

ISLAMIC ECONOMICS BULLETIN

INDIAN ASSOCIATION FOR ISLAMIC ECONOMICS



VOLUME 8

NUMBER 3

MAY - JUNE 1998

MUHARRAM-SAFAR 1419 AH

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

SUBSCRIPTION

	Overseas	India
One year	US\$ 10	Rs. 25
Two year	US\$ 20	Rs. 50
Five year	US\$ 50	Rs. 100

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Computerized by

Cosmos Computers, Aligarh. Ph. 401063

Printed by

International Printing Press, Aligarh.

Feasibility of Interest Free Banking

The switch over to interest free banking is possible. It will not cause any disruption in the availability of the financial services a modern society needs. But doubts are expressed which need being cleared.

Most people who deposit their savings with banks are regarded to be risk averse. It is asserted that supply of savings would decline should bank deposits become vulnerable to losses. Regarding this doubt it should be remembered, firstly, that demand deposits carrying no return for the depositors are not vulnerable to losses in the Islamic banking system. It is the investment account that are, in principle, vulnerable to losses. Secondly there is no empirical evidence that some people will stop savings if they can not find guaranteed returns on deposits. Profit-making is only one of the several motives for saving. Lastly, the practice of Islamic banking over the last twenty years has confirmed what the theory of interest free banking had affirmed since its inception : Though theoretically vulnerable, pooling, diversification and other possible devices will protect the depositors into investment account from actually sustaining losses.

Another doubt relates to the sharing based finance not being suitable for some particular business activities like very short term credit needs of traders, importers, etc. It should be noted, however, that profit-sharing or *mudaraba* is not the only alternative to interest in so far as financing business is concerned. The most popular current practice is *murabaha* i.e. credit sale at a price higher than cost price. This mode of finance is generally applied to financing imports or domestic trade. The importer or the trader asks the bank to pick up the bill and resale the commodity to it with a mark up, payment to be made later. The deal is different from bank loan as *murabaha* finance is tied to real assets e.g. imported goods and the amount due is set once for all. Leasing and prepaid orders (*salam* and *istisna*) are also being used by Islamic banks to finance agriculture and industry. As in *murabaha*, there is less risk involved in these modes of finance, but like *murabaha*, the scope of their application is also limited.

But the kingpin of Islamic finance being modes based on profit sharing, major doubts relate to it. For examples, would not businessmen taking money on profit-sharing basis cheat the bank by declaring losses even when they make profit? Will they not always understate their profits? There are at least three reasons why moral hazard will not disrupt the process of profit sharing finance.

Firstly, banks will tend to finance those with a healthy track record of paying back good returns. Whether it is due to cheating or due to a failure to realise profit and /or report them correctly, if the bank ends up with losses or much lower profits than it expected from its deal with a client, the chances of that client getting finance in the future will be doomed. Those who wish to stay in business and intend to seek a continuous stream of bank finance would do nothing to jeopardise their chances. Cheating would be counter productive. Self interest will teach honesty.

Secondly, finance based on profit-sharing would best thrive with standardisation of audit and accounts procedures. Subjecting *mudaraba* financed firms to independent audit, preferably by an agency of the Central bank and regulations such as all significant payments must be through cheques, etc. will also help. Monitoring arrangements can be made with mutual consents which would minimize the possibilities of fraud.

Thirdly, internalization of moral values, building trust and other normative improvements are always conducive to peace, progress and happiness. In the context of participatory finance their role will become more crucial. We hope the very change over from interest to sharing will trigger normative improvements.

M.N. Siddiqi

Two Ph.D Students enrolled in Islamic Economics at A.M.U., Aligarh

Aligarh : The Committee for Advance Studies and Research (CASR) of Faculty of Social Sciences, Aligarh Muslim University, has approved the Ph.D topics of Mr. Shariq Nisar; "Recent Developments in Banking Organization with Special Reference to Islamic Banking," and Mr. Chatchawan, N.; "Development of Islamic Banking and Finance in South East Asia with Special Reference to Malaysia,". Dr. A.A. Islahi will guide the research.

\$ 200 Billion in Islamic Banking

The Islamic banking is advancing at a rate of about 20% a year, according to some international analysts. The *Shariah*-based financial institutions may already be worth as much as \$ 200 billion and could absorb some 50% of all Islamic savings in the world by the end of the century.

The rush to Islamic banking is particularly noticeable in the Middle East and Southeast Asia, but there are also interesting beginning of it in former Soviet Central Asia where several countries are now developing their abundant natural resources, including oil and gas.

Among examples of expansion in Islamic banking is the recent \$ 1.2 billion refinancing operation for Kuwait's Equate petrochemical project and financing of some segments of Bahrain's aluminium scheme. Also, Abu Dhabi Islamic Bank with a capital of \$ 272 million has 39% of its equity held by the Emirates Airline. In Bahrain last year four new units of Islamic banks were set up, including the First Islamic Investment with a capital of \$100 million.

Other new developments in the Islamic banking include the conversion of the Arab Bank of Jordan into the Arab Islamic International Bank with a capital of \$57 million, aimed at the local and regional markets. American Express Bank has set up a joint venture with Faisal Finance of Jersey, an affiliate of the DMI group. Both have launched the Islamic Multi-Investment Fund. The fund is aiming to tap a total of \$ 100 million in Islamic saving by end of 1998.

(Impact, London).

Islamic Banking in South East Asia

Singapore : Singapore's overseas-Chinese Banking Corporation (OCBC) will soon become the country's first bank to offer special accounts that conform to Islamic law. It would offer savings and current accounts that are officially considered interest free.

Jakarta : The Islamic Development Bank and other Muslim financial Institutions plan to buy Indonesian shares to bolster the staggering Jakarta Stock Exchange. The Islamic Investors will pool money to make an initial investment of \$ 100 million in Indonesian shares, D.M. Qureshi, the Islamic Development Bank's portfolio director said at a news conference.

Bangkok: The Siam City Bank has decided to allow its Muslims clients to open interest-free accounts for purposes like saving for Hajj pilgrimage according to Bank President Som Jatusipitak.

Bangladesh, Dhaka : The first branch in Bangladesh of the world's largest Islamic Bank, Faysal Islamic Bank of Bahrain (FIBB) was formally inaugurated on 5 March 1998 by the Bank chairman, Prince Mohammed Al Faysal Al Saud. FIBB's transactions are in non-interest bearing form and an innovative range of Islamic services like saving deposits and *mudaraba* STD accounts, are available which have a high rate of profits calculated on a daily product basis.

Islamic Investors have better year in 1998

London : Stock markets adhering to strict Islamic *shariah* law should enjoy better return in 1998 according to Fleming Oasis International Equity Fund, which manages \$30 million in developed stock markets according to *shariah* rules. Utilities which have a large presence in Islamic portfolios would gain from lower global bond yields, the Fund said. Generally lower global interest rates would reduce the cost of 'purifying' portfolios which involves fund managers adjusting returns for that component which comes from interest receipt of the companies.

Trade Agency Calls for Islamic Free Zone

The Islamic Chamber of Commerce and Industry seminar concluded in March this year with an agreement on the need for greater effort to establish an Islamic Free Zone other than the Arab Free Zones. Both could be the nucleus for an Islamic Common Market.

A study of the Islamic common market will be prepared by the Chamber for the next meeting in Indonesia with suggestions to priorities and gear up for the challenges of the coming millennium. It has been urged that due to current economic trends, Islamic countries should act as an economic power in the international arena. (New Horizon,).

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Teaching Economics in Islamic Perspective
Muhammad Nejatullah Siddiqi. Scientific Publishing Centre Jeddah, Saudi Arabia 1996, 246 pp.

In recent past much has been written on Islamic economics and voluminous literature on different aspects of this fast growing discipline is available. Nevertheless very little is written on the subject of "how to teach economics from Islamic view point". As the subject of Islamic economic is being recognised as an academic discipline at graduate and post graduate levels in a number of academic institutions worldwide, there is an apparent need for introducing Islamic ideas and values in the teaching of economics.

The present work by Prof. M.N. Siddiqi addresses that particular need. The volume is primarily addressed to teachers. It is intended to assist those teachers who, convinced by the relevance of religion and morality to economic behaviour and policy wish to handle the subject from the view point of Islamic *Shariah*. The book is divided into six chapters and provides a bibliography on Islamic economics as well as on conventional economies.

Behavioural assumptions of conventional economics do not apply to behaviour required of Muslims by their religion. Assuming average level of compliance with Islamic injunctions, some care for others is germane to religious attitude. This has important implications for microeconomics discussed in Chapter I. In Chapter II, which covers Macroeconomics, guidelines are provided for teachers, analysing the impact on the economy of the Islamic behaviour in consumption and production and of Islamic policies. It tends to analyse how does the absence of interest from the economy affects man's attitude towards money and the role of money in the system? The chapter also seeks to incorporate the unique Islamic provision of *zakah*, and guarantee of a minimum level of living to all humans.

Public expenditure in an Islamic economy, an Islamic evaluation of contemporary taxes and significance of *zakah* are discussed in the context of teaching Public Finance in chapter 3. The chapter also explores the possibility of borrowing from the public on the basis of profit sharing and other Islamic modes of finance. The fourth chapter discusses international economic relations and issues in development economics in the third world perspective within the frame work of Islam. The Issue of free trade versus protection, issues relating to financing development and potential of Islamic modes of finance are examined in chapter 5. The last chapter of the book focuses on 'Money and Banking'. Teachers are advised to provide a critique of interest based banking, and to present Islamic banking as an alternative which is likely to ensure greater stability, efficiency and fairness.

The present volume of Prof. Siddiqi is a useful guide to teacher. It is neither a source book on economic teaching of Islam nor a work on contemporary Islamic economic practices. The book to a great extent assist those teachers who wish to handle their subject matter from an Islamic perspective.

Islamic Banking on Internet

Here is a list of websites on Islamic banks from across the world that will enable the Islamic banking scholars, businessmen, researchers and users to get an overview of concept, introduction and services.

***Kuwait Finance House**

<http://www.kfh.com>

This provides a corporate profile, shariah board, products and areas of operation.

The International Investor

<http://www.tiikwt.com/education/islamicbanking.htm>

Provides corporate brochure and gives a spoken presentation.

***Arab Banking Corporation**

<http://www.arabbanking.com>

Currently under construction.

***King and Spalding Legal Services**

<http://155.229.224.122/menu/islam.htm>

Only one page is devoted to legalities associated with islamic finance.

***Bank Rakyat Malaysia**

<http://ktpk.gov.my/rakyat/bservO:1.htm>

Lists corporate detail, products plus information request form for electronic communication.

***Faysal Islamic Bank of Bahrain**

<http://www.bateleo.com.bh/FIBBindex.htm>

Details of the Bank's products and services with feedback form.

***Islamic Investment Company of the Gulf**

<http://www.whifip.harvard.edu/hifipiicg.htm>

It is a page from the Harvard Islamic Banking site.

***Oman Insurance Company**

<http://www.oicem.com/health.htm>

Provides detailed concept of life, health, and medical insurance.

***Bank Muamalat Indonesia**

<http://www.yellowpages.co.id/partner/muamalat/bisnis.htm>

List bank's services

***Failaka**

<http://www.failaka.com>

Provides glossary of terms, services, upcoming conferences and a page of useful links to other organisations.

***Islamic Financial Institutions in US**

<http://www.msa-natl.org/org/resources/Finance.html>

It is a page of Muslim Students Association provides details of 15 Islamic funds and finance institutions.

***Abrar Group**

<http://www.abrar.com>

Currently unavailable but may be on soon.

***Islamic Chambers of Commerce**

<http://www.islamic-commerce.org>

Provides news on Islamic finance sector and forthcoming events.

***ICNA**

<http://www.icna.org/MSI>

A site which provides a listing of MSI financial Services Corporation in the American continent that aim to be an alternative to conventional services.

***Amana Funds**

<http://www.saturana.com/amana/amana.html>

***Takaful Islamic Insurance International**

<http://www.lookukp.com/homepage/71614/home.htm>

***Top 100 Arab Banks**

<http://www.arab.net/arab-banks/assets.sorts.html>

Key words to use when searching for Islamic banking related sites include: Islamic Banks, Islamic Funds, Islamic Investments, Halal Investments, Islamic Insurance, Takaful, Mudaraba, Murabaha, ijara etc.

(The New Horizon, London.)

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