

ISLAMIC ECONOMICS BULLETIN

INDIAN ASSOCIATION FOR ISLAMIC ECONOMICS

نشرة



الجمعية الهندية للاقتصاد الإسلامي

VOLUME 8

NUMBER 6

NOVEMBER - DECEMBER 1998

RAJAB - SHA'BAN 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.

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

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The Bulletin will be offered to the Members free of charge. Subscription is payable in Bank draft, Cheques, M.O. or Cash. Cheques and drafts should be drawn in favour of Indian Association for Islamic Economics payable at Aligarh. Outstation cheques should add Rs. 15/- towards bank collection charges.

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Computerized by

Cosmos Computers, Aligarh. Ph. 401063

Printed by

International Printing Press, Aligarh.

Riba, (Interest) Inflation and Indexation

(Following is a response to the questionnaire issued by the supreme court of Pakistan in preparation of hearing of the governments appeal against the judgement of the Federal Shariah Court)

It is evident that the value of the paper currency has a trend of decrease in the inflationary situation. If a debtor who has borrowed a particular amount of paper currency repays the same amount to his credit after a substantial time, the creditor can suffer the effects of inflation. If he demands his debtor to pay more in order to compensate him for the loss of value he has suffered, can this demand be treated as a demand for riba?

1. This is a very complex issue. The real cause of erosion in the value of money is to be sought in the wrong monetary and economic policies which result in wide deviations from a state of price stabilisation. One of the major objectives of Islamic monetary policy is stabilisation of the value of money. In the Islamic context, money is primarily a medium of exchange and a measure of values. It is also a measure for deferred payment and as such its value has to be protected.
2. There is no substance in the thesis that interest is a reward for erosion of the value of money. The discussion in economics relating to the nominal rate of interest and the real rate of interest must not confuse us, because rationale for interest is one thing and the phenomenon of inflation and various ways to reduce, if not to mitigate, the evil consequences of inflation is a different matter altogether. While the challenge from inflation is a real issue, it should not be mixed up with the problem of interest which is multidimensional and must be addressed to separately in its own right. It is illogical to argue in favour of interest on the basis of inflation. Indexation is one of the many ways suggested to fight some of the effects of inflation but the results of such a policy are mixed and inconclusive, if not adverse. In fact, a lot of empirical evidence about movements in interest rates and rates of inflation leads to conflicting hypotheses. It is difficult to find out a positive correlation between the two in all parts of the world and even in the same country over a long-period time horizon. That is why under a regime of inflation even negative rates of interest have prevailed over certain time periods. The trends that emerge from empirical and econometric studies remain inconclusive, if not erratic. The remedy for erosion in the value of money lies in a monetary policy aimed at price stabilisation and not in bringing in the red-herring of interest. If in an inflationary situation there can be any "justification" for asking the debtor to pay more in order to compensate the creditors for the loss of value of money why the same should not be applied in the case of deflation and ask the borrowers to pay less? Moreover, why shouldn't there be an equal concern for the consumers, wage-earners, pensioners who suffer even more than the creditors in periods of inflation? Why this selective concern?
3. The issue of indexation has been dragged into this controversy over interest, but the two represent independent situations and should not be confused. Moreover, limited indexation would produce new anomalies and inequities and total and overall indexation proves meaningless over a medium and long period. As such all the evidence based on indexation experiments in different parts of the world suggest that the remedy does not lie in indexation but in curing the disease at its source, that is, monetary policy geared to price stabilisation.

Prof. Khurshid Ahmad

Al - Baraka Finance House at Aligarh

Aligarh : The Multinational Islamic finance group, Al-Barake Finance House Limited, working the framework of shariah concept, has opened its new branch at Aligarh. At an opening ceremony, the Managing Director of Al-Baraka, India group, Mr. Rasheed Oomer claims that 'it is the only Islamic institution in India with an approved credit rating of "adequate safety" for the depositors/ funds placed with the organization and it complies with all government of India and Reserve Bank of India rules and regulations.

Since its inception in 1990, Al-Baraka has an impressive record of growth in India as its fixed assets rose from Rs. 0.38 lacs in 1990 to Rs. 1232.35 lacs in 1998. Its total income too has jumped from Rs. 12.43 lacs in 1990 to 668.31 lacs in 1998. With a continuous increase in cash profits since 1991, Al-Baraka is successfully operating in other major cities of India like Bombay, Madras, Delhi Kanpur and Lucknow. Its current financing includes *murabaha* (for short term finance) and *ijara* (for long term finance). At present about 70 per cent financing is done through the *murabaha*, says Mr. Faran Shikoh, the young and energetic branch manager of Al-Baraka at Aligarh .

Speaking on the occasion, Mr. Abdul Hasib, Former Executive Director, Reserve Bank of India, highlighted the merits of Islamic banking, Also, the prominent Muslim economist and the president of the Indian Association for Islamic Economics, Dr. F.R. Faridi expressed his optimism on the development of Islamic finance industry worldwide. Dr. Abdul Azim Islahi, honorary secretary Indian Association for Islamic Economics, urged the Board of directors, Al-Baraka Finance House to help in the academic research in the field of Islamic banking and finance.

IAFIE's Seminar Recheduled

Aligarh: The date of IAFIE's seminar on Islamic Economics - Issues and Challenges, scheduled to be held at New Delhi on December 5-6, 1998, has now been extended to September 4-5, 1999. This was decided by the executive committee of IAFIE which met on November 17, 1998 and after taking into account the stock of the prevailing situation, decided to extend to the new date. Now the last date of the submission of the paper is fixed as March 31, 1999.

The meeting also discussed other different issues of interest.

Steady Performance of Islamic Banks

Islamic banking and finance is now one of the fastest growing areas of new banking, not only in the Islamic countries but all over the world. According to banking observers about 50 per cent of all Islamic savings in the world will be under Islamic management at the turn of the century which is approaching 200 billion dollars and increasing at the rate of between 15-20 percent a year. Same report .

* **Bahrain :** Bahrain Monetary Agency (BMA) is successfully promoting Bahrain as global Islamic Banking centre with half a dozen banks and Islamic financing operations already established there. Last year four new operations were announced. These include the \$ 100 million capitalised First Islamic Investment Bank. It is hoping to attract private equity in the US markets as well as the Middle East and Malaysia. Four Kuwaiti groups in finance and real estate etc. have together created the Investors Bank in Bahrain which has a paid up capital of \$ 30 million.

Abu Dhabi : Among the recent recoveries to the Islamic banking expansion are the Abu Dhabi Islamic Bank which has been established with a capital of \$ 272 million. This is primarily a private bank with the government of Abu Dhabi only holding a 39 per cent share and is one of the largest of the new banks.

Jordan : Arab Bank of Jordan, Which took over the Amman Bank for Investment nearly a year ago, has now converted it into the Arab Islamic International Bank with a capital of \$ 57 million. It aims to develop the local and regional Islamic markets.

Qatar: Qatar Islamic International Bank (QIIB) and Qatar Islamic Bank (QIB) are providing interest free loans to consumers for every thing from simple overdraft to finance for car and furniture. As the demand for religiously sanctioned deposits and savings grows, they are expected to provide stiff competition to the more conventional banks in the region.

Turkey : Founded via a governmental decree in 1984, the non-interest bearing banking sector in Turkey now comprise of six main establishments or special Finance Houses (OFKs) with 155 branches and around \$ 1.25 billion between them.

Saudi Arabia: Al-Rajhi Banking & Investment Corporation (ARBIC), the world largest Islamic bank with the assets of 9586 million continues to remain the most profitable Saudi banks in the previous year, showing returns on capital of 17.4 percent.

American Express Bank has also launched itself into the Islamic banking scene. It has formed a joint venture with Faisal Finance of Jersey (a part of Dar Al-Maal Al-Islami (DMI) Group) American Express and Faisal Finance have launched the Islamic Multi-Investment Fund, one of a growing number Islamic-based umbrella funds. This one hopes to raise about \$ 100 million by the end of the year.

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PH.D. Thesis Abstract

A Proposal Model For An Islamic Insurance Industry
(PH.D. Thesis). by, Mossavar-Rahmani, Farhang
D.B.A. United States International University, 1997, 391 PP.

An emerging phenomenon in Islamic finance can be noted that much more focus has been given to the development of Islamic insurance, partly because of its pressing need in the Muslim world. Unlike the earlier writings, a number of Muslim writers find nothing wrong about this un-Islamic in Shariah, so far as the basic principles underlying insurance are concerned; explaining as how it can be operated by the state or can be done through mutual basis. The current researches in this regard give details of operating principles and practice developed by Islamic insurance companies, such as cooperative principles, re-insertion, commission, expenses of management payable by policy holders, re-insertion protection-premium reserves and investment funds.

The Problem : This study addressed the need for a viable Islamic insurance industry that could be instrumental in developing the economies of Muslim countries.

Method : A modified Delphi method was applied to obtain consensus among experts on the validity of model formation rounds and questionnaire rounds. Also, the Delphi method used in this study included a structured questionnaire supported by an article to explain the model.

The model formation rounds were conducted during the early stages of development. Questionnaire rounds were scheduled in the late stages of development and after complain of the model formation rounds.

Results : A framework was developed and evaluated to provide guidance in answering the following questions : (1) What are the preconditions for establishing a viable Islamic insurance industry? (2) What organisational structures are likely to be suitable for Islamic insurance companies? (3) How should the rate of return (profit or loss) on investment of Islamic insurance companies be determined? (4) How should the rate of return for investors investing in the Islamic insurance industry be determined? (5) How should insurance premium be calculated ? (6) How should insurance products be designed ? (7) How should an Islamic government assist an Islamic insurance industry? (8) What roles should Islamic governments have regarding regulation of Islamic insurance companies especially in the areas of investment and operations? (9) How could the proposed model be applied to develop a viable capital market in Islamic countries.

Date Extended**National Level Seminar on Islamic Economics - Issues and Challenges***Dates : September 4-5, 1999**Venue : Dawat Nagar, Jamia Nagar New Delhi.**A few suggested topics :*

- * **An Appraisal of the Development in Islamic Economics**
- * **Islamic Banking & Finance System and the Indian Economic Challenges**
- * **The Muslim Economic Situation : An Islamic Prescription**
- * **Globalization, Liberalization, Privatization : Credits and Debits**

The organisers invite IAFIE's members, academics and finance professionals to attend this stimulating and enlightening seminar which promises to be an invaluable opportunity to interact with the issues related to the theory and practice of Islamic economics and finance.

Last date for submission of papers March 31, 1999.

For any clarification please contact :

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SURVEY OF INTEREST FREE FINANCIAL INSTITUTIONS IN INDIA

All India Council of Muslim Economic Upliftment Bombay has launched a survey of interest free financial institutions operating in India. The purpose behind this survey is to remove the information gap about these institutions in the society. The informations collected will be compiled in form of a Directory and Special Report and disseminated the same to people particularly information spreading agencies.

It is expected that this will bring wider recognition to these institutions. Thereafter moral and material support is bound to gather around them. Successful experiments will also encourage others to venture into the field. Ultimately interest free financial movement in the country will get strengthened.

Therefore we request the readers to kindly send us the names and addresses of all such institutions known to them. So that we can send them printed questionnaire for necessary information —

Please write to :

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