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India's Premier Islamic Financial Institution in Dire Straits

India's premier Islamic Financial Institution (IFI), Bait-un-Nasr (BUN), is closed for about two years now. It had put its shutters down in Sept 2001 after a run on it caused by an irresponsible media report. Since then BUN has not been able to resume its operations.

During the past few years several Islamic Financial Institutions have failed in India for various reasons. However the case of BUN is typically different for two reasons; firstly, it never raised deposits on PLS or for business purposes, and more than 90% of its depositors are from the economically lowest strata of the society.

BUN has been functioning since 1973. It accepted deposits from the public on interest-free basis and extended the same to the public on actual cost basis. It has devised a unique system of scientifically calculating its cost so that service charges accrued over and above this average cost were credited to the loanee's account whereas if the accrued service charges were less than the cost the same were charged from the loanees. In this way BUN avoided a major discrepancy found in the method of functioning of many present-day Islamic Financial Institutions. After its registration as an Urban Cooperative Credit Society in 1976 BUN was subjected to some restrictions. For example, it was not allowed to function beyond the geographical limits of Bombay and prohibited from functioning among non-members.

Two important features of BUN's bye-laws were:

(i) It will purely function as an interest-free institution and
(ii) It will not engage itself in actual business that means it will remain confined only to financial intermediation, on the basis of no-profit no-loss.

As time passed BUN grew stronger by the day. By the mid-1980's it was able to float a few partnership firms that engaged in Profit and Loss Sharing (PLS) businesses. However, on its own BUN was neither able nor allowed to participate in these businesses. Further, the Act under which BUN was registered also did not permit it to undertake any such activities. Moreover the management of both setups was in different hands.

BUN and the institutions floated by it kept growing separately. However, unlike the ups and downs faced by the companies running on PLS principles, BUN kept growing steadily till the time it was forced to close.

According to the latest estimates, the total net liability of BUN is not over Rs. 20 million. Of its total liability of around Rs. 120 million, it has already paid its depositors about Rs. 60 million and the remaining liability of Rs. 60 million is covered by assets and properties worth about Rs. 40 million.

The case of BUN is classic in the sense that it was closed when one of its former affiliates was taken over by the Government after incurring heavy losses in real estate investments. Another factor that added to the confusion was that BUN was promoted by the same person who was then managing the liquidated firm. A few people, in the local media in a hurry to make this news public, prophesied that BUN was bound to follow the liquidated firm. This had a shattering effect not only for the BUN and its 300 employees but also its 150000 depositors.

One remarkable thing about BUN is that till date nobody has filed a case against it despite being closed for so long. This should be taken as an opportunity not only to save one of the brightest IFI in the country but also the whole life savings of the poorest of the poor.

What, how and when could be decided by the leaders of the community. However, what seems appropriate at this stage is that people of Bombay especially those with some resources should come forward as the BUN is confined to the limits of Bombay. More importantly the management of BUN should come out of its protected covers to make a bold and honest appeal in this regard. If need be they should not hesitate to hand over the charge to a new management in the larger interest of the people.

Shariq Nisar

Comment [A1]: change

Muslim Financial Institutions in India (MFIs): A Survey Report

By: Shariq Nisar

There are a large number of Muslim Financial Institutions (MFIs) in India that began their operations with a resolution to introduce *Shariah* in their financial dealings and to relieve poor Muslims from the blight of *Riba*. After a fairly long period of operations it is now learnt that most of the MFIs have failed on both the accounts. They have not succeeded in introducing *Shariah* neither they have been able to relieve Muslims from the bane of *Riba* instead they, in many cases, have replaced those *Riba* seeking moneylenders with themselves.

In the light of above-mentioned issues few topmost Muslim economists and financial experts were contacted to express their opinions about the causes of these failures. In the first round of survey contact was made to Dr. Abdul Hasib, former Executive Director of the Reserve Bank of India; Mr. Abdul Wahab Dalvi, former Research Officer at the Reserve Bank of India and Managing Director of India's prominent Islamic Financial Institution, Bait-un-Nasr; and Mr. Mohammad Husain Khatkhatay, Managing Director, Barkat Investment Group and the former Executive Director, Al-Baraka Finance House India. Each of them was presented set of four identical questions, which were as follows;

Question 1: What in your opinion is the reason for Muslims failure on the above-mentioned two accounts?

Question 2: How far the governments' rules and regulations have been responsible for these failures?

Question 3: How do you look at the future prospects of these MFIs under current liberalization, privatization, and globalization scenario? What would be your suggestion to improve their functioning?

Question 4: Any other point that you may like to add in the light of your experiences?

Dr. Abdul Hasib, while speaking about the causes of these failures, cited some external as well as internal factors. He was of the view that it is extremely difficult if not impossible, to introduce Islamic financial institutions on a limited scale especially when the whole world finance is based on interest. As far the internal reasons he was of the opinion that since Islamic banking is based on ethical and moral principles it is not possible to put the entire burden of Islamic banking on the lending institutions where as borrowers` duties and responsibilities are seldom put in question. He pointed out that Many of the Islamic institutions have come to grief because of the mismatch between demand liabilities and illiquid assets where a part of the reason was the absence of suitable investment opportunities.

On the question of government regulations coming in the way of Islamic financing Dr. Hasib admitted that all those Govt. rules and regulations which are interest related come in the way of running an Islamic financial Institution. However he asserted that it is possible though not easy to live with these regulations. On the part of Muslims, he agreed that very few serious attempts have been made to convince the authorities of the usefulness and practicability of Islamic banking.

When asked about the future of Islamic finance in the country Dr. Hasib categorically said, "Honestly, I do not believe the prospects to be bright unless ISLAMIC BANKING IS SUCCESSFULLY INTRODUCED IN AT LEAST ONE Muslim country".

Abdul Wahab Dalvi on the other hand mentioned following important reasons that, according to him, were responsible for the failure of Muslim financial institutions on the said issue;

a) The prevailing laws do not permit the institution to fully act on the *Shariah.*
b) A majority of the MFIs have not been functioning under the competent and professional management.
c) Barring some all the depositors of the MFIs are not fully aware of the functioning of such institution.
d) Lack of an apex body that may provide financial help and guide the MFIs in case of need.

Dalvi shared the notion of Dr. Hasib that govt. rules and regulations do come in the way of proper functioning of these MFIs. One important point towards which Dalvi raised his concern was the need to probe the failure of MFIs by a committee of experts who are well versed with the functioning of the financial institutions as well as in *Shariah*.

Khatkhatay, regarding the failures of these MFIs was of the opinion that any comprehensive system of Islamic banking and/or investment needs to address four major areas:

a) Provide the common public an avenue of risk free safe keeping of savings which is not *Riba* based.
b) Provide an intermediary to help invest savings in profitable avenues without involving *Riba*.
c) Make available funds for businesses on a non-*riba* basis
d) Make available funds on a loan basis for non-business needs (such as for education, health, travel and urgent consumption needs) on a non-*riba* basis.

To him, it is in the fourth area that MFIs in India have scored the most significant successes. He said that from the Muslim Funds of Western UP to Toor Bait-ul-Maal of Hyderabad, the Bait-un-Nasr of Bombay and Islamic Welfare Society of Bhatkal they all have succeeded in relieving the financial burdens of people in need. These helping hands have not been confined only to the social & personal sphere but have also aided small businesses, agriculturists and persons seeking to defray expenses for obtaining overseas employment.

Khatkhatay, however, admitted that due to operational failures, none of the genuine attempts have been able to cater adequately to the needs of lay investors among Muslims over a sustained period of time. He also admitted the presence of some fraudulent concerns that have been able to give attractive returns for some years only to fall below market rates or skip returns and even fold up operations subsequently. Although he hastened to add that none of the genuine operations apart from the early Al Meezan experiment appeared to have flagrantly violated the profit sharing understanding & paid out non-existent profits.

Regarding govt. rules and regulations being responsible for these failures, Khatkhatay opined that in a tightly regulated environment such as India's MFIs face so many obstacles that few MFIs can be found which exhibit fairly good compliance with *Shariah*. Then, as the regulations are not framed with any Islamic stipulations in mind, it is also true that the extent of *Shariah* compliance by MFI's is equally a function of their ingenuity in devising structures which permit greater *Shariah* compliance, while allowing them to abide by the letter of the law.

New Books and Articles

Books:

1. *Experiences in Islamic Banking A Case Study of Islami Bank Bangladesh*, Islamabad, Pakistan: Institute of Policy Studies, 2000, 87pp.
2. *Islamic Banking & Finance in the Kingdom of Bahrain*, Manama, Bahrain: Bahrain Monetary Agency 2003, 114pp.
3. al-QARDAWI, Yusuf, *Fiqh-az-Zakat: A Comparative Study*, London, UK: Dar-al-Taqwa, 1999, 751pp.
4. *Towards Islamic Banking: Experiences and Challenges – A Case Study of Pilgrim Management of Fund Board, Malaysia*, Islamabad, Pakistan: Institute of Policy Studies, 2000, 111pp.
5. USMANI, M. Taqi, *The Text of the Historic Judgment On Riba: 22 December 1999*, Malaysia: The Other Press, 2001, 160pp.

Articles:

1. ABDIN, Al-Tayib Zein, 'The Disbursement of Zakah', *Islamic Studies* (Islamabad, Pakistan), Vol.42, No.1, spring 2003, pp.127-136.
2. Al-GAOUD, L.M. and Lewis, M.K., 'Corporate Governance in Islamic Banking: The Case of Bahrain', *International Journal of Business Studies*, No.1, 1999, pp.56-86.
3. ALI, A. Mohamed, 'The Role of IDB – Strengthening Islamic Banking Supervisory Capacities', *New Horizon* (London), Nos. 128/129, March-April 2003, pp.3-6.
4. BENTHALL, Jonathan, 'Organized Charity in the Arab Islamic World: A View from the NGOs', In: H. Donnan (ed.), *Interpreting Islam*, London: Sage Publications, 2002, pp.150-66.
5. ELGARI, M. Ali, 'Credit Risk in Islamic Banking and Finance', *Islamic Economic Studies*, (Jeddah, Saudi Arabia), Vol.10, No.2, March 2003, pp.1-25.
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7. KHAN, M. Akram, 'Zakah Accounting and Auditing Principles - Rules and Experience in Pakistan', *Islamic Economic Studies*, (Jeddah, Saudi Arabia), Vol.10, No.2, March 2003, pp. 29-43.
8. MARTIN, Josh, 'Islamic Investors Eye', *The Middle East* (London), No.329, December 2002, pp.32-35.

Book Review

Perspectives on Morality and Human Well-Being: A Contribution to Islamic Economics

By: Syed Nawab Haider Naqvi
The Islamic Foundation, United Kingdom, 2003, 244pp

This book is an important contribution in the sense that it avoids rhetorical superiority of Islamic economics and prefers to deal with issues of growth, distributive justice and poverty reduction in the light of prevailing ground realities. Another important aspect of this book is its attempts in bridging the gap between different ethical systems.

The author proceeds with the argument that the success of developed nations lies in abandoning morally enervating doctrine of predestination, innate human depravity and in freeing the mind and the soul from the excessive dogmatism to scientific enquiry. However, the author accepts that unrestricted self-interest behavior of an individual severing the right of the poor peoples in the wealth of the rich still remains the greatest flaw in the western economics.

On the other hand, the distributive justice found in Muslim economies could be traced to its link to Islamic ethics. Author points out that despite their backwardness and poor performance in all the areas Muslim countries have performed much better than the much richer non-Muslim countries on account of distributive justice.

The whole work is divided into six chapters Chapter One presents an overview of the hypothesis. Chapter Two argues that integration of ethics with economics offers richer value of human motivation and conduct than the one provided by value neutral positivism. Chapter Three demonstrate that the current practices of excluding religion as a source of universally accepted norms of economic behavior i.e. truth, honesty, justice, equality etc. has not at all been helpful even in western societies. According to the author voluntarily held ethical mores flowing from the religious believes get internalized in individual consciousness and therefore act as effective sanctions against unethical practices undermining the efficient working of market based social and economic institutions. This brings an entirely wholesome effect of reconciling private interest with collective welfare at significantly lower policing and regulatory costs than the value neutral secular economics and social system normally incurs. Chapter Four describes the Islamic moral values that attempts in balancing the individual freedom with social responsibility. Chapter Five gives a through analysis of an Islamic ethical system and its inner logical structure. It shows that the system can be effectively used to spell out and implement Islam's moral vision and to broaden it by drawing selectively on alien philosophy. Chapters Six concludes the implicit hypothesis that an ethics based economic system would more energize economic agents to work for the betterment of society.

Overall this book is a worthwhile shift from simple theoretical discussion to evaluating the significance of specific policies on the basis of empirical information. Prof. Khurshid Ahmad in his foreword rightly remarks, "the present work represent a landmark contribution towards the evolving discipline of Islamic economics". Like his previous attempts this time too Prof. Naqvi has not shied away from touching some sensitive issues like reconstruction of the basic principles of Islamic *Shariah.*

Abu Shariq.

Exclusive:

Mudarabah Model Unrealistic and Inconsistent With Financial Intermediation:

Prof. Monzer Kahf

Dr. Monzer Kahf is Ph.D, in Economics from University of Utah. For over a decade he has served as Research Economist at Islamic Research and Training Institute (IRTI) of the Islamic Development Bank (IDB), Jeddah, Saudi Arabia. He has authored more than 25 books and monographs and above 70 articles in English and Arabic, on Islamic banking and finance, Islamic economics, Zakah and *Awqaf*. In recognition of his invaluable contributions to Islamic Economics he was awarded IDB Prize in Islamic Economics: 2001. Prof. Kahf shares his views with Shariq Nisar (Editor).

Could you please let us know about your current area of engagement in Islamic economics?

I am presently working on Estate planning for Muslims in non-Muslim countries, the theory of distribution in Islam, and the Islamic financing and banking theory and practice.

During the last two and half decade more than 130 member countries of the IMF have faced some bout of banking crises. Several theories are put forth about the causes of these crises including the one pointed out by Islamic economists. In your opinion how important are these charges?

There is a lot of exaggeration in the claim that Islamic economics and elimination of interest is the pass-par-tout key. It is not the cure of every economic illness. Basically the late nineties crisis in Indonesia and other countries is the result of mismanagement, the prevalence of the American style values of "run for money regardless of any standards as long as you are not caught" and the promiscuousness of the system to abuses by dictators, their family members and other opportunists. Islamic economics and elimination of interest are no substitutes of honest and checked and balanced management of the economy. The latter can be done and will succeed in any reasonable medium term with or without interest as the economic history of Europe and Japan indicate.

Of course Islamic economics and elimination of interest bring in a lasting solution to the negative performance of American corporate imperialism once the failure of corporate values becomes well known.

Several western scholars have argued about remarkable shift in Islamic banking practices from the theory. What do you think is the reason for that?

This argument came actually from Islamic economists. The problem is that they and their Western imitators put the carriage before the horse. They theorized a model that turned out to be unrealistic and inconsistent with financial intermediation. The Model they theorized is the two-tier Mudarabah but the practice used Murabahah and leasing on the use of funds side of the banking transactions. Both modes are more consistent with financial intermediation while Mudarabah is more of a venture capital approach rather than financial intermediation process. Obviously Mudarabah succeeded on the funds mobilization side, in investment deposits because banks are regulated financial institutions, businesses are different.

This means that the theory was wrong. Yet many Islamic economists stick to it in a dogmatic manner because they accuse Murabahah to be less Islamic. This struggle is apparent in the five-year discussion of the newly adopted law of a Islamic banking in Kuwait. The law finally went along with permitting the Islamic bank to enter directly in business venture on its own initiative. In spite of the restrictions and the discretionary authority the central bank may exercise, this approach loosen specialization and allow the Islamic bank to compete with business and to have its own stores for goods and services instead of remaining a financial intermediary only.

How would you assess the developments of past quarter century in Islamic economics and banking?

After a great take off since the First international Islamic Economic Conference in Makkah 1976, we went into stagnation in the nineties, most of the writings since the beginning of the nineties are repetitive and there is very little refinement, probably the whole profession of Economics is presently stagnant too.

There has been a call for Shariah scholars and professional economists working together to promote Islamic economics. How much progress you think has been achieved?

I think this is been going on for the last quarter of a century. Now the stage is for a new breed of Shariah well versed economists. This is what is direly needed now.

What would be your advice to the young researchers entering the field of Islamic economics and finance?

Improve your systemic Shariah foundation; don't take it from hunches you find scattered in Islamic economics writing and go for rigorous economic training.

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