Riba- a Shariah Appraisal', *Hamdard Islamicus* (Karachi, Pakistan), Vol.24, No.3, 2001, pp.15-52.
8. ROSLY, Saiful Azhar and SANUSI, Mahmood, 'Some Issues of *Bay al' Inan* in Malaysian Islamic Financial Markets', *Arab Law Quarterly* (London), Vol.16, No.3, 2001, pp.263-80.
9. ZIYA, Onis, 'The Political Economy of Islamic Resurgence in Turkey: The Rise of the Welfare Party in Perspective', *Third World Quarterly* (London), Vol.18, No.4, 1997, pp.743-66.

*Contd. from Page 4.*

*Why did you not approach the Islamic Financial institutions of other countries to save your organization?*

We did, we wrote to Islamic Development Bank (IDB) and also to some other Islamic banks abroad as well as some other institutions and well-placed individuals. We did receive some help from some individuals but nowhere near what was required. One Islamic bank too helped us indirectly by paying us lucrative fees for arranging some financing deals between them and Indian businesses. The regret is that these deals were structured as *murabahah* and involved a compromise on our part though our participation was not direct and our involvement was in a situation of extreme crisis.

*Barkats' parent organization Bait-un-Nasr (BUN) is also reported to be facing a lot of difficulties.*

Yes, BUN is in trouble. It is closed though not yet taken over by the authorities. It will be a pity if it too folds up. BUN crisis was brought on by distorted media reporting. Though it was indirectly linked with Barkat, at the time of the run on it, it had a healthy liquidity position. At the time it was hit it had an asset base of about Rs. 150 to 160 millions and a daily cash collection of Rs. 1.2 to 1.5 millions. With the infusion of Rs. 30 to 40 millions it can be revived with a bold and dynamic team with vision.

It will be sad if BUN goes under. Unlike Barkat, which was based on profit and loss sharing investment, BUN is based on small deposits and small shareholders numbering almost half a million, mostly with an average stake of about a thousand rupees or less. It was being run on a no-profit-no-loss basis.

One other reason why BUN needs to be saved is that unlike almost all other substantial loans operations on interest-free basis. Such as the Muslim funds in the north, it did not make compromises with *Shariah* principles. It is also the only institution to have tried to scientifically work out its costs and link charges to costs. It had a developed HR department, a proper performance evaluation system with remuneration levels linked to performance and a planned management hierarchy. Its accounts were also computerized to a fairly high level, mostly using in house talent.

*It is alleged that you had put all your eggs in one basket?*

It is not an allegation it is the truth. However, being wise by hindsight does not help. On the other hand, as I mentioned in passing, insufficient analysis and attention to investment strategy in the absence of the *murabahah* option and the difficulties in profit and loss sharing investment, falsification of accounts, high investigation and monitoring costs and hostile taxation/laws (taxing equity investment heavily while exempting debt, and unlimited liability of partnerships) also prevented us from reducing dependence on what had been a solid investment option (barring a few short lived downturns) over the previous half century in India ; real estate.

*What is the future of Islamic finance in the country?*

A difficult one, I think we have missed the bus. It is the eighties and nineties that were the best and most opportune period for Islamic finance in India. It was during this period that the government threw open the fields of mutual funds, banking and insurance. Regulations have also been made more stringent and thresholds have been raised. Then, many niche areas, which were accessible earlier due to compatibility with Islamic requirements, are now, due to changed regulatory conditions, either closed to us or will now involve bigger compromises with Islamic stipulations. The political climate too has turned more unfavorable to Islamic banking. Also, since in the earlier phase of liberalization, things were in a flux, on the whole the bureaucracy and the entire polity was more open to new ideas.

Of course I am still optimistic and hope for a new dawn. Only, it will require greater efforts, much larger capital and more dedication.

**EXCLUSIVE:****The Future of Islamic Finance in India**

Mohammad Hussain Khatkhatay, popularly known as M. H., the Managing Director of the India's largest Islamic Financial Institution, the Barkat Investment Group, has been instrumental in almost every important Islamic financial activity in the country, whether it be an establishment of Modern Educational Social and Cultural Organization (MESCO) 1958, Bait-un-Nasr (BUN) 1973, Barkat 1983, Federation of Interest Free Organization (FIFO) 1986 to the establishment of Al-Baraka Finance House in 1989, it has been a journey full of events. The man who built a financial empire is now the helpless spectator of the falling all these one by one. First it was Barkat Group in May 2000 and now the BUN, which is almost at the door of liquidation. MH explains to Shariq Nisar, Joint Editor of *Islamic Economics Bulletin*, the tragic events of Barkat and its ramifications on the Islamic financial activities in the country. (Editor).

*Having an academic background of B. Tech in Metallurgical Engineering and M.B.A. in production. Why did you choose the field of Islamic finance?*

By the time I had finished my MBA in 1973 I had already made up my mind to make the switch from Engineering to Finance and Management. Islamic Finance was then a natural progression. One factor, which did make me inclined to working in the financial field rather than in other areas of benefit to the community was that I was struck by the wide charm in this field between mere assertions by Muslim leaders and writers and the stark reality. For instance, I remember having read, somewhere in the mid sixties in an old magazine issue of the fifties, an article by Dr. Hamidullah about the feasibility of Islamic Banking. I could not help feeling that we could do with some practical constructive work in preference to mere discussion and self-glorification. This was the spur that led me to decide to implement the Islamic injunctions in the finance area.

*Your Barkat Investment Group has been one of the highly successful Islamic Finance Company in India in 1980s and till mid 1990s. What do you think are the main reasons that led to the collapse of the Barkat?*

Apart from the obvious and immediate cause being the sustained recession in the real estate market (in which we had a heavy exposure) and the vagaries of the stock market, I think we can account for the following:

- Failure of management in not taking care to diversify as well as not paying sufficient attention to mismatch in tenures of assets and liabilities.
- Weak capital structure due to high gearing.
- Lack of institutional support infrastructure (absence of financial support on Islamic basis).

- The crisis period coincided with a period of very rapid changes in the regulatory framework imposed by the government, which led to cutting off some Islamic options, which could have eased our situation.
- Management philosophy being oriented more to growth (to provide a palpable justification for the feasibility of Islamic Banking), rather than a more cautious income orientation.
- One may also add, that the self-imposed restriction on not engaging in *Murabahah* and the difficulties in engaging in profit-sharing business led us to painting ourselves into the corner of real-estate investment. This was, however, again a management failing as the same should have been anticipated by some serious analysis.

*I personally interacted with few depositors, who blamed to your adamant attitude of not seeking help from the conventional financial institutions. Moreover, you never opted for the Murabahah financing, which is allowed in the Shariah and practiced by Islamic financial institutions worldwide.*

What you have stated is true. As far as dealing in *riba* is considered, that cannot be condoned in any circumstances and I am satisfied that we stood our ground and did not compromise on it. As far as *Murabahah* is concerned, we started with the idea that if we are attempting an Islamic alternative, let us be sincere in it. There were already so many people doing the same conventional financing under Islamic names. Then if we were getting into Islamic finance, there was no point in replicating the same practices of dubious authenticity. But once we got into a crisis I doubt going in for *Murabahah* would have helped. It was already too late.

*Why did you prefer liquidation? Has it brought any solace to the beleaguered community?*

Let me clarify that we did not voluntarily take Barkat into liquidation. We tried for two and a half years to keep it afloat. It was finally taken over by the authorities when some investors lost their patience and went to the police. In fact for us the period of struggle before the closure was the most trying and stress-filled and yet we did not adopt the easy way out.

Regarding the letter, certainly not. If anything, it has only increased their loss. For one, the intervention of the authorities dried up the non-funding income from the Islamic bank, I mentioned.

At that time we had several proposals in the pipeline, which could have materialized and generated income in millions. Infact, we received Rs. four million from a completed deal after the Barkat was closed and the money was deposited with the court when it came through. If we had been allowed to continue, more people would have got repaid to a greater extent. As things stand, for the last two years no investors are being paid and as and when properties are sold they will fetch even less than they would have done if Barkat was still a going concern. This is unfortunately how things happen in such situations.

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