

AN EVALUATION ON CURRENT ISLAMIC FINANCE AND BANKING

By

Aliasghar Arabi

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
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Committee in charge:

Professor Jinsoo LEE, Supervisor _____

Professor Kun-Ho LEE _____

Professor Wook SOHN _____

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ABSTRACT

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**By
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In the recent decade, the Islamic financial system has experienced remarkable growth and transformation, demonstrating its potential as a competitive form of financial intermediation. In developing the Islamic financial system, it is important to focus on the appropriate pre-requisites that will facilitate its efficient evolution. Fundamental to this is the development of the institutions, the markets, the range of financial products and services and having in place the accounting, legal, regulatory, supervisory and Shariah frameworks, as well as, for the monetary authority to have the capacity to manage its financial policies within this context.

In Islamic banking, the management of risks becomes more challenging due to its peculiar risk characteristics and the requirement for compliance to Shariah principles.

An Arabic word for Islamic law, Shariah governs both secular and religious life of devout Muslims. It covers religious rituals and many aspects of day-to-day living, politics, economics, banking, and law.

Another facet to risk management is the need for the Islamic banking industry to develop a derivatives market. In addition, it also needs deeper and more efficient money and capital markets to facilitate sound asset and liability, and liquidity management by Islamic financial institutions.

The development of a vibrant Islamic finance and banking sector cannot be achieved without the support of appropriate human capital development and strengthening of research and intellectual capacity in the sphere of finance and Shariah. The Islamic banking industry needs to be equipped with a new breed of innovators, risk managers,

regulators and supervisors who have the right blend of knowledge of finance and the understanding of the Shariah.

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Dedicated to Asila Hajian Motlagh

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1. Introduction

A central tenet of an economic system based on Islamic principles is the absolute prohibition on the payment and receipt of interest. It is this prohibition that makes Islamic banks and financial institutions differ in a fundamental sense from their Western counterparts. As the use of the interest rate in financial transactions is precluded, Islamic banks are expected to conduct operations only on the basis of profit-sharing arrangements or other modes of financing permissible under Islamic law. At present, some 300 Islamic Financial Institutions (IFI) are operating in 75 countries, mostly concentrated in Gulf Cooperation Council (GCC), and have some type of Islamic banking or financial institutions.¹ This development, which has gained momentum since the second half of the 1970s, has basically taken two forms. The first has been an attempt to establish Islamic financial institutions side by side with traditional banking. In such attempts, two types of institutions have evolved: Islamic banks, established mostly in Muslim countries, and Islamic investment and holding companies, operating in some Muslim but mostly in non-Muslim countries. In both cases, generally, the banking operations of Islamic banks are subject to specific regulations that apply to all banks. These institutions compete with conventional banks to attract deposits-but without paying a predetermined interest rate-and invest these funds wherever they find profitable investment opportunities. The majority of these institutions were established through private initiatives.

The paper has been divided into 6 sections. Section 1 is introduction. Section 2 looks into the Past and Present of Islamic Finance and Banking. Section 3 of the paper provides an overview of the Islamic financial ethics. Section 4 deals with

¹ Islamic Development Bank (IDB)

Characteristics of Islamic Finance and Banking. Section 5 presents Future Challenges for Islamic Finance and Banking. Finally last section provides a brief conclusion of the paper. Appendix investigates Islamic financial system in Iran.

2. Past and Present of Islamic Finance and Banking

2.1. History of Islamic Finance and Banking

Local Islamic banks formed in the 1970s in Muslim countries such as Malaysia, Pakistan and Dubai and originally emphasized joint-venture structures akin to private equity. They quickly evolved to provide short-term credit facilities by using the *murâbaha* structure. With increase in scale, Islamic banks began to branch out to more complex financing schemes, such as retail banking, including, deposit taking and consumer lending and Bonds (*sukûk*) and Medium- and Long-term leases (*ijâra*). Impact of 9/11 led to Reverse Capital Flight. Perception of hostile climate in many Western jurisdictions, in particular, the United States, led to repatriation of dollars by Arab investors to Middle Eastern banks. Islamic banks, along with conventional banks in the region, benefited from this reverse flight of capital. Moreover, increase in oil prices led to dramatic increase in liquidity in the Gulf. Later, Conventional Banks Open “Islamic Windows” and began to respond to requests from Muslim clients to offer products that complied with Islamic law. As the size of the potential market became clear, conventional banks responded with the creation of divisions dedicated to Islamic banking. Some of Conventional International Banks with Islamic Windows are such as Citigroup, HSBC, Deutsche Bank, UBS, ABN AMRO, Standard Chartered Bank. Almost all regional banks have followed the international banks in creating “Islamic” windows and some have converted, or are in the process of converting, to the Islamic banking model.²

² See " Munawar Iqbal and Philip Molyneux (2005)"

2.2. Recent Trends

The recent phenomenal growth of Islamic banking underpinned the need for greater innovation and flexibility to facilitate wider acceptance of Islamic products and services. Table 1 presents an estimate of the global Islamic industry.

Table 1: Estimate of Global Islamic Industry

Number of Islamic financial institutions	275
Countries of presence	75
Asset holding size	US\$280bn
Financial investments	US\$400bn
Growth in last five years	15%

Source: IMF Research, Monetary and capital Market Department

Islamic banking customers are not only confined to limited areas such as the Middle East but are spreading across Europe, the US and Asia Pacific. The global Muslim population is approximately 1.6 billion and Islam is considered to be the fastest-growing religion in the world. Under these circumstances, it is hardly surprising that global financial institutions are creating a range of Islamic investment instruments.

The industry has embraced a wide range of institutions and products, including commercial Islamic banks, Islamic investment companies, Islamic investment banks, insurance companies, asset management companies, e-commerce, brokers and dealers. Products include commercial Islamic banking products, insurance products, mutual funds and unit trusts, Islamic bonds and Shari'a compliant stocks. It has been over two decades since Islamic banks first appeared as active players and today Islamic banking and finance has become a force to be reckoned with. The provision of banking services adhering to Shari'a rules has grown to such an extent that many conventional banks, both in the Middle East and in the US and Europe, have realized that it is a segment that demands their attention.

In September 2003, the General Council of Islamic Banks reported that assets in the global Islamic banking and finance (IBF) industry exceeded US\$250bn and were growing at an annual rate of about 23.5%. Over the previous decade, annual IBF growth averaged about 10%. At US\$280bn, the market is still small, but the addressable market is huge.

There is a spread of Islamic banking outside the Middle East and the Gulf countries. Singapore, for example, already manages around US\$2bn of Shari'a compliant capital market funds and is seeking to grow rapidly over the next few years, particularly in the fields of wealth management, capital markets and reinsurance within the Islamic banking sector. Malaysia is also a strong player. Islamic banking has figured here for 23 years. Its share of the total market for Shari'a products has now reached around 12%. With strong support from its government, it is slowly creeping up year on year and is currently worth in the region of £10.7bn (British pound). And by sheer force of numbers, the Republic of Indonesia is still the most populous Muslim-majority nation in the world, with almost 86% of Indonesians declared Muslim according to the country's 2000 census. Its total population in July 2006 was more than 245 million.³

2.3. Growth and Business Development

The Muslim population accounts for nearly one quarter of the world's population, and it is expected to grow at a faster rate. With demand for Islamic products rising, the availability of Shari'a-compliant banking, investment, and insurance products continues to grow.

The industry faces competition from a number of angles, not least from the conventional financial sector. Well established, western-based global financial players

³ Source : International Banking System Report

continue to open and expand operations in Muslim regions of the world and have built infrastructures to enter markets, particularly in the Islamic financial centers of Dubai, Bahrain, and Kuala Lumpur. They are using their considerable operational, marketing, and technology skills to produce and distribute Islamic financial products in direct competition with indigenous financial institutions.

Today, more than 250 Islamic banks (90 institutions of them are in the Middle East) are operating from China to the US. Western banks, through their Islamic units in the UK, Germany, Switzerland, Luxembourg, and others countries also practice Islamic banking.

Pure-play Islamic banks and financial institutions manage over US\$280bn in assets and a further US\$200-300bn is managed by the Islamic windows and subsidiaries of international banks. The Gulf Cooperation Council (GCC) region has been a hotbed of activity as far as the Islamic banking industry is concerned, where 41 Islamic financial institutions are currently operating in the GCC countries (of which 18 are banks). Qatar and Bahrain are the leaders and hold a 70% share of the assets, while the UAE accounts for 19% of assets. The growth in assets is estimated at 15% and expected to remain so, for several reasons such as growth in overall wealth in the Middle East, growing awareness about the Islamic products, wider availability and variety of Islamic financial products and because equity/asset ratio of Islamic banks stands at 13.1% compared to 11.3% for conventional banks in the GCC region. This indicates under-utilization of capital and provides a lot of scope for taking on additional risk on the balance sheet.⁴

⁴ IBF review, July-Sep 2007

3. Islamic Financial Ethics

Islamic scholars have undertaken a thorough examination of relevant verses from the holy Quran and the Sunnah and have long established the basic principles, which govern the rights and obligations of participants in the financial markets. I present below some important norms of Islamic ethics as are applicable to financial markets. All these norms may form the basis of regulation and legislation relating to financial markets.⁵

3.1. Freedom to Contract

Islam provides a basic freedom to enter into transactions. The holy Quran says: Allah has made trade lawful. (2:275). Further, no contract is valid if it involves an element of coercion for either of the parties. The holy Quran also says: let there be among you traffic and trade by mutual goodwill (4:29). However, this basic norm does not imply unbridled freedom to contract and may be sacrificed when there is a trade-off with other norms requiring specific injunctions.

3.2. Freedom from Al Riba (Excess or Interest)

All forms of contracts and transactions must be free from *riba*. This implies that there is no reward for time preference and under conditions of zero risk. The question of *riba* has been addressed in a large body of literature and there is a general consensus about the meaning and implications of *riba*. (Explained in detail in coming sections)

3.3. Freedom from Al Gharar (Excessive Uncertainty)

All forms of contracts and transactions must be free from excessive *gharar*. This implies that contracting under conditions of excessive uncertainty is not permissible. Islamic scholars have identified the conditions and highlighted situations that involve excessive uncertainty and consequently, disallow a contract.

⁵ See " Kamali, M. Hashim (1999)

3.4. Freedom from Al-Qimar (gambling) and Al-Maysir (Unearned Income)

Contracting under excessive uncertainty or gharar is akin to gambling (*al-qimar*). And uninformed speculation in its worst form is also akin to gambling (*al-qimar*). The holy Quran and the traditions of the holy prophet explicitly prohibit gains made from games of chance which involve unearned income (*al-maysir*). Here it may be noted that the term speculation has different connotations. It always involves an attempt to predict the future outcome of an event. But the process may or may not be backed by collection, analysis and interpretation of relevant information. The former case is very much in conformity with Islamic rationality. An Islamic economic unit is required to assume risk after making a proper assessment of risk with the help of information. All business decisions involve speculation in this sense. It is only the gross absence of value-relevant information or conditions of excessive uncertainty that makes speculation akin to a game of chance and hence, forbidden.

3.5 Freedom from Price Control and Manipulation

Islam envisages a free market where prices are determined by forces of demand and supply. There should be no interference in the price formation process even by the regulators. It may be noted here that while price control and fixation is generally accepted as unIslamic, some scholars, such as, admit of its permissibility. Such permissibility is subject to the condition that price fixation is intended to combat cases of market anomalies caused by impairing the conditions of free competition. It is a requirement that the forces of demand and supply should be genuine and free from any artificial element. Islam therefore, condemns any attempts to influence prices through creating artificial shortage of supply (*ihtikar*). Similarly, any attempt to bid up the prices by creating artificial demand is considered unethical. Such an action of

bidding up the price without an intention to take delivery is termed as *najas* and is not permissible.

3.6 Entitlement to Transact at Fair Prices

Prices that are an outcome of free play of forces of demand and supply without any intervention or manipulation are believed to be fair. However, in some instances, pricing is based on a valuation exercise. In such cases the difference between the price at which a transaction is executed and the fair price (as per the opinion of valuation experts) is termed as *ghubn*. The presence of *ghubn* makes a transaction unethical.

3.7 Entitlement to Equal, Adequate and Accurate Information

Islam attaches great importance to the role of information in the market. Release of inaccurate information is forbidden. The concealment of vital information (*ghish*) also violates the norms of Islamic ethics and according to the traditions of the holy prophet; the informationally disadvantaged party at the time of the entering into the contract has the option to annul the contract. The traditions refer to price information in the market as well as other information relevant for valuation of the commodity. Islamic scholars are of the opinion that a transaction must be free from *jahalah* or misrepresentation to be considered Islamic. The institution of a transparent market is, thus, quite important and transactions should be executed within the market after taking into account all relevant information. It may be noted that the holy traditions that deal with the issue, refer to a commodity transaction. In case of a commodity transaction, the commodity in question is subject to inspection and both the parties can be reasonably sure about the benefits that are going to flow from future possession of the commodity. Unlike a commodity, however, the benefits from a project are in the form of expected cash flows. These expected cash flows are also subject to continuous revision as new events occur. Hence, Islamic ethics requires that

all information relevant to expected cash flows and asset valuation should be equally accessible to all investors in the market.⁶

3.8. Freedom from Darar (Detriment)

This refers to the possibility of a third party being adversely affected by a contract between two parties. If a contract between two parties executed with their mutual consent is detrimental to the interests of a third party, then it may enjoy certain rights and options.

The list of norms of Islamic ethics stated above is by no means exhaustive. It differs from the norms of mainstream financial ethics significantly - in imposing injunctions against *al-riba*, *al-qimar*, and *al-maysir*.

The next important question is how to prioritize various norms of Islamic financial ethics when there is a possible conflict or trade-off. The Islamic ethico-legal system has a clear scheme of priorities in legislation. Where there is a clear injunction in the holy *Quran*, for example, in the form of prohibition of *riba* and games of chance, these must be observed at all costs. Next in importance are the norms that follow from the *Sunna* or traditions of the holy prophet, and *ijma* or consensus, in that order. For example, the principle of freedom from *darar* is *Sunna* and hence, is accorded lower priority than prohibition of *riba*. There may be certain areas however, which are “unrestricted” by *Shariah*. What should be the guiding principle for the regulator in establishing a system of priorities in these areas?

3.9. Maslahah Mursalah (Unrestricted Public Interest)

The answer to the above may be found in the framework of *maslahah mursalah* or “unrestricted” public interest, which is a valid framework of Islamic legislation. The framework is called “unrestricted” public interest on account of its being undefined by

⁶ See " Mahmoud Amin Al-Gamal (2006)"

the established rules of *Shariah*. *Maslahah* consists of “considerations which secure a benefit or prevent a harm but are, in the mean time, harmonious with the objectives (*maqasid*) of *Shariah*. These objectives consist of protecting five essential values, namely, religion, life, intellect, lineage and property, which have a much wider scope and meaning. For instance, protecting the right to live includes protecting the means, which facilitate an honorable life, such as, freedom to work and travel. Protection of property requires defending the right of ownership. It also means facilitating fair trade and lawful exchange of goods and services in the community. Any measure which secures these values falls within the scope of *maslahah* and anything which violates them is *maf sadah* (evil), and preventing the latter is also *maslahah*. For example, any attempt to curb monopolistic tendencies or block the free flow of information in the market place is a step to secure a *maslahah*. Further, an act which implies the attaining of a *maslahah* and the warding off a harm should not be forbidden even if it were, from another aspect, to negate a *maslahah* and to bring about a harm, as long as the secured *maslahah* outweighs the harm that results from the act or the *maslahah* that may be negated in consequence of it.

Thus, the framework essentially involves a comparison of benefits and costs at a macro-level. And needless to say, this principle of ensuring maximum net social benefits is clearly accorded a lower priority than principles emanating directly from the holy *Quran* and the *Sunna*. Of course, this specific norm ensuring maximum net social benefits is a valid, and at the same time, a dynamic basis of regulation and legislation in the Islamic framework. It is dynamic, because it can meet the challenges of ever-changing circumstances facing a Muslim society. The nature and intensity of factors affecting social benefits and costs are likely to vary across space, and time.⁷

⁷ See "Hussein Hamid Hassan (1994)"

4. Characteristics of Islamic Finance and Banking

4.1. Objection to interest

In order to understand why there is a demand for specifically Islamic financial instruments it is necessary to appreciate Muslim objections to conventional interest or *Riba*. The fact that *Riba* is explicitly prohibited in the Koran is sufficient justification for Muslims to avoid transactions which involve interest. Such avoidance is not only based on faith, but also on reason, there is a distinguished tradition in Islamic scholarship for using reasoned argument.

The distinctive implications of interest collection have always been a major moral concern. Worries about debtors being exploited through usury were by no means the exclusive concern of Muslims. Many Christian theological writers concerned with economical and social issues have taken a similar position, although the teaching of the medieval saints and scholars seems to have been conveniently, overlooked in the present age of moral relativism. Thomas Aquinas in the thirteenth century examined the reasons for being opposed to interest and took a much more fundamentalist position pointing to biblical teaching. In the New Testament, Luke 6:35 clearly states: 'lend, hoping for nothing in return'. The Old Testament teaching is spelt out in Exodus: 'if you lend money to any of my people with you who is poor, you shall not be to him as a creditor, and you shall not exact interest from him.' (22:25)

Whether all interest or only excessive interest is usury has been much debated by Muslim and Christian economists. Modern western economists tend to regard the interest charges of commercial banks to their business and personal clients as necessary to cover financing costs, but modern Islamic economists interpret the Koran literally, and equate all interest with usury. The Koran states that: 'God will deprive usury with all blessing, will give increase for deeds of charity.' (Sura 2:276) interest is

regarded as unjust and exploitative return. The notion of interest as a reward for deferring consumption is rejected, as saving will bring its own reward, without the need for additional monetary compensation. Excessive saving may result in underconsumption, recession and damage to legitimate trade. In the Koran it is stated that: ' God hath permitted trade and forbidden usury.' (Sura 2:275) There are parallels between these concerns and the Keynesian stress on maintaining the flow of income to minimize the unemployment.

Islamic economics object to the principle of interest, not merely excessive interest. The problem is how to define usury, as stating that it occurs when interest exceeds certain predetermined amount is inevitably an arbitrary procedure. Yet this is the case of western anti-usury laws, such as those still enforced in France. Such laws relate to nominal interest and make no allowance for variable inflation. If inflation falls but nominal interest fails to adjust, borrowers will be penalized through no fault of their own, while savers and lenders will benefit from unjustified windfall gain.

Islam stresses that all transactions should be just, and Muslims view interest-based transactions as inherently unjust. One difficulty is where interest rates are set by either central bank or government in order to attain macroeconomic objectives such as control of inflation. This affects microeconomic agents such as savers and investors, who are then burdened with unwanted political and economic risks as well as their own personal finance and business risk. If interest ceases to be an instrument of monetary policy, as in Islamic economy, microeconomic agents can focus more sharply on their own commercial concerns.⁸

⁸ See " El-Gamal, Mahmoud Amin (2000)"

4.2 Sources and Uses of Funds

The main sources of funds for an Islamic bank would be two forms of deposits-transactions deposits and investment deposits. Transactions deposits are directly related to payments and can be regarded as equivalent to demand deposits in a conventional banking system. Although a bank would guarantee the nominal value of the deposit, it would pay no return on this type of liability. Investment deposits constitute the principal source of funds for banks, and they resemble more closely shares in a firm rather than time and saving deposits of the customary sort. The bank offering investment deposits would provide no guarantee on their nominal value and would not pay a fixed rate of return. Depositors, instead, would be treated as if they were shareholders and therefore entitled to a share of the profit, or losses, made by the bank.⁹ The only contractual agreement between the depositor and the bank is the proportion in which profits and losses are to be distributed. The share, or distribution, parameter has to be agreed on in advance of the transaction between the bank and the depositor and cannot be altered during the life of the contract, except by mutual consent.¹⁰

The bank can acquire profit-sharing assets via two principle modes of transactions: Mudarabah and Musharakah. Under the provisions of the first mode, surplus funds are made available to the entrepreneur to be invested in a productive enterprise in return for a predetermined share of the profits earned. Financial losses are borne exclusively by the lender. The borrower, as such, loses only the time and effort invested in the venture. This arrangement, therefore, effectively places human capital on par with financial capital. In Musharakah, on the other hand, there is more than a single contributor of funds. All parties invest in varying proportions, and the profits (or

⁹ See " Iqbal, M. and Llewellyn, D.T., (2002)"

¹⁰ See " Siddiqui, M. Nejathullah (1985)"

losses) are shared strictly in relation to their respective capital contribution. This financing method corresponds to an equity market in which shares can be acquired by the public, banks, and even the central bank and the government. Traditionally, Mudarabah has been employed in investment projects with short gestation periods and in trade and commerce, whereas Musharakah is used in long-term investment projects. These two modes have their historical counterparts in farming (Muzar'ah) and in orchard keeping (Musaqat), where the harvest is shared between and among the partners based on pre-specified shares. Following table is a Synoptic Analysis of Islamic Modes of Financing:

Table 2: Profit-and-Loss (PLS) Modes of Islamic Financing:

TYPE	DESCRIPTION	COMMENTS
PLS Modes	Profit-and-loss-sharing modes	At the core of Islamic banking
Mudaraba	<p>Trustee finance contract</p> <p>Under this kind of contract, the bank provides the entire capital needed for financing a project, while the entrepreneur offers his labor and expertise. The profits (or losses) from the project are shared between the bank and the entrepreneur at a certain fixed ratio. Financial losses are borne exclusively by the bank. The liability of the entrepreneur is limited only to his time and efforts. However, if the negligence or mismanagement of the entrepreneur can be proven he may be held responsible for the financial losses incurred.</p> <p>Mudaraba is usually employed in investment projects with short gestation periods and in trade and commerce.</p> <p>It affects both assets and liabilities sides of banks balance sheet. On the liabilities side, the contract between the bank and depositors is known as unrestricted Mudaraba because depositors agree that their funds be used by the bank, at its discretion to finance an open-ended list of profitable investment and expect to share with the bank the overall profits accruing to the bank's business. On the assets side, the contract between the bank and the agent-entrepreneur is known as restricted Mudaraba because the bank agrees to finance a specific project carried out by a specific agent-entrepreneur and to share the relative profits according to a certain percentage.</p>	<p>At the core of Islamic banking</p> <p>Three conditions need to be met:</p> <ol style="list-style-type: none"> 1. The bank should not reduce credit risk by requesting collateral to this purpose: it bears entirely and exclusively the financial risk. Collateral may be requested to help reduce moral hazard, for example, to prevent the entrepreneur from vanishing. 2. The rate of profit has to be determined strictly as a percentage and not as a lump sum. 3. The entrepreneur has the absolute freedom to manage the business. <p>The bank is entitled to receive from the entrepreneur the principal of the loan at the end of the period stipulated in the contract only if a surplus exists. If the enterprise books show a loss, this will not constitute default on the part of the entrepreneur, except for negligence or mismanagement.</p>
Musharaka	<p>Equity participation contract</p> <p>The bank is not the sole provider of funds to</p>	Banks can exercise the voting rights

	<p>finance a project. Two or more partners contribute to the joint capital of an investment.</p> <p>Profits (and losses) are shared strictly in relation to the respective capital contributions.</p> <p>This kind of contract is usually employed to finance long-term investment projects.</p>	<p>corresponding to their share of the firm's equity capital. Their representatives can sit on the firm's board of directors.</p> <p>All parties invest in varying proportions, and have the right to participate in the management of the enterprise.</p>
Muzar'ah	<p>This is the traditional counterpart of the Mudaraba contract in farming.</p> <p>The harvest is shared between the bank and the entrepreneur. The bank may provide funds or land.</p>	
Musaqat	<p>This is the traditional counterpart of the Musharaka contract in orchard keeping.</p> <p>The harvest is shared among the partners based on their respective contributions.</p>	
Direct investment	<p>This represents the same concept as in conventional banking. The bank cannot invest in the production of goods and services which contradict the value pattern of Islam, such as gambling.</p>	<p>Banks can exercise the voting rights corresponding to their share of the firm's equity capital. Their representatives can sit on the firm's board of directors.</p>

In transactions where profit sharing is not applicable, other modes of financing can be employed, which include the following.

Table 3: Non-PLS Modes of Islamic Financing

TYPE	DESCRIPTION	COMMENT
Non-PLS mode	Non-profit-and-loss-sharing modes	<p>They are used in cases where PLS modes cannot be implemented, for example, in cases of small-scale borrowers or for consumption loans.</p>
Qard al-Hasanah	Beneficence loans These are zero-return loans that the Qur'an exhorts Muslims to make to "those who need them." Banks are allowed to charge the borrowers a service fee to cover the administrative expenses of handling the loan, provided that the fee is not related to the amount or maturity of the loan.	
Bai' Muajjal	Deferred payment sales The seller can sell a product on the basis of a deferred payment in installments or in a lump sum payment. The price of the product is agreed upon between the buyer and the seller at the time of the sale and cannot include any charge for deferring payments.	<p>Contrary to contracts based on the PLS principle, modes such as markup, leasing, and lease purchase have a predetermined and fixed rate of return and are associated with collateral.</p> <p>In fact, banks add a certain percentage to the purchase price and/or additional costs associated with these transactions as a profit margin, and the purchased assets serve as a guarantee. Moreover, banks may require the client to offer collateral.</p>
Bai' Salaf	Purchase with deferred delivery The buyer pays the seller the full negotiated price of a product that the seller promises to deliver at a future date. This mode only applies to products whose quality and quantity can be	<p>These instruments can be considered to be more closely associated with risk aversion and they do not substantially differ from those used in a conventional banking system, other than in their</p>

	fully specified at the time the contract is made. Usually, it applies to agricultural or manufactured products.	terminology and in some legal technicalities. They are considered to conform to Islamic principles because the rate of return is meant to be tied to each transaction, rather than to a time dimension. However, some Muslim scholars advocate a stricter utilization of such modes.
Ijara Ijara wa Iqtina	Leasing Lease purchase A party leases a particular product for a specific sum and a specific period of time. In the case of a lease-purchase, cash payment includes a portion that goes toward the final purchase and transfer of ownership of the product.	
Murabaha	Mark-up The seller informs the buyer of his cost of acquiring or producing a specified product; then the profit margin (or mark-up) is negotiated between the buyer and the seller. The total cost is usually paid in installments.	
Jo'alah	Service Charge A party undertakes to pay another party a specified amount of money as a fee for rendering a specified service in accordance to the terms of the contract stipulated between the two parties. This mode usually applies to transactions such as consultations and professional services, fund placements, and trust services.	

Sources: Kazarian, 1993; Iqbal and Mirakhori, 1987.

The above list is by no means exhaustive. Under Islamic law the freedom of contracts provides the parties with a flexibility that makes possible a virtually open-ended variety of forms of financial transactions and instruments. There is nothing to constrain the system from creating any contractual form so long as the contract does not include interest and both parties are fully informed of the details of the contract.

Here, it can be useful to compare Islamic and Conventional Banking as table 4 provides a synoptic comparison between Islamic and conventional banks.

Table 4: A Comparison between Islamic and Conventional Banking

Features	Islamic Banking	Conventional Banking
Guarantee of the capital value of Demand deposits Investment deposits	Yes No	Yes Yes
Rate of return on deposits	Uncertain, not guaranteed for investment deposits. Demand deposits are never remunerated.	Certain and guaranteed.
Mechanism to regulate final returns on deposits	Depending on bank Performance/ profits from investment.	Irrespective of bank performance/ profits from investment.
Applicability of Profit-and-loss (PLS) principle	Yes	No
Use of Islamic modes of Financing : PLS and non-PLS modes	Yes	Non-applicable
Use of discretion by banks with regard to collateral	Generally not allowed to reduce credit risk in PLS modes. By way of exception, may be allowed to lessen moral hazard in PLS modes. Allowed in non-PLS modes.	Yes, always

Source: IMF

Based on the above, the following points are worthy of note:¹¹

Owing to the use of profit-and-loss-sharing arrangements, Islamic banks are better poised than conventional banks to absorb external shocks. In the event of operational losses, unlike conventional banks, Islamic banks have the ability to reduce the nominal value of investment deposits, that is, reduce the nominal value of a portion of their liabilities. As a result, solvency risks that may arise from an asset-liability mismatch are typically lower in Islamic banks than in conventional banks.

Islamic banks show an operational similarity with conventional investment companies, including mutual funds owing to the fact that they do not guarantee either the capital value of or the return on investment deposits and that they basically pool depositors' funds to provide depositors with professional investment management.

¹¹ See " Fredrick Vernon Iffert (1998)"

There is, however, a fundamental conceptual difference between the two that also needs to be recognized. It lies in the fact that investment companies sell their capital to the public, while Islamic banks accept deposits from the public. This implies that shareholders of an investment company own a proportionate part of the companies equity capital and are entitled to a number of rights, including receiving a regular flow of information on developments of the companies business and exerting voting rights corresponding to their shares on important matters, such as changes in investment policy. Hence, they are in a position to take informed investment decisions, monitor the company's performance, and influence strategic decisions. By contrast, (investment) depositors in an Islamic bank are only entitled to share the bank's net profit (or loss) according to the PLS ratio stipulated in their contracts. Investment deposits cannot be withdrawn at any time, but only on maturity and, in the best case, at par value. Moreover, depositors have no voting rights because they do not own any portion of the bank's equity capital.

4.3. Issues in the interest-free finance and banking

The replacement of an interest-based banking system by an alternative system that relies primarily on profit-sharing arrangements raises a number of fundamental theoretical and practical questions, among the most important of these are: First, how will an Islamic banking system function? Second, what would be the effects of adopting such a system on the economy and, in particular, on macroeconomic variables like savings and investment? And third, what role, if any, would monetary policy play in the Islamic system?

Research on these types of questions is still in its very early stages. Nevertheless, in recent years there have been a number of studies that have attempted to conceptualize the basic ideas underlying Islamic banking, as well as the likely consequences that

would follow from the institution of this system. Taking the view that the reliance on profit-sharing arrangements makes the Islamic system akin to an equity-based system, relatively straightforward theoretical models have been developed analyzing the workings of the system.¹² In these models, depositors are treated as shareholders (as in a mutual fund or investment trust, e.g.) and banks provide no guarantee on the rate of return or the nominal value of shares. Symmetrically, banks themselves become partners with the borrowers and accordingly share in the returns obtained from the borrowed funds.¹³ An interesting result that emerges from such models is that the Islamic system may be better suited to adjust to shocks that can lead to banking crises than an interest-based banking system. In an equity-based system, shocks to the asset positions of banks are immediately absorbed by changes in the nominal value of shares (deposits) held by the public in banks.

Therefore, the real values of assets and liabilities would be equal at all points in time. In the conventional banking system, since the nominal value of deposits is guaranteed by the bank, an adverse shock to assets of the bank can create a divergence between real assets and real liabilities-leading possibly to negative net worth for the bank-and it is not clear how the disequilibrium would be corrected and how long the process of adjustment would take.¹⁴

The elimination of a risk-free asset with a positive predetermined return is expected to have significant consequences for savings, investment, financial development, and so forth, as well as for the conduct of monetary policy. For example, there is a presumption that the removal of a fixed interest rate increases uncertainty, which in turn would reduce savings and make lenders worse off. However, this will depend on the behavior of financial rates of return in the economy. Serious issues also arise in

¹² See " Siddiqui, M. Nejathullah (1983)"

¹³ See "Al-Omar, Fouad and Mohammed Abdel Haq (1996)"

¹⁴ See "Haron, Sudin (1996)"

the area of investment as the adoption of a profit-sharing arrangement between lender, that is, the bank, and investor may raise monitoring costs and discourage investment. To avoid this adverse effect and moral hazard issues that arise when the lender and investor have different information on the profits from the investment requires the implementation of a legal and institutional framework that facilitates appropriate contracts. The form of these contracts, and the mechanism for enforcing them, still need to be spelled out. Insofar as monetary policy is concerned, the central bank would lose the ability to directly set financial rates of return in an Islamic banking system. However, theoretical work has shown that indirect methods through control of credit extended by banks, reserve requirement changes, and varying of profit-sharing ratios can achieve results for monetary policy similar to those in a conventional interest-based economy.¹⁵

In summary, while there have been significant advances in the development of the theoretical foundations of Islamic banking and finance, many important issues are as yet unresolved. For example, the role and conduct of fiscal policy, and particularly the financing of fiscal deficits, is as yet undefined. Nor has there been much attention paid to exchange rate and trade policies and to foreign debt questions. It is clear that even if countries fully reorient their economies along Islamic concepts, the fact that these countries must coexist with non-Islamic countries raises a variety of issues that have a significant bearing on foreign economic relations.

5. Future Challenges for Islamic Finance and Banking

5.1. Islamic liquidity management

Islamic banks investing in long-term assets are still faced with a problem in that most of their deposit liabilities are very short-term leading to a massive liquidity problem.

¹⁵ See "Al-Harran, S.A.S. (1993)"

Liquidity management tools that are both flexible and undeniably Shari'ah compliant are lacking.¹⁶ Although Sukuks(Islamic Bonds) can be traded, most of them are held to maturity.

It is inevitable that competition between various conventional banks and Islamic ones has led to segmentation and prevented a really substantial market developing leading to a spiraling vortex of liquidity. For things to change there will need to be more co-operation amongst Islamic banks and between them and their conventional counterparts.

In addition to the lack of long-term assets to invest in and get out of, Islamic banks face another serious problem in balance sheet management: the lack of an Islamic inter-bank market. Because Islamic banks unlike conventional banks cannot borrow at interest to meet unexpected withdrawals from their depositors, it is difficult for them to run mismatched asset and liability portfolios. And this is aside from the interest rate risk they run when they invest long at fixed rate and have their liabilities re-price frequently. The way banks have most commonly solved this problem is to have more liquid assets than would be in the case of conventional banks and these are placed with commodity Murabahas on the understanding that they can get liquidity when required through early cancellations at an explicit or hidden cost.¹⁷ There are a few Islamic liquidity vehicles but these are fairly small and could not withstand a several hundred dollar injection or withdrawal. There needs to be a market-wide central solution that allows institutions to park funds between medium to long term investments. We need a solution that involves high quality, standardization, gets away from bilateral Murabaha investments by the investor with all the problems of break clauses, listing and price transparency and are able to transact in substantial size.

¹⁶ See " Karimi, Abdul Jabbar (2005)"

¹⁷ See " Saiful Azhar Rosly.(2005)"

Several initiatives are in hand and there are likely to be some announcements by the end of the year.

In summary, whilst there have been a number of Islamic Sukuks (Islamic Bonds) issued recently; most of the paper is bought to hold rather than trade. Thus liquidity is a problem both for on sale and price determination and mark to market is difficult. This is a result of a combination of two factors. There is a shortage of quality paper issued into the market and also the view in some quarters that the trading of debt is not Shariah compliant.

In terms of Asset / Liability Management there is a hedging problem for institutions that lend long term at fixed yield through Ijaras and finance through short term and therefore variable yield accounts. There is thus a pressing need for Islamic derivatives to address this gap problem. But most derivatives are deemed to be Haram or not Shariah compliant on the grounds of being gambling. Perhaps "Financial Takaful (insurance)" would be a better banner to address this problem and a number of institutions believe they have much needed solutions to this problem.

There is also a problem in terms of the lack of Islamically compliant short-term liquidity instruments. The Sukuks, even if they were traded and liquid, are medium to long term. And the current shortage of credit lines to some Middle Eastern institutions has led to an increase in short term cash holdings but the lack of suitable instruments creates a liquidity trap. There needs to be a truly global-sized liquid inter-bank market where institutions can park their liquidity reserves.¹⁸

5.2. Islamic Financial risk management

From the exhaustive discussion on the Islamic financial ethics it is clear that some efficiency notions, such as, informational and pricing efficiency are clearly in

¹⁸ See " Mohammed Obaidullah (2002)"

conformity with the Islamic and ethical notions relating to adequacy and accuracy of information and fair pricing. As regards full-insurance efficiency or operational efficiency, these can be justified in the Islamic ethical framework in terms of their *maslahah* for the people at large.¹⁹ What then is the *maslahah* underlying the derivative contracts?

Risk management products allow the market participants at a micro-level to avoid undesirable risks. These products make it possible to transfer risks to other participants who would like to bear them. Risk management products or derivatives have proliferated over the last two decades in response to large-scale volatility witnessed in global markets in commodities, currencies, stocks and bonds. The products can often be quite complex, engineered specifically to meet the risk management requirements of a particular market participant. At a basic level, however, these products can be discussed in the category of options and forward contracts. Often the more complex products include features of these basic contracts.

It is quite clear that options and futures (and forwards) do provide certain benefits to market participants exposed to certain kinds of risky situations. And given the complexity of modern business requiring advance planning, and the many risks arising out of fluctuations in prices and rates in markets for commodities, currencies, and other financial assets, the *maslahah* seems to be real and substantial.

However, as discussed earlier in Islamic financial ethics, in forming the basis of legislation, maslahah such as above is to be accorded a lower priority than the Quran, or the Sunnah, or Ijma. Among the various norms of ethics, the ones that are the most important are freedom from riba, gharar and qimar or maysir. Prohibition of riba, gharar and qimar are central to Islamic law of contracts in view of the strong Quranic

¹⁹ See " Al-Jahri and Munawar Iqbal (2001)"

condemnation of these elements. If the so-called risk management products are to be admissible in the Islamic framework, they would have to be free from these elements.²⁰ Clearly, fulfilling certain social needs or providing certain maslahah does not; by itself constitute a strong enough ground for permissive legislation.

The most significant objection against futures and options is that these are invariably settled in price differences only and never result in actual delivery of the object of exchange. How does one use derivatives for gambling, or speculation of a variety akin to a game of chance?

Let us consider the case of simple options, such as, a call option. A call option enables the buyer to magnify his returns if his expectations materialize. In the game the buyer and seller must have diametrically opposite expectations. The possibility of risk and returns are magnified, the gains of the buyer being equal to the losses of the seller and vice versa. Thus, the purchase and sale of options is a risky zero-sum game. It can be demonstrated how a buyer or seller in a forward or future can speculate on the direction of prices with no intention of giving or taking delivery of the object of exchange. Invariably, the transactions are reversed on or before the date of maturity and the game boils down to playing in price differences. The possibility of such gains encourages economic units to speculate on the future direction of the price of the underlying asset. Since prices of such assets fluctuate randomly, gains and losses are random too and the game is reduced to a game of chance. There is a vast body of literature on the predictability of stock prices, currency exchange rates etc. Prices and rates are volatile and remain unpredictable at least for the large majority of market participants. Needless to say, any attempt to speculate in the hope of the theoretically infinite gains is, in all likelihood, a game of chance for such participants. While the

²⁰ See " Mushtaq Ahmad (1983)"

gains, if they materialize, are in the nature of maysir or unearned gains, the possibility of equally massive losses do indicate a possibility of default by the loser and hence, *gharar*.²¹

The presence of large scale speculation is tolerated in conventional financial markets on the grounds of providing liquidity and ensuring vibrant and active markets. The speculators are seen to provide for the “other” end of the transaction whenever a hedger wants to hedge. Their presence is seen to improve operational efficiency of the market by bringing down transaction costs. However, in the Islamic framework, the provision of hedging facility is hardly an adequate rationale for tolerating qimar and maysir. The Shariah does not disapprove of hedging, since it brings in some maslahah. It is the zero-sum nature of the game that the Shariah finds objectionable, as in it, lay the roots of social disharmony and discord. Clearly, solutions to risk management problem need to be found elsewhere, and not through derivatives trading. Even from a conventional efficiency point of view, large-scale speculation may indeed threaten the stability and allocational efficiency of the system, though this line of argument may not easily find favor due to lack of empirical academic support.

5.3. Other Challenges

This phenomenal rate of growth is likely to be affected by a number of challenges:

- Shortage of experts in Islamic banking: The supply of trained or experienced bankers has lagged behind the expansion of Islamic banking. The training needs affect not only Arab domestic banks, both Islamic and non-Islamic, but foreign banks as well.

21 See " Ariff, Mohamed, Mannan, M.A. (1990)

- Absence of accounting (and auditing) standards pertinent to Islamic banks: Uncertainty in accounting principles involves revenue realization, disclosures of accounting information, accounting bases, valuation, revenue and expense matching, among others. Thus, the results of Islamic banking schemes may not be adequately defined, particularly profit and loss shares attributed to depositors. The need is to satisfy local generally accepted accounting principles (GAAPs), IFRS, and financial and prudential regulations, etc.
- Lack of uniform standards of credit analysis: Islamic banks have no appropriate standard of credit analysis. Similarly, there is a widespread training need involving related aspects such as financial feasibility studies, monitoring of ventures and portfolio evaluation.
- Differences with central banks: Islamic banks have been established as separate legal entities; therefore, their relationships with central banks and/or other commercial banks are uncertain. Problems may be further aggravated when an Islamic bank is established in a non-Muslim nation, and is subject to that nation's rules and requirements.
- Differences within domestic banks, foreign banks, and Islamic banks: It appears that domestic banks and foreign banks will experience continuing difficulty in adopting Islamic banking practices until they can become more confident of the results of investing ventures.
- Instruments that meet the demand of specific investment requirements: One of the biggest challenges facing institutions is the provision of short-term investment instruments. Several institutions

have tried to develop high quality short-term instruments, but have been hampered by their ability to generate assets, by their credit ratings, and by liquidity.

- The product development needs to be enhanced and moreover consistency is required in product structure.
- Improvement of corporate governance and risk management practice.
- Revision of usual tax regimes to meet the needs of Islamic products and create a level playing field with conventional products.

To fulfill this potential, the pressure remains on Islamic financial institutions to move toward additional and more sophisticated offerings for consumers who demand Shariah-compliant products. These consumers are making it increasingly clear that returns, service, and convenience of these offerings are just as critical as Shariah compliance.

Indeed, this is a clear measure of the progress the industry has made in a matter of years - no longer is there a perception that you should be prepared 'to pay extra' for Shariah-compliant products.

Historically, Shariah compliance was the primary issue among investors. The debate now encompasses additional issues such as quality of return, transparency of disclosure and excellence of customer service.

6. Conclusion

In the recent decade, the Islamic financial system has experienced remarkable growth and transformation, demonstrating its potential as a competitive form of financial intermediation. Today, Islamic finance represents a multi-billion dollar industry with

a comprehensive range of products and services, serving a broad spectrum of consumers and businesses that extends beyond the Muslim world.

In developing the Islamic financial system, it is important to focus on the appropriate pre-requisites that will facilitate its efficient evolution. Fundamental to this is the development of the institutions, the markets, the range of financial products and services and having in place the accounting, legal, regulatory, supervisory and shariah frameworks, as well as, for the monetary authority to have the capacity to manage its financial policies within this context.

With the development of these respective components having made significant progress, we are now seeing the Islamic financial services industry enter a new phase of development. Following increased liberalisation, the progress in the development of the international financial architecture for Islamic finance and the increased innovation resulting in the development of new products and services, the international dimension of Islamic finance is becoming increasingly more significant.

Islamic financial institutions are now also venturing their operations beyond their domestic borders. Islamic-based papers are also being issued in international financial markets, generating significant interest from global investors. The international financial architecture for the development of Islamic finance has also been strengthened with the establishment of the international boards to set the accounting and prudential standards. These developments have cumulatively evolved the Islamic financial system to increasingly become an integral component of the international financial system.

In Islamic banking, the management of risks becomes more challenging due to its peculiar risk characteristics and the requirement for compliance to Shariah principles.

The identification of usual risk factors have to be complemented with consideration of the other dimensions of risks that are inherent in the Islamic financial transactions. The risk management infrastructure in Islamic financial institutions needs to identify, unbundle, measure, control and monitor all the specific risks in the Islamic financial transactions and instruments.

Another facet to risk management is the need for the Islamic banking industry to develop a derivatives market. In the current increasingly uncertain global financial environment, investors need to be in a position to mitigate and manage these emerging new risks. Islamic banking institutions, in particular, have to large extent long-term assets which include long-term Islamic housing mortgages and Islamic financial instruments, that are funded by short-term deposits, thus giving rise to a maturity mismatch between the assets and liabilities. There is therefore a need for the development of a broader range of Islamic financial market instruments to provide the industry with effective risk mitigating instruments.

In addition to the derivatives market, the Islamic financial system also needs deeper and more efficient money and capital markets to facilitate sound asset and liability, and liquidity management by Islamic financial institutions.

Notwithstanding the significant progress made so far, there are still outstanding issues confronting the Islamic financial system today, particularly the different interpretations of the Shariah injunctions. Internationally, there continue to be debates among Shariah scholars on the compliance to the Shariah principles.

The development of a vibrant Islamic banking sector cannot be achieved without the support of appropriate human capital development. Underpinning the success of Islamic banking system is the strengthening of research and intellectual capacity in

the sphere of finance and Shariah. The Islamic banking industry needs to be equipped with a new breed of innovators, risk managers, regulators and supervisors who have the right blend of knowledge of finance and the understanding of the Shariah.

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Bulletin of Central Bank of Islamic Republic of Iran

International Banking System Report

International Monetary Fund Survey

Appendix: Islamic Financial System in Islamic Republic of Iran

Briefly, the process of Islamization of the banking system in Iran has gone through three distinct phases. In the first phase (1979-82), the banking system was nationalized, restructured, and reorganized in order to remove the weaknesses of the inherited system. External and internal developments in this phase did not allow the policymakers to develop a coherent plan for Islamization of the banking system, although various piecemeal attempts were made toward this objective.

The second phase began in 1982 and lasted until 1986. In this phase a legislative and administrative quantum leap was made in adopting and implementing a clearly articulated model of Islamic banking. The Law for Riba-Free Banking was passed in August 1983, giving a very short deadline of 1 year to the banks to convert their deposits in line with Islamic law and their total operations within 3 years from the date of the passage of the law. During this phase the central bank was implicitly envisioned as a quasi-independent economic institution similar to that in most Western banking systems, with a considerable degree of autonomy from the rest of the government. As in other countries, the central bank exercised extensive control over the operation of individual banks.

The third and current phase, which began in 1986, defines a role for the banking system different from the earlier phases, in that the system is now expected to be an integral part of the Islamic government and, thus, a direct instrument of its policies. This development is a direct result of the political debate within Iran surrounding the proper role of the government in an Islamic economy.

Much of the trend in Islamic banking in Iran has been influenced by factors that have their roots in the pre-Revolutionary economic structure, as well as post revolutionary external and internal political developments. The post revolution economy had

inherited a host of difficult economic problems. Before the revolution, the Iranian economy had become highly dependent on oil revenues as well as on importation of raw materials, intermediate goods, and food. The industrial sector was organized without due attention paid to efficiency or comparative advantage and with very weak forward and backward linkages to the rest of the economy. The agriculture sector, which was producing surplus commodities up until the late 1960s, began to contract, and there was a massive migration of farmers into the cities. Poor economic planning, influx of enormous oil revenues, and rapid increase in government expenditures stimulated the growth of a private sector enjoying import controls, exclusive licenses, low-interest loans, and low taxes on profits. The result of these policies was that at the time of the revolution Iran had a private sector that had a perception of its role in the economy quite different from that envisioned by the Islamic leadership of the country. The revolution brought with it a host of economic problems including, *inter alia*, massive capital flight, which almost led to the collapse of the banking and financial system. The problems began to multiply for the economy at a rapid pace as the revolution took root.

The economy, already vulnerable to internal and external shocks, faced the freezing of foreign assets, economic sanctions, interruptions in production. The constitution of the Islamic Republic specified objectives for the economy to be pursued-such as income redistribution, self-sufficiency in production, strengthening of the agriculture sector, creation of an active cooperative sector in the economy, and reduced reliance on oil revenues-all of which required fundamental restructuring of the society's economic behavior and institutions. The political objective of nonreliance on external

financial resources inevitably meant that the banking system would have to be relied on to play a role far broader than that of pure intermediation.²²

Table 5: Iran: Modes of Permissible Transactions Corresponding to Types Of Economic Activity

Type of Activity	Permissible Mode
Production (industrial, mining, agricultural)	<i>Musharakah</i> , lease-purchase, Salaf transactions, installment sales, direct investment, Muzara'ah, Musaqat, and Jo'alah
Commercial	Mudarabah, <i>Musharakah</i> , Jo'alah
Service	Lease-purchase, installment sales, Jo'alah
Housing	Lease-purchase, installment, Qard al-Hasanah, Jo'alah
Personal consumption	Installment sales, Qard al-Hasanah

SOURCE: Based on information supplied by Bank Marakazi (Central Bank of Iran).

Table 5 shows the various modes that facilitate financing of transactions in each line of economic activity. However, this table is only suggestive in that a bank can finance a given economic project with any, or a combination, of the permissible modes. For example, the Bank of Industries and Mines, which is an investment bank, breaks down the total financing requirements of a particular project into their various components in accordance with the size of each required amount of financing and with the gestation period. The component is then matched with a particular mode of financing. The objective is to reduce the burden of financing on the profits of the firm. For instance, the working capital requirement of the project may be financed with *Salaf*, machinery with lease-purchase, and production costs with *Musharakah*.

²² See " Mohsin S. Khan; Abbas Mirakhor "

Table 6: Asset side of banking system in Iran.

Numbers in billion I.R. Rial, 2006 / 2007

Facilities	Commercial Banks	Specialized Banks	Private Banks and Credit institutions	Total	Percent
Installment sale	291803.8	58751.3	11616.5	362171.6	34.1
Housing	111935.0	146895.7	48801.0	307631.7	29.0
Civil Partnership	66743.2	18500.6	40558.1	125801.9	11.8
Mudaraba	59425.2	2591.2	28610.5	90626.9	8.5
Salaf	49872.2	7011.7	305.3	57189.1	5.4
Qad al Hasanah	33323.3	626.9	497.3	40082.5	3.8
Leasse purchase	7101.7	1426.0	14755.0	23282.7	2.2
Legal Partnership	12789.5	6023.1	2583.4	21396.0	2.0
Joalah	17164.1	1372.4	2230.8	20767.3	1.9
Direct investment	9565.0	156.2	1761.8	11.483.0	1.1
Other	234.1	78.2	1688.7	2001.0	0.3
Total	659967.1	249068.3	153408.3	1062433.7	100.0

Source: Iran Economics Magazine

As it can be seen clearly from table 6, among all facilities, Installment sale and housing with 34.1 and 29 percent has the biggest share, respectively and Qard al Hasanah has the lowest share. The most part of Qard al Hasanah facility was given by commercial banks. In contrast, for private banks and credit institution Qard Al Hasanah with 497.3 billion Rials, after Salaf, is the lowest facilities among the others.