

# ISLAMIC ECONOMICS

# BULLETIN

INDIAN ASSOCIATION FOR ISLAMIC ECONOMICS

VOLUME 15 No. 1

January – February 2005

Dhulqada – Dhul Hijja 1425 AH

## ADVISORY COUNCIL

F.R. FARIDI	(President)
ABDUL HASIB	(Member)
M.N. SIDDIQI	(Member)
AUSAF AHMAD	(Member)
ABDUL AZIM ISLAHI	(Member)
S. AFZAL PEERZADE	(Member)
M. OBAIDULLAH	(Member)
ZAFARUL ISLAM	(Member)
JAWED AKHTAR	(Member)

### Editor

JAVED AHMAD KHAN

### Joint Editor

SHARIQ NISAR

*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.

Note: For private circulation only.

## SUBSCRIPTIONS

	Overseas	India
One year	US\$ 10	Rs. 50
Two year	US\$ 20	Rs. 100
Five year	US\$ 50	Rs. 200

## IAFIE MEMBERSHIP

Patron	US\$ 500	Rs. 5000
Life Member	US\$ 100	Rs. 2000
Annual Member	US\$ 10	Rs. 100

The Bulletin will be offered to the Members free of charge. Subscription is payable in Bank Draft, Cheque, M.O. or Cash. Cheques and drafts should be drawn in favor of *Indian Association for Islamic Economics* payable at Aligarh. Outstation cheque should add Rs. 25/- towards bank collection charges.

## Address for Correspondence:

The Editor,  
Islamic Economics Bulletin  
4/1914, Faridi House, S.S. Nagar  
Aligarh, 202002,  
U.P. - India  
Phone: 0571-2401028

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

Designed at:  
Net Viral,  
Regency Plaza, Medical Road  
Aligarh

## *Murabahah* Versus Interest

*Prof. M. Nejatullah Siddiqi*

*Murabahah*, as practiced by Islamic financial institutions, is re-sale of a commodity with a mark-up on purchase price. Alternatively we can describe it as cost-plus. The financing bank sells to a customer the commodity the customer needs and the customer undertakes to pay the (higher than current market) price at a future date. The bank purchases the desired commodity only after getting a commitment from the customer to buy it. Part of this commitment is the price to be paid by the customer which is higher than the market price at which the bank buys it, by a certain amount or percentage. The contracted price cannot be increased even if there is a delay in payment by the customer. The customer's obligation to pay is not affected by what becomes of the thing purchased. For example, if it was raw material purchased to manufacture something and sell at a profit, but there is a loss in the business enterprise, the customer is still bound by the contract to pay the price at the agreed time. The price owned to the financier is treated as a loan would have been treated. The debt arising from borrowing cash are at part, insofar as the obligation to repay is concerned.

*Murabahah* financing leaves the entire results of the use of the commodity financed in productive enterprise for the user, the owner of the enterprise. It is the one to bear losses, if any, and it is the one who owns all the profits. The financier has to share in the profit of a *murabahah*-financed enterprise. That sound good for the incentive to work and manage the enterprise to the best of ones capacity. No agency problems and no moral hazard, as we encountered in the otherwise superior profit-sharing finance.

There is no injustice involved in *murabahah*-financing, insofar as the relationship between the financier and the entrepreneur-buyer-on-credit is concerned. On that count it is superior to the financing arrangement based on interest. The financier is financing not a venture of uncertain results but the acquisition of a commodity of acknowledged utility and known current price.

The mark-p on current price is tacked on the commodity, whereas in interest-based borrowing it is tacked on money capital (the principal). By converting its money capital into a commodity the financier has already given up liquidity and taken the risks associated with owing a real asset, e.g. a fall in its market price, destruction due to natural causes or theft, etc. He/she also takes the risks associated with relaying on the other party's promise to buy, like the risk of bankruptcy of the would-be buyer or backing down on its promise to buy. Also, by selling on credit the financier is taking the risk of default by the buyer as arisen as time passes. Time, which is not recognized by shariah as a basis of claiming an excess over principal when making a money loan, becomes part of the justification for a mark-up in credit sale. The fact that shariah does not allow any further increase in the contracted price, should more time elapse before the actual payment is made, clearly demonstrates that there is no price for the mere passage of time involving a sum of money.

### **IDB to Send Relief Missions to Tsunami-Hit Countries**

JEDDAH, 8 January 2005 — The Islamic Development Bank (IDB) is to send missions to Indonesia, the Maldives and Sri Lanka to provide relief assistance to the victims of the tsunami disaster. Later, this would be followed by visits to assess and prepare reconstruction and rehabilitation projects as announced by the Bank's vice president who was attending the ASEAN leaders' summit on the aftermath of tsunami in Jakarta. IDB has pledged \$500 million to the countries affected by tsunami — India, Somalia, Thailand, Indonesia, the Maldives and Sri Lanka. Earlier, the bank had announced in Jeddah an allocation of \$10m to provide emergency relief to tsunami victims in the affected countries. The amount would be used for relief operations and construction of devastated areas, transportation, health, and education. The Bank would make arrangements with aid partners in the region to ensure quick disbursement.

(Source: *Khaleej Times*)

### **Deutsche Bank Hosts Seminars on Islamic Finance**

Deutsche Bank AG has launched a series of educational seminars throughout the Middle East to highlight the need for greater innovation in the Islamic finance sector.

Islamic finance has become one of the world's fastest growing sectors as investors show an increasing appetite for a variety of Islamic financial instruments.

At meetings held in Riyadh and Dubai, leading Islamic scholars from the Dar Al-Istithmar (DI), a leading Shariah think-tank and joint venture with Deutsche Bank, presented their views on the role of innovation in developing new Shariah compliant products.

DI is a highly positioned Shariah think-tank and joint venture between Deutsche Bank, Oxford Center for Islamic Studies, and Russell Wood Ltd., a renowned adviser on investment structures in the Middle East.

"Deutsche Bank is fully committed to providing a greater choice of financial solutions to Muslim investors," Geert Bossuyt, managing director, Investment Products Group, Deutsche Bank, said commenting on the new range of products under development. This range will cover all asset classes and offer investors a much greater level of liquidity, in fact daily liquidity, than currently offered by other Islamic funds, he added.

Our products will also introduce a new level of transparency to the industry; through the use of the Bank's or even third parties' established benchmarks.

Deutsche Bank also held a seminar in Kuwait and plans to hold similar seminars in Singapore, Kuala Lumpur, Brunei and Geneva.

### **Islamic Finance Awards**

At a big networking event held in Dubai on March 13-15, 2005, the Shaikh Mohammed awards in Islamic Finance was given in the areas of 'Innovation in Islamic finance', 'Achievement in Islamic finance' and 'A new voice in Islamic finance'. The awards are in only three categories and the winners of each are selected from nominations from all over the world by a panel of distinguished judges. General Shaikh Mohammed is the patron of the International Islamic Finance Forum, a twice a year event which attracts more than 400 participants from around 50 countries and is dubbed as "the premier event in Islamic finance."

### **GFH Wins UK Journal Award**

Gulf Finance House (GFH) of Bahrain has been awarded the Best Islamic Real Estate Finance House' title for 2005 by the London-based journal, Euromoney, specializing in global capital and money markets. This award is in recognition of GFH's ingenuity in structuring real estate-based investment products and its expertise in Islamic finance. Euromoney has cited the bank's strategy of concentrating on infrastructure, real estate, as being highly successful.

### **Lloyds TSB Launches Islamic Current Account**

UK's high street Bank Lloyds TSB launched its debut Islamic banking current account on February 14, 2005, thus joining the ranks of ABC International Bank, Ahli United Bank, HSBC, The Royal Bank of Scotland, Bank of Ireland, and Islamic Bank of Britain in offering Shariah-compliant retail banking products to customers. The Lloyds TSB Islamic Current Account is an important step toward offering a dedicated range of Islamic financial services to Muslims who currently use conventional current accounts or opt out of traditional banking services altogether. The bank plans to launch a suite of Islamic retail and trade finance products before the end of 2005. The account is being piloted in selected Lloyds TSB branches across the UK, including London's Edgware Road, with its large expatriate population from the GCC states; as well as at Lloyds TSB branches at Temple Row and Saltley in Birmingham; and at the George Street and Legrave branches in Luton, both with large Muslim populations from Pakistan, India, and Bangladesh.

Mushtak Parker, *Arab News*

### **IDB President wins King Faisal International Prize**

Dr. Ahmad Muhammad Ali, President Islamic Development Bank, and the Al-Hariri Foundation of Lebanon were jointly awarded winners of the 2005 King Faisal International Prize for Service to Islam.

Dr. Ali was awarded the prize in recognition of his achievements in the field of Islamic banking. As president of the IDB, he had not only consolidated the conformity of banking transactions with Islamic laws but also set an example of successful and modern Islamic banking.

He also established a comprehensive infrastructure within the bank, including the Islamic bank portfolio, investment shares, Islamic investment institution, Islamic research and training institute, prize for Islamic economics and many others.

In his acceptance speech, the IDB chief referred to the challenges facing the Islamic Ummah, both from within and outside. He said two of the major challenges were the attempt to misrepresent Islam as a "kernel of terrorism."

"Another very important challenge is poverty and illiteracy that prevail in most Islamic countries, and the backwardness in different fields of science and technology, as revealed by current international and local economic statistics," he said.

Dr. Ali announced that he had decided to donate his monetary share of the prize to serve as a nucleus for a fund, under the auspices of the Islamic Development Bank, to establish an annual prize for best achievement in promoting trading cooperation between Islamic countries.

### **Chidambaram on Islamic Banking**

Replying to questions from Saudi businessmen, during his recent visit of Saudi Arabia the Finance Minister Chidambaram said India did not make any distinction between Islamic banking and any other model of banking. "The bank is entitled to follow its own practices provided it subscribes to the regulatory and prudential norms laid down by the central bank — Reserve Bank of India."

### New Books and Articles

#### Books:

1. ABU-BAKER, Hamid Sultan Bin, *Janab's Key to Practical Convincing, Land Law and Islamic Banking*, Kuala Lumpur, Malaysia: Janab (M) And.Bhd. 2003, 102 pp.
2. AHMAD, Khurshid, *The Contemporary Economic Challenges and Islam*, Islamabad, Pakistan: Institute of Policy Studies, 2002, 57pp.
3. HIDEIMITSU, Kuroki (ed.), *The Influence of Human Mobility in Muslim Societies*, London: Kegan Paul, 2003, 326pp.
4. KHAN, Waqar Masood, *Transition to a Riba Free Economy*, New Delhi, India: Adam Publishers, 2004, 144pp.

#### Articles:

1. ABDIN, Al-Tayib Zein, 'The Disbursement of Zakah', *Islamic Studies* (Islamabad, Pakistan), Vol.24, No.1, 2003, pp.127-36.
2. ABDUL-MAJEED, Abu Bakar, 'Islam in Malaysia's Planning and Development Doctrine', In: R.C.Foltz (et-al), (eds.), *Islam and Ecology: A Bestowed Trust*, Cambridge, MA, USA: Harvard University Press, 2003, pp.463-75.
3. AHMAD, Khurshid, 'The Challenge of Global Capitalism: An Islamic Perspective', In: J.H. Dunning (ed.), *Making Globalization Good: The Moral Challenges of Global Capitalism*, Oxford: Oxford University Press, 2003, pp.181-209.
4. ALIERO, Ibraahim Hussaini, 'Islamic Banking and the Problems of Financing Small-Scale Enterprises (SSEs): A Critical Review', *Islamic Culture* (Hyderabad, India), vol.76, No.3, 2002, - pp.27-44.
5. ALSHECH, Eli, 'Islamic Law, practice, and legal Doctrine: Exempting the Poor from Jizya Under the Ayyubids (1171-1250)', *Islamic Law and Society*, (Leiden, The Netherlands), Vol.10, No.3, 2003, pp.348-75.
6. GILBAR, Gad G., 'The Muslim Big Merchant Entrepreneurs of the Middle East, 1860-1914', *International Journal for the Study of Modern Islam* (Leiden, The Netherlands), vol.43, No.1, 2003, pp.1-36.
7. HARON, Sudin, 'Islamic Financial System in Malaysia: Some Issues', *Journal of Islamic Banking and Finance* (Karachi, Pakistan), Vol.20, NO. 2, 2003, pp.24-40.
8. HNEEF, Mohammad Aslam, 'Economic Development, Globalization and Muslim Countries', *Studies in Contemporary Islam* (Youngstown, OH, USA), Vol.4, No.1, 2002, pp.27-52.
9. IQBAL, Muhammad Mazhar, 'a Broader Definition of Riba', *Journal of Islamic Banking and Finance* (Karachi, Pakistan), Vol.20, No.3, 2003, pp.7-31.
5. KHASHAN, Hilal and Kreddee, Lina, 'The Social and Economic Correlates of Islamic Religiosity', *World Affairs* (Washington, DC), Vol.164, No.2, pp.83-96.

### Current Researches

#### Efficiency in Islamic Banking: An Empirical Analysis of Eighteen Banks

by Ronsyah Yulistira

*Islamic Economic Studies* (Jeddah, Saudi Arabia), Vol.12, No.1, August 2004, pp.1-19.

Although the phenomenon of Islamic banking and finance has developed significantly in recent years, only very few studies have tackled the issue of stability and efficiency of Islamic banks. This paper provides evidence on the performance of 18 Islamic banks over the period 1997-2000. The paper is based on efficiency measurement in which the nonparametric approach, Data Envelopment Analysis, is utilized to analyze the technical and scale efficiency of Islamic banking. In specifying input-output variables of Islamic banks, the intermediation approach is selected as it is in the line with the principle of Islamic financial system. Capital structure of an Islamic bank is acknowledged to be equity-based because of the domination of shareholder's equity and investment deposits, which are derived from profit and loss sharing principles. In other words, the return on capital would be determined *ex post* or would be based on the return of economic activity in which the funds were utilized. Overall, the results show that Islamic banks suffer slight inefficiencies during the global crisis 1998-9 but performed very well after the difficult periods. This would also suggest that Islamic banks have to build strategic alliance with other banks. It will also be useful to build bridges between existing Islamic banks and those conventional banks that are interested in doing banking on Islamic principles. Supported by the non-parametric technique and regression analysis, Islamic banks within the Middle East region are less efficient than their counterparts outside the region. Additionally, market power, which is common in the Middle East, does not significantly impact on efficiency. The reason is that Islamic banks from outside the Middle East region are relatively new and very much supported by their regulators. Furthermore, publicly listed Islamic banks are less efficient than their non-listed counterparts.

#### Impact of Inflation on Mudarabah Profits: Some Observations

by Hifzur Rab

*Journal of King Abdul Aziz University: Islamic Economics* (Jeddah, Saudi Arabia), Vol. 17, No. .2, 2004, pp.21-25.

The author demonstrates that the currency and its use of account jeopardize the ability of *mudarabah* (profit sharing) to do justice to the *rabb-al-mal* and it results in transfer of most of the gains (real) and in some cases even part of the capital to the *mudharib* (entrepreneur). In addition to moral hazards, it is an important cause of non prevalence of profit sharing mode of finance. It adversely affects *musharakah* and it has reduced the availability of *qard hasan* to almost nil. The author argues that the use of depreciating paper currency as an unit of account turns *mudarabah* into an unjust and impractical business practice. Clearly this adverse division of profits is a very important cause of failure of Islamic banks and other shariah complaint creditors to finance business on the basis of *mudarabah*. However, it is also seen that use of a stable unit of account that will result in sharing of real profits makes *mudarabah* a very just and equitable mode of finance.

The viability of these modes of finance is vital for ensuring the full utilization of Islamic finance. If *mudarabah* contract is modified so that it provides for sharing or real profit in agreed propositions (instead of normal profits), inflation would not affect profit sharing and both *mudharib* (entrepreneur) and *rabb-al-mal* share real profit in agreed proportion.

### Globalization of Islamic Banking Going Strong

Mushtak Parker, *Arab News*

The globalization of Islamic banking continues unabated with license applications for new banks in the process of being submitted to three regulatory authorities in the UK, Canada, and Kenya. The common factor is London, and all roads lead to the UK regulator, the Financial Services Authority (FSA), which seems to have set the global market alight following its authorization of the Islamic Bank of Britain in August 2004. The "UK model" of authorizing an Islamic bank has caught the imagination of banking regulators worldwide.

A delegation from the Central Bank of Kenya spent a week in the UK this month having meetings with the FSA, and with a number of local banks including Islamic Bank of Britain; HSBC Amanah; ABC International Bank and Lloyds TSB, which recently launched its two debut Islamic consumer finance products — a current account and an Islamic mortgage.

A group of investors from Canada is also in the process of finalizing a license application to the Canadian Central Bank for a stand-alone Islamic bank. They too had a number of meetings with the FSA and local banks earlier this year during a visit to London.

Both banks, according to reliable banking sources in these countries, should get the authorizations; and will eventually go to the market with a private placement to raise further equity funding. Canada especially should be a good investment prospect; given the soundness of the Canadian economy; and the presence of a largish above-average income professional Muslim immigrant minority community, characterized also by its diversity — Pakistanis; Croatians; Bosnians; South Africans; Egyptians; Palestinians; and others.

The third Islamic bank seeking authorization from the FSA is the European Islamic Investment Bank (EIIB), which confirms that it was incorporated in the UK on Jan.11, 2005, "with the objective of becoming the first independent Islamic investment bank in Europe".

The word 'independent' is puzzling though in this context, given that EIIB is a privately-owned institution comprising founding shareholders largely similar to those of Islamic Bank of Britain (IBB). In fact, EIIB is the investment banking sister bank of IBB, and is being promoted by the Bahrain-based by Islamic Joint Venture Partnerships (IJVP) BSC.

IBB shareholders include the Emir of Qatar; Qatar International Islamic Bank; Dawnay Day

Global Investments in the UK; and the London-based DCD London & Mutual PLC, a South African-owned financial investment group. The chairman of EIIB is Adnan Yousif, formerly chairman of ABC Islamic Bank and currently with the AlBaraka Banking Group in Bahrain. Yousif is also the brother of Abdul Rahman Abdulmalik, the current chairman of Islamic Bank of Britain.

EIIB says that it intends to submit an application for authorization to the FSA by the end of May. EIIB plans to offer Islamic treasury; capital markets; asset management; trade finance; correspondent banking and private banking products and services.

EIIB is capitalized at 110m UK pounds. Its recent private share offering to raise initially 50 million UK pounds closed in mid-April and was heavily oversubscribed. Subscriptions, according to IJVP, totaled in excess of 113 million pounds, compared to the initial target of only 50 million pounds.

"We decided to increase the initial capital we were seeking from founding shareholders from 50 million pounds to 100 million pounds before commencing the offering, due to indications of strong demand from potential shareholders. We are obviously delighted that even with this increase in the size of the offering, demand was very high, and the board of directors has decided to authorize the issue of additional shares to meet this high demand," stresses Yousif.

Subject to FSA authorization and consent, EIIB confirms that it plans to increase its capitalization from the current level of 110 million pounds to about 300 million pounds shortly after the bank commences operations, through a public offering in the UK and other permitted jurisdictions, and a parallel private placement in the Arab world and Asia.

### PRINTED MATTER

To,



\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

*If undelivered, Please return to:*

The Editor,  
Islamic Economics Bulletin  
4\1914, Faridi House, S.S. Nagar  
Aligarh, U.P.  
India, 202002