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In The Name of Allah,

The most Beneficent, The most Merciful

“O Believers: devour not Riba, doubled and redoubled;

and fear Allah, in the hope that you may get prosperity.”

Sura Ale-Imran (verse No. 130)

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1. Editor’s Note

2. Financing Public Infrastructure Using Sovereign Sukuk
   By Salman Ahmed Shaikh

3. The Concepts of Discounting and Time value of money in Islamic Capital budgeting Framework: A Theoretical study
   By Muhammad Abubakar Siddique and Memoona Rahim

4. Capital Adequacy, Liquidity and Risk: Is Islamic Banking Too Expensive?
   By Camille Paldi

5. Nigeria Economic Meltdown: Islamic Banking As A Sustainable Trend
   By Dr. Ibrahim Foudalmoula & Wasiu Aminat Abidemi

6. Comparative Analysis of Performance of Islamic Vis a Vis Conventional Banking of Pakistan during Global Financial Crisis 2007-2010
   By Dr Ambreen Zeb

7. Mutuality based Islamic Insurance
   By Prof. Dr. Abdul Azim Islahi

8. The Role of Religion in Islamic Bank Patronizing Behavior: A Survey in Mauritius
   By Muhamad Abduh Ph.D & Shaheen Ramjaun

9. Insights on Islamic Finance (Part - two)
   By Imran Hussain Minhas

10. Potential of Halal Industry for Maghreb Countries
    By Mohd Ali Mohd Noor & Mohammed Rizki Moi

11. Adoption of AAOIFI Accounting Standards: Case of Pakistan


14. News Monitor
“Hamdard”, meaning one who shares your grief and misery and provides comfort and relief is a friend indeed. Truly, for over a century, Hamdard has remained not only a compassionate companion but also a benevolent healer.

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Editor’s Note

According to the recent SBP survey, there is an overwhelming demand for Islamic banking in the country among both the rural and urban areas. The demand is evenly distributed amongst varied income groups and education levels. According to the analysis, demand for Islamic banking is higher amongst retail (95%) than businesses (73%).

To cater to the potential retail market, there is need to focus on increased outreach especially in the rural areas where masses of people live. The study indicates an important aspect about the outreach of Islamic banking as the individuals in rural areas or in low income brackets have relatively limited access to financial services. This highlights a huge opportunity for Islamic microfinance in rural areas. Although branchless banking has helped a lot in extending banking facilities in the countryside, yet a bulk of the population in remote or rural areas has no access to banking finance in Pakistan.

On the consumer finance front, Islamic banks have ample room to swell their market share after the consumer finance bust of 2007-09. During 2003-07, consumer finance segment was majorly dominated by the conventional banks, during a period of rapid monetary expansion and expansionary monetary policy set by the central bank of the country. But, the consumer finance bust led to the closure of various modes of consumer credit from the conventional banks while the Islamic banks surged in capturing the market in car and home finance. With ease in monetary policy in recent times, the Islamic banks stand to benefit once more with increased penetration in consumer finance segment with a much more extensive branch network in urban areas as compared to the 2003-07 period.

With an ambitious five-year plan, that regulators hope will double the industry's share of the banking sector to 20 percent by 2020, Islamic banking is well poised to continue the growth trend with sustained profitability. A growing client base and improving asset quality helped the Islamic banks post profits before tax of Rupees 12 billion ($119.1 million) in the third quarter of last year, almost double the year-earlier amount.

However, the Islamic banks need to improve their finance to deposit ratio so that the gap between spreads can be lowered in coming quarters to attract more clients towards Islamic banking with competitive products. Recently, the central bank has also urged the Islamic banks to reward customers in line with a rise in their profitability. Banks were advised to come up with their own solutions or the central bank will apply Shari’ah-compliant measures to address the issue. Such an ad hoc
measure will further exacerbate the perception about Islamic banking since usually the general public perceive that there is no difference in the treatment of Islamic and conventional banks by the regulator. Such an ad-hoc forceful decision to raise rates or impose penalty will do little to reduce that perception.

Many Islamic financial institutions appear among top five banks in their respective countries. In Pakistan, the largest Islamic bank is Meezan Bank, which is fast assuming mainstream prominence. Growth of Islamic banking in the country has been over 30% in the last few years, which is certainly above the average global growth rate of Islamic banking and finance. If this trend continues, then the ambitious target of 20% market share by 2020 does not look all that ambitious. If that target is achieved, the country will stand next to a number of Gulf countries and Malaysia where Islamic banking represents between 20% and 30% of the market share.

Now, the Islamic banking industry will soon have its own benchmark i.e. IBOR which has been approved in principle by the government as well as the financial regulators in Pakistan. This will help in improving the perceptions about Islamic banking since currently, the banks use the same conventional benchmark for pricing products, i.e. Karachi Interbank Offered Rate (KIBOR). This new benchmark will also deepen the money market for Islamic financial institutions and enable the central bank to deal with Islamic banks in Sukuk and other transactions using the Islamic benchmark.

This issue of Journal of Islamic Banking & Finance documents scholarly contributions from authors around the globe. Contributions in this current issue discuss the theoretical underpinnings of an Islamic economy, contemporary issues in Islamic finance and performance based empirical studies on Islamic banking and finance. Below, we introduce the research contributions with their key findings that are selected for inclusion in this issue.

Salman Shaikh in his article “Financing Public Infrastructure Using Sovereign Sukuk” discusses that since public infrastructure is important for economic growth, Government of Pakistan can use sovereign Sukuk financing to mobilize sufficient funds through which the public infrastructure can be provided in urban centers. He goes on to say that provision of public infrastructure is circularly related to investment, tax base and tax collection. Improvement in public infrastructure induces investment in the economy that can help in increasing the tax base with the entry of firms and increase in employment creation. As a result, increase in tax base can boost the government’s capacity to service sovereign Sukuk effectively.

In their study “The Concepts of Discounting and Time value of money in Islamic Capital budgeting Framework: A Theoretical study”, Muhammad Abubakar Siddique and Memoona Rahim, say that hitherto studies have accepted Time Value of Money as acceptable under Islamic Finance whereas in reality it is not. They discuss how Time Value of Commodity is an acceptable concept which explains away many of the objections that can be levied on Time Value of Money in the Islamic system.

The next article Capital Adequacy, Liquidity and Risk: Is Islamic Banking Too Expensive? By Camille Paldi aims to explore the risks involved in Islamic banking and determine whether or not this leads an Islamic bank to hold more regulatory capital. A bank’s capital provides a cushion for it to absorb losses and remain solvent. In addition,
it provides ready access to financial markets and thus guards against liquidity problems caused by deposit outflows. At the same time, the bank’s capital limits risk taking and reduces the risk of the bank’s assets. Islamic finance instruments pose a unique set of risks and costs, which must be taken into account when determining the amount of regulatory capital a bank must hold. The author explores the balance between these two objectives in Islamic Banks.

In their article “Nigeria Economic Meltdown: Islamic Banking as a Sustainable Trend”, Wasiu Aminat Abidemi and Dr. Ibrahim Foudalmoula from University of Science and Technology, Khartoum, highlight the problems that beset the economy of Nigeria, their causes and how the use of Islamic Finance can make Nigerian economy a robust one. While discussing this, they talk about the benefits of Islamic financial system and how each of the current economic problems can be addressed with use of Islamic financial principles.

The next article is contributed by Dr. Ambreen Zaib and is titled Comparative Analysis of Performance of Islamic Vis a Vis Conventional Banking of Pakistan during Global Financial Crisis 2007-2010. The article is based on her study which aims to conduct a comparative analysis of performance of the impact of global financial crisis on Islamic and conventional banking in Pakistan during the period in the context of the indicators of Profitability, Liquidity and Soundness.

In his article Mutuality based Islamic Insurance, Abdul Azim Islahi credits Dr. Muhammad Hamidullah (1908-2003) for discovery, editing and bringing to light a number of rare and invaluable Islamic manuscripts and reveals that a significant aspect of his contribution is his pioneering writings on Islamic Economics. Isahi explains that Hamidullah authored more than a dozen essays related to Islamic economics and was the first one to write about mutuality-based Islamic insurance, now known as 'takāfūl'.

Muhamad Abduh Ph.D and Shaheen Ramjaun of the International University of Malaysia, conducted a consumer behavioural study of the people in Mauritius’s port city of Port Louis in determining if religious beliefs predisposes them to choose Islamic Banking as an option. They discuss their study in “The Role of Religion in Islamic Bank Patronizing Behavior: A Survey in Mauritius”. They describe how they found that religion was not the predeterminant of choice of Islamic banking in Mauritius and that service and the utility of the banking products was more so the reason for using a banking system.

In Part 2 of his article “Insights on Islamic Finance” Imran Hussain Minhas describes what Riba free finance means, its introduction in the world and especially in Pakistan and the role that regulatory bodies - SECP and SBP have and can play in promoting Islamic Banking even further.

Mohd Ali Mohd Noor and Mohammed Rizki Moi in their paper on Potential of Halal Industry for Maghreb Countries discuss the potential of halal industry in Maghreb countries namely Algeria, Libya, Mauritania, Morocco and Tunisia where majority of their Muslims population practices Maliki school of thought. They argue that Muslim population in these countries being nearly 100 percent is a good indicator for a ready halal product market. Despite the huge number of Muslims population, their
contribution to the world halal market, is rather scarce and insignificant. This study involves primary and secondary data which was analyzed using the SWOT analysis to indicate the potential and the treatment for each country.

The last paper is on “Adoption of AAOIFI Shariah Standards: Case of Pakistan”. AAOIFI is one of globally recognized international bodies that prepare Shariah based accounting standard for the Islamic financially industry. AAOIFI based standards are generally considered globally acceptance and are adopted in various jurisdiction of the world. This article explains the different types of companies and how AAOIFI Shariah standards apply to each.

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The opinions, suggestions from our worthy readers are welcome, may be communicated on e-mail: ia_ib@yahoo.com / facebook link: http://www.facebook.com/JIBFK website:www.islamicbanking.asia
Financing Public Infrastructure Using Sovereign Sukuk

By
Salman Ahmed Shaikh

Abstract

Markets fail in the provision of public goods. Public goods are non-rival and non-exclusive. This creates the problem of free riding. Hence, public goods and infrastructure is often provided by governments. As discussed in endogenous growth models, the public infrastructure and capital goods can enable the private sector’s production processes to experience increasing returns to scale. This can result in permanent source of economic growth in an economy. Given that public infrastructure is important for economic growth, the issue is how the government of Pakistan can mobilize enough resources to improve the public infrastructure and expand it. We argue that by way of sovereign Sukuk financing, it can achieve sufficient funds through which the public infrastructure can be provided in urban centers. The rationale for financing sovereign Sukuk rests on the fact that public infrastructure development leads to positive externalities. Provision of public infrastructure is circularly related to investment, tax base and tax collection. Improvement in public infrastructure induces investment in the economy that can help in increasing the tax base with the entry of firms and increase in employment creation. As a result, increase in tax base can boost the government’s capacity to service sovereign Sukuk effectively. This can also help in reducing i) urban congestion, ii) urban crimes, iii) reduce prices of real estate, iv) widen the urban centers, v) generate employment in new urban centers, vi) facilitate closer migration to wide choice of urban centers, vii) create new growth nodes and production zones and viii) reduce ethnical conflicts that arise from ethnical diversity in congested urban centers.

Keywords Public Goods, Public Infrastructure, Public Finance, Sukuk, Islamic Bonds

JEL Code Q42, Q43, Q48

1. Introduction

Islamic finance is a growing industry that has penetrated Middle East and South Asia and now has entered Europe, Africa and North America (A. Khaleq & Richardson, 2013). Salman Ahmed Shaikh is a PhD scholar in Economics. He can be contacted at: islamic economicsproject@gmail.com
The product mix of Islamic finance has also widened from personal and retail commercial banking to alternatives for public finance, securitization, asset management, wealth management and syndicate finance.

Sukuk is an alternative Islamic finance instrument for conventional bonds. Sukuk is a certificate that represents ownership in underlying real asset(s). Islamic law does not permit interest and hence conventional coupon paying bonds are impermissible as per Islamic law. However, Islamic law allows sale and lease of real assets and the resulting income that arises in the form of profit on sale or rental income stream on lease of assets. Holders of Sukuk share in the lease or profit income generated from the ownership of real assets that the Sukuk certificate represents.

Wilson (2004) explains that transparency and clarity of rights and obligations are one of the distinguishing features of Sukuk. In Sukuk, the income from securities must be related to the purpose for which the funding is used and all Sukuk should be backed by real underlying assets. Figure 1 shows the trend in global Sukuk issuance from year 2000 onwards.

**Figure 1: Global Sukuk Issuance**

In the years to come, Sukuk could turn out to be an instrument of choice after the current financial crisis. Not only Muslim countries, but non-Muslim majority countries are also taking interest in it including Luxemburg, UK, Hong Kong and South Africa to name a few.

A typical sovereign Ijarah Sukuk would work like this. For instance, if government requires financing for public infrastructure, it will sell certain assets or piece of land in its
ownership and possession to an investment agency, i.e. a special purpose vehicle (SPV). SPV will issue Sukuk that can be purchased by institutional and/or retail investors. From the proceeds of Sukuk, SPV will purchase the assets or piece of land sold by the government. In a separate agreement, SPV and government will enter into a lease agreement which will provide the right to use the asset or piece of land by the government in lieu of making periodic lease payments. During the period of lease, the government will pay rents and these payments will generate income stream for the Sukuk holders who had invested in the Sukuk. After the lease period is over, the government will purchase the asset in a separate contract and this will enable the Sukuk holders to be able to redeem their investment. Figure 2 illustrates the process flow.

Figure 2: Process Flow of a Typical Sovereign Ijarah Sukuk

In Pakistan, capital markets are not as developed and most of the formal sector financing takes place through banks. Savings rate is very low (12%-14%) and the inflation rate on average has remained above 10% since year 2005. Capital market instruments require long term investment horizon and liquidity. Due to political instability and policy inconsistency, usually, the long term investments are not very popular among the investors. In the last few years, only a handful of IPOs have taken place. The bond market is also very small and dominated by sovereign issues than corporate bonds.

While risk averse investors have found comfort with bank investments even though banks do not offer inflation beating returns, most savers with adequate risk apatite look to invest in secondary market for equities. Karachi Stock Exchange had provided return of 48% and 49% in year 2012 and 2013 respectively. Hence, the less risk averse investors favor equity investments in liquid stocks for parking their surplus money.

There are many reasons why corporate bond market did not develop as per expectations in Pakistan. The national savings scheme instruments issued by the
government of Pakistan are offering very attractive yields and they are default free. Some national saving scheme instruments are also tax-free and hence after-tax yield on such instruments are even higher as compared to the corporate bonds.

Moreover, the corporate sector itself has lost confidence and interest for long term big investments in the country ever since the episode of nationalization in the 70s. Afterwards, indirect taxation and removing import barriers had also made corporate investment more challenging in the 80s and 90s. Then, the rise of industrializing countries on the external front together with energy and security crisis on the domestic front had resulted in even more challenging times for formal corporate sector businesses, especially in the manufacturing sector. As a result, neither new IPOs nor corporate bonds had much of a success in the country since the year 2007.

However, all is not bleak. Islamic banks have surplus liquidity and they have less choice of investment class assets for parking that liquidity. In Figure 3, it can be seen that Investment to Total Assets (INV to TA) ratio is much greater in Islamic banks than Finance to Total Assets (FIN to TA) ratio.

**Figure 3: Investment and Financing as Ratio of Total Assets of Islamic Banks**

![Figure 3: Investment and Financing as Ratio of Total Assets of Islamic Banks](image)

**Source:** SBP Islamic Banking Bulletin, Various Issues

More Sukuk issuance can increase the investment choices for Islamic banks and also enable them to have a wider market of firms looking for expansionary investment in lumpy assets. This will definitely help the steeply declining Finance to Deposit (FIN to DEP) ratio as shown in figure 4.
In Pakistan, 78 Sukuk have been issued so far for an amount of Rs 637.43 billion. Out of the total 78 issues, 32 Sukuk issues for an amount of Rs 100.10 billion have been fully redeemed. Government of Pakistan (GoP) had issued Ijarah Sukuk on numerous occasions in past to meet its escalating borrowing requirements. Government sector companies like Water & Power Development Authority (WAPDA) and Sui Southern Gas Company Limited (SSGC) had also issued Sukuk in past. Karachi Shipyard has also issued an Ijarah Sukuk in the year 2007.

Sovereign Ijarah Sukuk issued by the Government of Pakistan (GoP) have been structured in such a way that it allows the government to gain funds for meeting its expenditures. The Sukuk holders are also able to earn Shari’ah compliant income. It also facilitates Islamic banks to manage their liquidity as well as meet statutory liquidity requirement stipulated by the central bank of Pakistan. In 2014, Government of Pakistan has raised $1 billion from international debt markets through the issuance of five-year dollar-denominated Sukuk bond by pledging the Islamabad-Lahore Motorway.

In the corporate sector, Sitara Chemical Industries Limited, Wateen Telecom, Engro Chemicals, Dawood Hercules, Century Papers & Boards, Attock Generation Limited, Arzoo Textile, Liberty Power, Amreli Steels, Eden Builders, Quetta Textile, Pakistan American Fertilizers, PEL and Kohat Cement are some of the companies that have issued Sukuk in past.

Recently, K-electric (formerly KESC) issued Rs 6 billion Sukuk which is also listed on the Karachi Stock Exchange (KSE) and Lahore Stock Exchange (LSE). There was no Pre-IPO placement and the entire amount of Sukuk issue was offered to the retail investors and it was fully subscribed in a matter of few hours.
In recent times, Meezan Bank also arranged the country's first airtime-based Sukuk. This Sukuk uses intangible assets such as minutes of mobile telephone use as underlying assets. The structure of this Sukuk is based on Ijarah and sub-Ijarah of services. Assets are airtime (minutes) represented by prepaid calling cards and identified by the serial number of each card.

On the regulatory front, Securities and Exchange Commission of Pakistan (SECP) has issued guidelines for the issuance of Sukuk. According to SECP, the issuer must not have over-due loan and the issuer’s as well as the instrument rating should not be lower than triple B minus (BBB-).

SECP has decided that Sukus would be offered in three types, that is Sukuk-1 of up to Rs 750 million for a tenor of 13 months, Sukuk-2 of up to Rs 3,750 million for a tenor of three years and Sukuk-3 of Rs 1,500 million for a tenor of five years.

The SECP explained that the subscription period would be for three months. The rate of return on Sukuk-1 will be 1 month KIBOR plus 100 bps, Sukuk-2 will be 3 month KIBOR plus 225 bps and Sukuk-3 will be 3 month KIBOR plus 275 bps. KIBOR is Karachi Interbank Offered Rate and used as a benchmark in pricing financial products just like the use of LIBOR in the international markets.

Through issuance of more Sukuk, the investment class assets universe will expand and it will enable the Islamic-conscious individual and institutional investors to effectively diversify their portfolios. Treasuries of Islamic banks will also have an expanded set of investment avenues. It will increase liquidity of these Sukuk and generate wider interest among all investors in the economy to consider investing in these investment vehicles.

In most developing countries, the governments pay more than 50% of their tax revenues in servicing debt and spend very little on development. Often, these governments trim development spending to cover other non-discretionary current expenditures. Islamic banks can finance the Government of Pakistan (GoP) for the purchase of infrastructure that can be used in development projects. In Pakistan, as much as 2% of sovereign financing is now by way of Sukuk. These Sukuk can deepen Islamic money market and provide more investment alternatives to Islamic banks’ treasuries.

2. Infrastructure Deficit in Pakistan

Energy infrastructure in Pakistan has not kept pace with the growing demand of energy in a country with high population growth rate and increase in size of private sector since the deregulation program of 90s. With energy supply almost at a standstill with limited addition to capacity, the cost has been borne by households and firms with hike in energy prices and extended periods of load shedding. For estimating the cost of energy on output in Pakistan, Siddiqui et al (2011) estimated the cost of unserved energy using primary data from firms. According to their estimates, the overall industrial sector loss ranges between Rs 269 and Rs 819 billion. The figure roughly equals 1% to 3% of total GDP.
Provision of public infrastructure is circularly related to investment, tax base and tax collection. Improvement in public infrastructure induces investment in the economy that can help in increasing the tax base with the entry of firms and increase in employment creation. As a result, increase in tax base can boost the government’s capacity to service sovereign Sukuk effectively.

According to World Bank estimates, Pakistan has shortage of 8 million houses currently. It is also a known fact that population growth rate in urban areas is almost twice as much as the overall population growth rate. It is because urban population growth rate is amplified by the rate of net migration rate which is positive in most developing countries like Pakistan which are going through rapid urbanization process. Urban centric development projects also compliment the rapid urbanization process. This leads to increased cost of living in urban areas. Figure 5 shows the house rent inflation during the last 20 years.

Figure 5: House Rent Inflation during 1993-2012

The need of the hour is to develop new cities with comparable level of facilities available in other developed cities so as to reduce burden on already congested cities and their infrastructure. Once a city is developed, it has significant positive and network externality effects. But, the problem comes in developing new cities and their infrastructure. Since markets fail in the provision of public goods, government usually has to provide public goods and infrastructure. But, then the government itself has to fund these developments by raising sufficient amount of taxes.

In this paper, we discuss how sovereign Sukuk financing can enable the government to fund necessary public infrastructure. The increase in such infrastructure will induce accelerated private investment in the economy that can help the government to widen the tax base. In the next section, we present our mathematical model that explains the effect of improved public infrastructure (funded via sovereign Sukuk issuance) on the tax base and revenue collection. In section 3, we discuss the potential challenges that can be faced while applying sovereign Sukuk financing in Pakistan. Section 4 concludes the paper with discussion on the welfare benefits of applying sovereign Sukuk financing in Pakistan.
3. Mathematical Representation of The Model

In this section, we explain how developing public infrastructure can help the government to mobilize more revenues because of positive externalities associated with public infrastructure development. In our model, tax on property \( T \) function is based on two components, i.e. tax rate on property \( t_p \) and taxable base value of property \( BV_p \).

\[
T = t_p \times BV_p \quad \text{(1)}
\]

The taxable base value \( BV_p \) can be decomposed into its own components, i.e. number of properties in a locality \( N_p \) times market value of each property \( MV_p \):

\[
T = t_p \times \left[ N_p \times MV_p \right] \quad \text{(2)}
\]

In our model, the number of properties \( N_p \) is a function of three variables:

Urban population growth rate \( N_u \), which is a sum of natural rate of increase in population plus the net migration rate.

Level of public capital including physical infrastructure for sustaining basic urban lifestyle \( K_p \).

Net capital inflows \( NCI \) into the country which includes remittances and foreign direct investment in production sector. It may include foreign aid as well but it excludes foreign portfolio investment for our model.

\[
N_p = f(N_u, K_p, NCI) \quad \text{(3)}
\]

\[
\frac{\partial T}{\partial N_p} > 0 \quad \text{and} \quad \frac{\partial T}{\partial BV_p} > 0 \quad \text{which implies that} \quad \frac{\partial T}{\partial N_p} > 0 \quad \text{and} \quad \frac{\partial T}{\partial MV_p} > 0
\]

Assuming a simple Cobb-Douglas functional form for \( N_p \), we have:

\[
N_p = N_u^\alpha K_p^\beta NCI^\gamma \quad \text{(4)}
\]

We can represent \( MV_p \) as a function of \( K_p \) and governance \( G \):

\[
MV_p = K_p \times G \quad \text{(5)}
\]

If we put (4) and (5) in (2), we get:

\[
T = t_p \times \left[ N_u^\alpha K_p^\beta NCI^\gamma \times K_p \times G \right]
\]

\[
T = t_p \times N_u^\alpha K_p^\beta NCI^\gamma \times G
\]
Finally, assuming a Laffer curve relation between $t_p$ and $T$, we put $t_p^\delta$ in place of $t_p$ where $\delta < 1$ for diminishing marginal contribution in taxes of increase in $t_p$.

$$T = t_p^\delta \times N_p^\alpha \times K_p^{1-\beta} \times NCI^\gamma \times G$$ --- (6)

In our model, $\beta > 0$ and hence $1 + \beta > 1$ and hence we have increasing returns in taxes with additional investment in public infrastructure $K_p$. In our model, $\gamma > 0$ and has no upper bound as it is possible to have a value greater than 1 for $V$ especially in developing countries with high rates of growth. Lastly, we assume that $G$ will also be positively related to $MV_p$ and hence also with amount of $T$ that can be collected in the economy.

Hence greater the value of $\alpha$, $\beta$, and $\gamma$ and base values of $K_p$ and $NCI$, greater will be the value of $N_p$ and hence a circular complimentary process will lead to increase in both $N_p$ and $T$, leading to more accumulation of $K_p$ and subsequent increase in $MV_p$ in an iterative process.

4. Why Investment in Public Infrastructure is Low in Pakistan?

Pakistan has one of the lowest tax to GDP ratio in the world. It is a country where less than 2% people in the population are registered tax payers. Such low tax collection results in a weak government with a limited capacity to provide public goods including public infrastructure like roads, dams, power plants, warehouses etc. Studies in tax administration and policy in developing countries had been undertaken in past and in general, low tax collection and low tax to GDP ratio in developing countries had been attributed to low documentation, low level of monetization, lack of industrial base and lack of openness (Ahmed, 1994).

Pakistan is classified as a lower to middle income country by IMF and it is ironic that among those countries, Pakistan has lowest tax to GDP ratio, i.e. 9.5%. What is more concerning is the fact that the trend of the dismal tax to GDP ratio has shown even further decline in recent years. Chaudhry & Munir (2010) explained that determinants of low tax revenue in Pakistan include narrow tax base, more dependence on agriculture sector, devaluation, foreign aid, informal economy and low level of literacy rate. They opined that low tax revenue in Pakistan owes to large traditional agriculture sector and other ‘hard to tax’ sectors such as small business and shadow economy. Ahmed (2010) mentioned that rent seeking in tax administration has also led to dismal tax collection in Pakistan.

Figure 6 presents tax to GDP ratio and it shows that the ratio has decreased consistently in last two decades in Pakistan. Still, the income tax collection is not as broad based as it should be and lack of documentation and ‘un-documentation’ due to stringent conditions for formal sector has resulted in slow progress in the expansion of tax base.
Figure 6: Tax to GDP Ratio (%)

Source: Ministry of Finance

Figure 7 presents Pakistan’s tax to GDP ratio in comparison to the other regional countries and also in comparison to the average for the world as a whole, middle income countries and high income countries. Comparison shows that Pakistan’s tax to GDP ratio is lowest in comparison to the regional countries.

Figure 7: Comparison of Tax to GDP Ratio Globally (% of GDP)

Source: IMF

Due to low tax to GDP ratio, the fiscal deficit has remained largely above 4% of GDP leaving little room for development expenditure as most of the tax and non-tax revenues are eaten up by current expenditure. Development expenditure has in most periods declined with the rise in fiscal deficit as can be seen in Figure 8.
5. Welfare Benefits of Sovereign Sukuk in Pakistan

Growth literature highlights the importance of capital formation, complimentary investments and physical and social infrastructure. The long term growth literature from Harrod (1939)-Domer (1946), Solow (1956) and Romer (1986) is almost unanimous on the role of savings and capital accumulation for long term economic growth. Endogenous growth theory sheds light on importance of complimentary investments and public infrastructure that can not only result in increasing returns to scale, but also lead to permanent source of continued long term growth.

As discussed in endogenous growth models, the public infrastructure and capital goods can enable the private sector’s production processes to experience increasing returns to scale. The rationale for sovereign Sukuk financing rests on the fact that public infrastructure development leads to positive externalities. If Government owns the unused land which can potentially be used for commercial and residential use, it can lease it on long term basis and generate sufficient lease income. By issuing public securities, it can generate the seed capital and which can be serviced via these lease payments. The seed capital can also come from sovereign Sukuk financing.

The government of Pakistan has been running a huge budget deficit at 8.6% of GDP. In case of Pakistan Railways, the government could develop a long-term Sukuk program to raise $10-20 million over a period of 10 years to modernize and expand railway infrastructure. Similar modernization programs can be instigated with sovereign Sukuk financing in other loss making state owned enterprises to turn them around so that the burden on fiscal exchequer can be reduced.

Conclusion

In this paper, we discussed how the government of Pakistan can mobilize enough resources to improve the public infrastructure and expand it by using sovereign Sukuk...
financing. The rationale for sovereign Sukuk financing rests on the fact that public infrastructure development leads to positive externalities. Provision of public infrastructure is circularly related to investment, tax base and tax collection. Improvement in public infrastructure induces investment in the economy that can help in increasing the tax base with the entry of firms and increase in employment creation. As a result, increase in tax base can boost the government’s capacity to service sovereign Sukuk effectively. This proposal can also help in reducing i) urban congestion, ii) urban crimes, iii) reduce prices of real estate, iv) widen the urban centers, v) generate employment in new urban centers, vi) facilitate closer migration to wide choice of urban centers, vii) create new growth nodes and production zones and viii) reduce ethnical conflicts that arise from ethnical diversity in congested urban centers.

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Memoona Rahim

Abstract:
The concept of discounting is a most important issue in the world of economics and finance from both conventional and Islamic perspective, because it relates to capital and interest. Islamic finance cannot depend on the conventional techniques of capital budgeting because of interest. Conventional capital budgeting techniques involve time value of money and discounting the future cash flows in this respect which is strictly prohibited in Islam. There are two aspects of discounting: evaluation tool and consideration. A few scholars have discussed the time value of money and discounting in different aspects but all studies ignored the role of discounting as an evaluation tool. They also did not distinguish the time value of money from the concept time value of commodity. The purpose of this study is to answer the question whether discounting as an evaluation tool is permissible in Islamic perspective or not? The study will also differentiate the time value of money from time value of commodity. The study also clarifies that there is no objection in taking time value of money just for sake of capital budgeting and what is prohibited is time value of money taken as consideration.

Keywords: Capital budgeting in Islam, Time value of Money, Discounting in Islam, time preference theory, Functions of Money

1. Introduction
It is the need of the time to reconsider classical techniques of capital budgeting especially in Islamic finance perspective, because there are many Shariah issues in project evaluation techniques of conventional financial system. For example, discounting which bothers the Muslims faith and mind. Conventional capital budgeting techniques involve time value of money and discount the future cash flows in this respect which is strictly prohibited in Islam.

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There are two aspects of discounting; evaluation tool and consideration. There are a few studies e.g. Zarqa (1983), Azhar (1986), Khan (1991), Kahaf (1994), Siddique (1996), Hassan (2004) and Nurrachmi et al (2012), which have discussed the time value of money and discounting in different aspects but all studies ignored the role of discounting as an evaluation tool. They also did not distinguish time value of money from time value of commodity. The purpose of the study is to answer the question whether discounting as an evaluation tool is permissible or not? The study will also differentiate the time value of money from time value of commodity. The study further clarifies that there is no objection in taking time value of money just for sake of capital budgeting and what is prohibited is time value of money taken as consideration.

2. Literature Review

2.1. Discounting and Time value of Money

There are two main problems all the time; limited resources and unlimited objectives. To address the issue, conventional finance uses the techniques of discounting the cash flows based on the concept of "time value of money" which is strongly opposed in Islamic perspective. Though there are some authors who believe in the permissibility of discounting. According to Zarqa (1983), rate of return on projects, which are running and are equally risky, can be taken as benchmark for the discount rate for evaluation of any new project, but he did not address whether Islam considers the time value of money permissible or not.

Azhar (1986) suggested that profit rate would be the suitable rate of discount in an Islamic economy, but the interest rate is not appropriate for this purpose. His conclusion lost its Islamic sense, because he used conventional assumptions of perfect foresight and lack of uncertainty (Khan, 1991). It could be Islamic or close to the Islamic perspective by using just foresight. He also did not distinguish the concept, nature and principles of time value of money according to the nature of contracts e.g. loan and investment. Furthermore, he concluded that money is not subject to any return if it is in currency form, but will be entitled to return if it is transformed into a real asset which, according to Khan (1991), does not reflect the correct Islamic position about return on money capital. Khan (1991) argues that it is quite possible in a business enterprise that a partner is entitled to profit though his cash is yet in putty form and business made profit from another partners investment. This logic presented by Khan (1991) is wrongly footed because profit earned by a partner whose cash remained in putty form cannot be said to profit which is earned on cash only as he supposed. Khan (1991) also presented another example that if an amount of money loaned to a business enterprise with principle amount guaranteed is not entitled to any return even if money is transformed into clay. Again the logic presented by Khan (1991) is wrongly footed because after the loan is issued to the borrower, loaned amount does not belong to the lender that is why he is not entitled to any return or profit, but borrower in his capacity as an investor of business will be entitled to profit.

Masri (1986) focused on the time value of money and discussed in detail. He concluded that time value of money is permissible; however he ignored the nature of relationship between time value of money and interest. His results would have been changed, if he had considered this nature of relationship. He also ignored the proper

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1 "Perfect foresight" means that people "optimally" forecast the future based upon what they know now.
determinant of the time value of money and hence of the discount rate in an Islamic economy.

Khan (1991) tried to establish that time value of money is not prohibited in general but in specific instances. According to him fixed predetermined time value of money is not allowed in Islam. He also confirmed this view with Fiqh principle "no compensation for time (alone)" without any reference. Furthermore, he explained his view with different examples regarding Salam and bay muajjal etc and confused time value of money with time value of commodity. All examples presented by him are related to time value of commodity, but he proved his idea about time value of money. He explained the reason behind the high price of a good obtained through bay muajjal with the help of two assumptions; Time preference\(^2\) and Supply-Demand conditions\(^3\) and suggested that *ex-post* time value of money is permissible in Islam and there is no space for *ex-ante* time value of money. Whereas this explanation involves the concept of time value of commodity not time value of money. Moreover, he seemed to express that time preference is consumption based phenomenon only.

Khan (1991) also proved his conclusion with the help of positive time preference theory and considered it a rational option for an economic agent in an Islamic economy. According to him, Islam does not deny to have a positive time preference. However, it is more sensible to assume the time preference as a function of time. He refused to accept other time preference theories e.g. zero and negative. Batcha (2009) is also of the view that Islam recognizes the idea of positive time preference, whereas very long ago, Fisher (1954) proved that zero and negative time preferences were possible with their own conditions. Zarqa (1983) also discussed the consumer time preference theory and concluded that it is neither a principle of rationality nor empirically established predominant trend among consumers. It is simply one of three patterns of inter temporal choice; positive, negative and zero time preference, each of which is rational and observable under its own conditions. He further concluded that it is not necessary that time preference are predominantly positive, because it does not justify always to discount the future costs and benefits to evaluate a project. However, he argued that discounting is one of the explicit requirements for efficiency in investment in both the private and the public sectors. He suggested that for private projects, the rate of return on projects with similar risks should be an appropriate rate of discounting. For public projects, the discount rate should be adjusted downward to reflect the common view that such projects are less risky and that the objectives are more complex.

Kahaf (1994) critically analyzed Khan's paper (1991) and raised questions and answered them in his own way, but he partially agreed with Khan that time value of money was a permissible concept. He highlighted that the time value of money was an investment phenomenon rather than consumption phenomenon and its valuation can only be realistic if it takes place at the end of investment when its outcome becomes known. Any evaluation before that point is only illusionary. However, illusion can be used for mental operation but must not be exchanged for actual goods and services. He denied the

\(^2\) Time preference means one may not be indifferent between the same value at two points of time i.e. $100 now may not be same as $100 after a year because of the time element involved.

\(^3\) One may assume that the supply-demand conditions and hence price in future may be different than the present conditions and price.
notion presented by Khan that paying wages and rents is practically the same as recognizing money’s time value. Disproving the idea that bay Muajjal is considered on the basis of demand and supply forces, he suggested that the legality of bay Muajjal and bay Salam can be rationalized along the lines of Musharakah, Mudaraba, and Ijarah on the basis of ownership and the distinction between money’s anticipated and realized time value.

Siddiqui (1996) observed that usually people may not have pure or complete positive time preference. According to him, what may emerge as a pure time preference may not be a preference for present consumption over future consumption, for people are generally not irrational or unmindful of their future needs. He disagreed with Kahaf and stated that bay Muajjal is neither similar to Mudaraba or Musharakah nor could its permissibility be linked to bay Salam.

Ahmad and Hassan (2004) are also of the view that time value of money is an investment concept. According to them, Shariah does not deny this concept because it doesn't forbid any increment in a loan issued to cover the price of a commodity in any sale contract to be paid on any future date, but making money's time value a part of any lending relationship that make it predetermined value is prohibited. Finally they conclude that time value of money is a permissible concept if it is used in asset pricing and their usufruct, but not acceptable in the case of any increment to the loan or debt. Like others, they are also confused between time value of money and time value of commodity. They used examples of Salam and Istisna and tried to prove the permissibility of time value of money in Islamic perspective.

After deep analysis, it becomes very clear that everyone is ignoring the status of money in Islamic perspective. So it is necessary to mention status of money in Islamic perspective and to differentiate the time value of money from time value of commodity to keep the research pattern right and smooth in this regard.

3. Status and Functions of Money

In conventional perspective, Money is a commodity. It is most liquid asset and can be used as a medium of exchange. It also stores its value with respect to time (Ikass, 2009). Whereas Money does not keep any intrinsic value and has no ability in itself to satisfy any human need unless it is used to obtain anything. Money can only be used as medium of exchange and unit of account, but does not store its value in Islamic perspective (Meera, 2002, Ahmad and Hassan, 2004 and Mohsin, 2009).

It becomes clear that money has no intrinsic value so cannot be said to be a commodity and that is why it cannot be sold more or less than its face value, otherwise it would be Riba. By deep analysis, it becomes clear that one makes profit on a commodity on behalf of its intrinsic value, for example if someone buys an apple for Rs. 10 and sells it for Rs. 15, it means that the additional Rs. 5 is made against intrinsic value of a commodity and this is an acceptable rationale, while there is no rationale in the sale of a currency note of Rs. 10 for Rs. 15. Moreover, it is not necessary that intrinsic value always causes an increment and profit, it can result otherwise also, but it depends on environment, condition of subject matter, supply and demand forces etc. But no one can justify the increment against a thing having no intrinsic value and it also does not make a sense. Finally, money can only be used as medium of exchange and does not store its value in an Islamic perspective.
4. **Time value of Money vs Time value of Commodity**

Time value of money is a term introduced by conventional economics, while time value of commodity is a new term and an Islamic concept not used in previous literature. The main difference between the two is that former leads to Riba and latter leads to legal profit.

Time value of money means that money available today is worth more than the same amount tomorrow due to its potential earning capacity (Mohsin, 2009). This core principle of finance holds that, one would prefer to receive money today rather than the same amount tomorrow, for example Rs. 2,000 today is not the same as Rs. 2,000 after a year, because one can utilize one year to earn some profit, say Rs. 500, on Rs. 2,000 and can raise to total Rs. 2,500, which is far better than Rs. 2,000 after a year without any increment irrespective of whether nature of the contract is loan or investment. Therefore a rational individual would prefer the former than the latter. In conventional paradigm, it is also a time value of commodity because money is a commodity which stores its value, so increment is justifiable, whereas in Islamic perspective till this stage it is the concept of time value of money. But when one justifies that one can purchase a commodity for Rs. 2,000 today, will get it at Rs. 2500 tomorrow, it remains no more time value of money but time value of commodity provided that deal must be done in commodity e.g. Salam, Istisna and credit sale (bay Muajjal). All examples presented in previous literature in this regard are related to time value of commodity, but has been confused with permissibility and acceptance of time value money.

5. **Capital Budgeting in Islamic Financial system**

Capital budgeting is the process through which one may reject or accept a project. Capital budgeting may cause negative effects on cash flow and financial implications, if it is not deliberate, so it is a very important concept (Johnson, 1999; Du Toit and Pienaar, 2005). Investment analysis usually involves the discounting of cash flows as a main element (Vivers and Cohen, 2011). Discounting is a procedure through which one evaluates projects and makes ones preference regarding acceptance or rejection of a project, so rationale does not deny the discounting as a procedure of evaluation or evaluation tool.

Reconsider the example of time value of money, if one think that Rs. 2,000 today is not the same as Rs. 2,000 after a year, because one can utilize one year to earn some profit, say Rs. 500, on Rs. 2,000 and can raise to total Rs. 2,500, which is far better than Rs. 2,000 after a year without any increment. So on for this reason one prefers Rs. 2,000 today over Rs. 2,000 tomorrow. It would be a rational choice and Islam does not object to it. Islam will object only when one will prefer Rs. 2,000 tomorrow with guaranteed Rs. 500 potential profit today or tomorrow whether it is a loan or investment contract. It means one is making Rs. 500 a consideration against Rs. 2,000 which is prohibited.

So discounting would be treated in the same way. If discounting is being used as an evaluation tool then it is alright and Islam has no problem with it. If discounting is taken as consideration then it would be *haram* in Islamic perspective. So discounting to evaluate the projects for comparison and to make a decision regarding accepting or rejecting the project is permissible. But discounting the bills e.g. bill of exchange is prohibited because discounting is taken as a consideration which is Riba. What is prohibited and *haram* in Islam is taking discounting as a consideration, but as an evaluation tool discounting is not an objectionable phenomenon.
6. Conclusion

The concept of time valuation is possible only in business and trade of goods not in exchange of monetary values and loans or debts. Therefore, no time value can be added to the principal of a loan, or a debt after it is created or the liability of the purchaser stipulated. The important conclusion in view of Islam is, time value of money is not acceptable, while time value of commodity is acceptable. Unlike time value of money, the concept of time value of commodity implies that there are possibilities for positive, negative and zero time preference according to the circumstances and other important variables e.g. supply and demand forces.

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Capital Adequacy, Liquidity and Risk: Is Islamic Banking Too Expensive?

By Camille Paldi*

Abstract

This paper explores the risks involved in Islamic banking products. It argues that Islamic finance instruments pose a unique set of risks and costs, which must be taken into account when determining the amount of regulatory capital a bank must hold. Riskier products require higher capital charges; therefore, Islamic banking is more expensive than its conventional counterpart and requires more regulatory capital. In addition, the existing assets of Islamic banks are not as liquid as compared to conventional banks and due to slow development of financial instruments; Islamic banks are unable to quickly raise funds from the markets. One means of obtaining liquidity is through the securitization of Islamic financial contracts, which requires the establishment of an Islamic secondary market. This would increase liquidity and allow banks to start moving away from murabahah. Furthermore, since the existing lender of last resort (LLR) facility is based on interest, Islamic banks cannot utilize LLR facilities. Hence, illiquidity and liquidity risk are major problems for Islamic banking, which also makes it necessary for banks to hold more regulatory capital.

Keywords: Islamic Banking, Risk Management, Regulatory Capital, Liquidity Risk

Introduction

The aim of this paper is to explore the risks involved in Islamic banking and determine whether or not this leads an Islamic bank to hold more regulatory capital. A bank’s capital provides a cushion for firms to absorb losses and remain solvent. In addition, it provides ready access to financial markets and thus guards against liquidity problems caused by deposit outflows. At the same time, the bank’s capital limits risk taking and reduces the risk of the bank’s assets. Islamic finance instruments pose a unique set of risks and costs, which must be taken into account when determining the amount of regulatory capital a bank must hold. The amount of regulatory capital is

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determined by each financial intermediary in light of the regulator(s), the IFSB and Basel II capital adequacy standards (not less than 8%), liquidity risk, and the bank’s liquidity function, one of the key functions of the bank. (Haron and Lee Hin Hock 2007:97) The 2nd pillar of Basel II ensures that a bank’s capital position is consistent with its overall risk profile using market-based risk weights and enables early intervention by supervisors. Supervisors have the ability to require banks to hold capital in excess of the minimum regulatory requirement. Riskier products require higher capital charges (Ahmed 2011:156), therefore, Islamic banking is more expensive than its conventional counterpart and requires more regulatory capital. As the objective of financial institutions is to maximize profit and shareholder wealth (Ahmed 2001:25) while containing risk, true Shari’ah banking may be difficult to implement due to risk and cost.

In addition, the existing assets of Islamic banks are not as liquid as compared to conventional banks and due to slow development of financial instruments, Islamic banks are unable to quickly raise funds from the markets (Ahmed 2001:149) exacerbating liquidity risk. According to Vogel and Hayes, one means of obtaining liquidity is through the securitization of Islamic financial contracts, which requires the establishment of an Islamic secondary market. (1998: 238) This would increase liquidity and allow banks to start moving away from murabahah. Furthermore, since the existing lender of last resort (LLR) facilities are based on interest, Islamic banks cannot utilize LLR facilities and most Islamic banks do not have formal liquidity management systems in place. (Ahmed 2001:149) Hence, illiquidity and liquidity risk are major problems for Islamic banking, which also requires banks to hold more regulatory capital.

**Risks of Islamic Financing Instruments**

In *murabahah*, the IFI is exposed to credit risk in that the customer may default in payment (Haron and Lee Hin Hock 2007:96) and the bank is liable for any loss arising from damage of the goods prior to delivery. (Ahmed, 88: 2011) Also, the bank cannot charge anything in excess of the agreed upon price even due to late payment. (Ahmed 2001:54) Despite credit risk, *murabahah* has low liquidity and operational risk making it a preferred mode of short-term finance among banks promoting liquidity and allowing for lower levels of regulatory capital.

In *salam* financing, the IFI is exposed to credit/counterparty risk in the event that goods are not delivered or delivered on time according to specification after payment is made. The IFI is exposed to market (price) risk on the goods in that the spot price on delivery may be lower than the amount paid. (Haron and Lee Hin Hock 2007:98) Furthermore, the commodities require inventories exposing the banks to storage costs and other price risk. (Ahmed 2001:55) In the event of default, the IFI may not be able to recover its capital from customers and/or the financial guarantee may not cover the full amount of *salam* capital. (Haron and Lee Hin Hock 2007:96) With regard to parallel *salam*, if the supplier under the *salam* defaults on delivery, the IFI may have to purchase the goods in the open market in order to meet its delivery obligation under parallel *salam* for a price higher than the original. (Haron and Lee Hin Hock 2007:98) However, parallel *salam* allows the IFI to sell the commodity for future delivery at a predetermined price, thus hedging the price risk on the original *salam* and protecting the IFI from having to take delivery of the commodity and warehousing it. (IFSB 2005: 25) *Salam* poses high credit, market, liquidity, and operational risk and has a high capital charge requiring high levels of capital, however, the risks may be mitigated by use of parallel *salam*.
In *istisna’a*, the IFI faces market risks if the costs of production rises and credit risk if the buyer either declines to accept the goods or defaults on payments. (Ahmed 2011:89) The counterparty risks include failure to meet the quality and time of delivery terms of contract and not receiving the selling price of the asset from the customer either in pre-agreed stages of completion or upon full completion of the manufacturing or construction process. (IFSB 2005: 28). In parallel *istisna’a*, the IFI assumes the completion risk associated with the failure to complete the project, delay in completion, cost overruns, *force majeure*, and unavailability of qualified subcontractors. *Istisna’a* displays high credit, market, liquidity, and operational risk and has a high capital charge, which may require high levels of regulatory capital. *Salam* and *istisna’a* are expensive as they are risky and require Shari’ah mechanisms to hedge price risk, which are currently unavailable. However, these risks may be mitigated through use of parallel *salam* and *istisna’a*.

In operating *ijarah* and *ijarah muntahia bittamleek* (IMB), all risks pertaining to the leased asset are borne by the IFI, except for the residual value risk at the term of an IMB, which is borne by the lessee. The lessor is exposed to market (price) risk on the asset while it is in the lessor’s possession prior to the signature of the lease contract, except where the asset is acquired following a binding promise to lease. (IFSB 2005: 33) The lessor is exposed to credit risk of the lessee as counterparty in servicing the lease rentals and market (price) risk attaching to the residual value of the leased asset at the end of the *ijarah* contract or at the time of repossession upon default. (IFSB 2005: 33) *Ijarah* has a high credit, market, and liquidity but low operational risk. However, off-balance sheet modes of finance such as *ijarah* may mitigate risks by nature of off-balance reporting requirements and ratios effect. Furthermore, leases do not require the same level of investigation and audit of the lessee’s affairs as would an investment made in the lessee’s enterprise, making it an attractive form of finance. (Vogel and Hayes 1998: 190) In addition, financial *ijarah* actually produces financial leverage and operating leases can be used to gain capital structure leverage. (Vogel and Hayes 1998: 188) Therefore, *ijarah*, although risky and expensive, may not require high levels of capital.

In *musharakah*, the IFI is exposed to credit risk in respect of the customer’s purchase payments as well as to the risk attaching to the IFI’s share of the underlying asset in the transaction. (IFSB 2005: 38) The IFI is further exposed to entrepreneurial risk of the managing partner (IFSB 2005: 38) and the risk that the manager may not report actual profits generated. (Ahmed 2011:93) The IFI may face a risk when a withdrawing partner owes money and if a venture enters bankruptcy, the IFI may be exposed to the risk of losing its entire invested capital, as this capital ranks lower than debt instruments upon liquidation. In the case of diminishing *musharakah*, the amounts due from the partner to purchase the agreed shares of the asset on the agreed dates are subject to credit risk in respect of the partner’s ability and willingness to pay, with the shares of the partner in the asset providing credit risk mitigation as collateral. The capital invested by the IFI is also subject to risk that the amounts recoverable from the partner may be less than the amount invested because the value of the *musharakah* assets has decreased. (IFSB 2005: 39) *Musharakah* has high credit, market, liquidity, and operational risk and high capital charge making it one of the costliest Islamic modes of finance to implement and requires high levels of regulatory capital.

In *mudharabah*, the IFI is exposed to capital impairment risk if the venture incurs losses or if the *mudarib* defaults on payments due to the *mudharabah*. Furthermore, if a
customer cancels the agreement to purchase, the IFI has to sell the goods in the open market at a possibly lower selling price than the purchase price. Alternatively, the IFI may have to hold the goods and incur storage costs. (Haron and Lee Hin Hock 2007:98) Mudharabah has a high credit and market risk, but low liquidity and operational risk rendering it more feasible for implementing than musharakah at this time in terms of cost and required regulatory capital.

**Conclusion**

Islamic banking is less liquid and more expensive requiring higher levels of capital as Islamic modes of finance are riskier and are based on undertaking real transactions. Furthermore, banks are expected to take a degree of ownership in risks. Therefore, Islamic banks may need to keep additional capital for the moment while developing internal control and Shari’ah products, risk management techniques, and measures to enhance liquidity such as a secondary market. However, the amount of regulatory capital held by each IFI is the regulators and management’s decision based on risk, regulation, and liquidity taking into account the capital charge of the particular mode of finance.

**Bibliography**


Nigeria Economic Meltdown: Islamic Banking As A Sustainable Trend

By
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Dr. Ibrahim Foudalmoula

ABSTRACT

Nigerian economy is facing the most severe financial crisis since the Great Depression of the last century of global economic meltdown and if this situation continues to deteriorate, Nigeria would be in great jeopardy. This paper seeks to assess the Economic meltdown in Nigeria Economy and investigates whether Islamic banking has the ability to withstand the challenges of the economic meltdown in the face of the current crisis facing the Country.

Islamic banking is one of the principles of Islamic economics system which cater for welfares’ of the citizen of a particular country. This paper seeks to highlight the extremely useful contributions and confirms a lot of the economic benefits that Islamic banking can offer to Nigerian economy if its challenges is been taken care of.

The paper is both descriptive and exploring possibilities and constraints of inherited situations by applying critical thinking and analysis through the published literature in Islamic finance and does not include empirical investigation. The information used was extracted from both primary and secondary sources especially newspapers, magazines, and books. Some data were also accessed from Internet on global economic meltdown. Journals were also accessed through electronic means in libraries and the web.

The paper however suggests that for these economic benefits to be actualized and in order to think through how to prevent future financial collapses and make capital markets work more effectively, Central Bank of Nigeria (CBN) and the government respectively needs to address the regulatory and operational measure so that Nigeria could lay the foundation to become a leader in Africa in terms of economic growth.

Keywords: Islamic Banking, Economic meltdown, sustainability.

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1. Introduction and Background

Economic meltdown is an unexpected but accelerated financial system failure resulting in drastic reduction in economic activity. It is when the economy of a country is in bad shape, inflation is high, so in unemployment, property values drop, and companies go under, causing a recession or depression.

Emma (2014), “the concept epitomizes the current economic scenario where virtually all countries of the world have been severely affected. Consequently, the gross domestic product (GDP) of countries has gone into the negative zone, generally characterized by severe liquidity crunch, giving rise to diverse economic intervention programmes”.

The global financial crisis, brewing for a while, really started to show its effects in the middle of 2007 and into 2008. Around the world stock markets have fallen, large financial institutions have collapsed or been bought out, and governments in even the wealthiest nations have had to come up with rescue packages to bailout their financial systems. The global financial crisis began in the United States of America and the United Kingdom when the global credit market came to a standstill in July 2007 (Avgouleas, 2008). The crisis, brewing for a while, really started to show its effects in the middle of 2008. Around the world, stock markets have fallen, large financial institutions have collapsed or been bought out, and governments in even the wealthiest nations have had to come up with rescue packages to bail out their financial systems. Ogundipe( 2009). Mr. Sunny Nwosu, the national coordinator of Independent Shareholders Association of Nigeria (ISAN) said that while some other nations have well spelt out recovery plans, Nigeria has been virtually inactive in taking visible revival steps to bring the economy out of the woods.

Also at a special briefing of the Federal Executive Council on the 18th of March, 2009 the former Governor of the Central bank of Nigeria Soludo said “resource flows and capital flows around the world are frozen up. Nigeria depends for more than 95 percent of its foreign exchange on oil and the price has crashed to the extent that from about July last year (2008) the outflow of foreign exchange has actually far outstripped the inflows. He stress further that in 2008 Nigeria sold about a billion dollars a month to the bureau DE change but early this year the inflow has been about $800 million a month”.

In Appiah-Dolphyne 2009 at a seminar, the ICAN president addressed the loss of N9 trillion clipped off from investors in the nation’s capital market.

As at June 2011, Nigeria still faced the crisis of debt which stood at $37bn. This means that in the last two years, the debt stock had risen by $13.91bn. This shows a growth rate of 37.59 per cent.

The statistics obtained from the DMO website showed that as of June 30, 2013, the nation’s external debt stood at $6.92bn (about N1.08tn), while the domestic debt component stood at N6.85tn ($43.99bn).

This paper therefore, interrogates the implications of the global financial meltdown on the Nigerian economy and seeks to assess the effect of Islamic banking and recapitalization on the economy.

The paper is structured as follows; part two and three discusses the concept of economic meltdown and the causes of the crisis respectively, the basic principle of
Islamic banking are looked into. Part four looked at the survival strategies as well as possible policy as well as possible policy in relation with Islamic banking, part five conclude the paper.

2. Nigeria Economy

Nigeria is a middle income, mixed economy and emerging market, with expanding financial, service, communications and technology and entertainment sectors. It is ranked 26th in the world in terms of GDP (nominal: 30th in 2013 before rebasing, 40th in 2005, and 52nd in 2000). Nigeria Economy is largely oil based because our former military rulers failed to diversify the economy away from its overdependence on the capital-intensive oil sector which provides 95% of foreign exchange and 80% of budgetary revenues. In 2010 Nigeria GDP rose strongly because of increased oil exports and high global crude prices. According to International Monetary Fund (IMF) projections, Nigeria is the second fastest growing economy in the world and will outperform other African economies in the near future. Presently Nigeria is the largest economy in Africa (based on rebased figures announced in April 2014). It is also on track to become one of the 20 largest economies in the world by 2020. Its re-emergent, though currently underperforming, manufacturing sector is the third-largest on the continent, and produces a large proportion of goods and services for the West African region. Nigeria recently changed its economic analysis to account for rapidly growing contributors to its GDP, such as telecommunications, banking, and its film industry. As a result of this statistical revision, Nigeria has added 89% to its GDP, making it the largest African economy.

3. The Causes Of Economic Meltdown In Nigeria

1. Dependence: of Nigeria government on the crude oil's revenue from foreign countries caused it. According to the Africa News Services (2008), according to the CBN Governor, Nigeria gets over 95% of its revenue from oil, a trend that has been observed since the 1970’s.

2. Resource mismanagement: financial indiscipline of Nigeria government by embarking on short-term projects that will enrich their pockets instead of long-term that will bring future gains for the country.

3. The debt game (at all levels): Nigeria as a country is still heavily indebted to The World Bank and International Monetary Fund (IMF). Also banks financial crisis as a result of margin loans given to the intending shareholders which later exposed the banking sector and Nigerian capital market crumbled as a result of margin loans from banks by the shareholders.

4. The high rate of importation; interdependence of Nigerian economy on US economy is one of the causes of economic meltdown. Even the petroleum is been imported from abroad.

5. Over population: The changing dynamics of overpopulation has also affected the Nigerian economy because adequate plan have not been put in place for the nation's increasing population.

6. The recent activities of the Niger-Delta militants has worsened the situation as the barrels of crude produced per day dropped due to militant activities which include kidnapping, stopping operation s and damage to oil wells and facilities.
7. Lack of Infrastructure and High Production Costs: The cost of doing business is high in Nigeria. Basic infrastructures like good roads, power supply are lacking, leading to high cost of doing business.

8. Level of illiteracy: Growing gap between the elite and the impoverished also has its fair share on the nation's economic meltdown.

9. Unemployment: The national relocation of employment and the changing of means of labour also have resulted in too many people migrating to major cities like Lagos, Abuja, Port Harcourt causing these cities to be overpopulated and few people left to farm in the other states.

4. The Effects Of This Economic Meltdown
   1. Banks have incurred huge losses. Their earnings came down.
   2. Financial institutions have gone bust or have been taken over by bigger organizations.
   3. Infrastructure remains stagnant
   4. The housing prices have plummeted
   5. The liquidity in the financial system has come down
   6. High unemployment
   7. High level of poverty
   8. Crime increased immensely

5. Islamic Banking

   Islamic Banking cannot be discuss here without mentioning Islamic economic system because it is a banking system that is based on the principles of Islamic law (also known Shariah) and guided by Islamic economics. It is consistent with the principles of Shariah and its practical application through the development of Islamic economics. Islamic economic system is not a new phenomenon and can be traced back to the 7th century. However, Islamic economic system is the principles that describe the way of life which comply according to Shariah. It entails, law, finance, economics, business and social welfare of mankind. A key element of Islamic economics is distribution of equitable rewards to the different factors of production. Islamic economic system seeks system of redistributive justice where concentration of wealth in a few hands is countered and flow of money into the economy is fluent. Islamic banking is, therefore, seen as a lynchpin to achieving the economic and social goals of the Islamic economic system. (Moin 2008).

   Ziyaad Mohammed (2010) described Islamic economics as part of a dynamic, universal way of life that promotes social interaction at the highest possible level. He added that Islamic Economics promotes the overall economic well-being of the individual, his family, his community and mankind as a whole. The core values of Islamic economics are: social economic justice and equitable distribution of income and wealth (Ziyaad 2010 and Farooq 2007).

   Therefore, 'Islamic banking' is 'Shariah compliant finance'. The chief aim of Islamic banking is the prohibition of the collection and payment of interest and the sharing of
profit and loss. This is due to the fact that collecting interest is not permitted under Islamic law.

Shariah prohibits acceptance of specific interest or fees for loans of money (known as *riba*, or usury), whether the payment is fixed or floating. Investment in businesses that provide goods or services considered contrary to Islamic principles of Islamic law (Shariah) and guided by Islamic economics.

6. **Basic Principle Of Islamic Banking**

   i. **Islamic Banking is non-inflationary:** acknowledging the individual’s right to ownership of wealth legitimately acquired, Islam makes it obligatory on the individual to spend his wealth judiciously and not to hoard it, keep it idle or to squander it. While allowing an individual to retain any surplus wealth, Islam seeks to reduce the margin of the surplus for the well-being of the community as a whole, in particular the destitute and deprived sections of the society by participation in the process of Zakat (a tax on wealth that is distrusted to the needy).

   ii. **Islamic Banking is entrepreneur driven:** It permits the individual the right to seek economic well-being. Islam makes a clear distinction between what is halal (lawful) and what is haram (forbidden) in pursuit of such economic activity.

   iii. **Islamic ethics transaction and social justice:** In broad terms, Islam forbids all forms of economic activity, which are morally or socially injurious.

   iv. **Islamic Banking plays a vital role in economy’s vision:** That is the vision that moves away from debt based partnership to an equity based and stake taking partnership.

   v. **Islamic Banking believes in the principle of variable return:** (profit and loss sharing) and depends on the actual productivity and performance of the projects.

7. **Product Of Islamic Banking**

   Islamic Financial Products: The following is a brief description of Islamic financial products Adopted from (HabibullahKhan et al, 2008, P. 3):

   i) Profit sharing financial products- Musharakah- all partners participation in terms of equity, investment, management and profit (based on pre-agreed ratio) and loss (based on equity contributions).
      - Mudarabah-one contributes capital, others provide entrepreneurship. Profit is shared on a pre-agreed ratio.
      - QardHasan-charitable loans free of interest and profit-sharing margins; repayment by installments. Modest service charge is permissible.
      - Wakalah-a bank is authorized to conduct business on customers’ behalf.
      - Hawalah-an agreement by the bank to undertake some of the liabilities of the customer in return for a service fee. The customer pays back the bank when the liabilities mature.

   ii) Advance purchase financial products- Murabahah- a contract between the bank and its client for the sale of goods at a price that includes a profit margin agreed by both parties.
• Istithna’a- is contract for acquisition of goods by specification or order, where the price is paid progressively in accordance with the progress of job completion.

• Mu’ajjal-a sales contract that allows purchase with deferred delivery.

• Ijarah-a leasing contract under which a bank buys and leases out for rental fee equipment required by its clients.

iii) Deposit products- Wadi’ah- deposits, including current accounts (giro wadi’ah).

• Qard al-Hasanah-unremunerated deposit products, usually for charitable purposes.

iv) Insurance products: Takaful- Islamic insurance with joint risk-sharing.

8. ISLAMIC BANKING AS A SURVIVAL STRATEGY OF NIGERIA IN ECONOMIC MELTDOWN

Since banks play a major role in economic development, Islamic banking in Nigeria can play a vital role in Nigeria economic growth because the elimination of interest in its practice would emerge as the solution that lies in a shift to equity-based financing, which is the primary characteristic of Islamic Finance. Therefore, the solution lies in a shift to equity-based financing, which is the primary characteristic of not only Islamic Finance but what is needed in Nigeria to jump start business activity.

The large number of economic ills, including poverty, social and economic injustice, inequalities of income and wealth, economic instability and inflation of monetary assets are all in conflict with the value system of Islam.

It is the responsibility of the money and banking system to contribute to the achievement of socio-economic development and hence eliminate such economic ills.

Some economists even believed that because of the elimination of interest (riba), working according to Profit and Loss Sharing (PLS) and its similarity to universal banks, Islamic banking has a more important role than conventional banking systems in this regard. There are several empirical works regarding the role of Islamic banking in economic development.

For instance, Ahmed (2005) showed that there are operational problems related to the use of equity-based instruments to finance different financial growth factors, in particular working capital and argued that debt contracts and leasing contracts cannot be used to finance working capital and also that there are no operational models for using murabahah and mosharakah to finance working capital. He asserts that in order to solve the problem of financing different growth factors it is necessary to work on developing operational models of corporate finance in general and workable equity-based instruments and institutions in particular.

Islam encourages the earning of profit as profit symbolizes successful business dealing and creation of new wealth. Interest on the other hand is a cost that is in place regardless of the outcome of business operations. If business losses are experienced, there may not be real wealth creation. Social justice requires that lenders and borrowers
share both profit and lose in an equitable manner and that the method of accumulating and distributing wealth in the economy is fair and represents true productivity (Iqbal, 1997). To achieve these goals, there are several modes of finance used in Islamic banking, which will serve as a solution to Nigeria economic meltdown, these are discussed below.

- **EFFICIENT USE OF MONEY:** In order to save the world from economic crisis trading in money itself should be stopped. Exchange of different currencies is, of course, inevitable for the purpose of international trade, for which one currency has to be sold for another currency, and a margin of profit for the seller may be inbuilt in the exchange rate. So far as these exchange transactions are carried out for the genuine purpose of cross border trade of real commodities, it cannot pose a problem.

- **DISTRIBUTION OF RISK BETWEEN ENTREPRENEURS AND DEPOSITOR:** There will be greater transparency in their transactions with clients – depositors as well as fund-seekers due to compliance with the avoidance of gharar (ambiguity) resulting in clear contracts for every transaction. The Shariah has, however, made an exception to this rule in the case of salam and istisna where the goods are not already available in the market and need to be produced or manufactured before delivery. Financing extended through the Islamic modes can thus expand only in step with the rise of the real economy and thereby help curb excessive credit expansion.

- **STABILITY:** It is well known in traditional finance literature that interest based debt finance is an important source of economic instability when compared with equity finance will not only motivate the creditor to be more cautious in evaluating the credit risk but also prevent an unnecessary explosion in the volume and value of transactions. This will prevent the debt from rising far above the size of the real economy and also release a substantial volume of financial resources for the real sector, thereby helping expand employment and self-employment opportunities and the production of need-fulfilling goods and services. The discipline that Islam wishes to introduce in the financial system may not, however, materialise unless governments reduce their borrowing from the central bank to a level that is in harmony with the goal of price and financial stability.

- **INVESTMENT DRIVE:** The importance of the quality of a business plan is greater than the credit rating of borrower. Considering that the level of investments may not be as high as in some other infrastructure projects, private sector investments must also be encouraged in supply chain infrastructure as well as in agriculture and rural sectors through tax reductions and other incentives. The profit sharing scheme in Islamic banking encourages investment because investment depositors receive a share in the bank profits. This increase in investors will implicitly result in the increase in employment. Instead of being lenders, Islamic banks will provide financing by coming in as traders (murabaha), lessors (Ijara) or partners (mudaraba; musharaka).

- **POVERTY ALLEVIATION:** Islamic Development Bank (IDB) has always been conscious of the poverty incidence in its member countries and
particularly in Sub-Saharan African member countries and of its obligations to play its role to help the countries in their fight against poverty. Having this in mind, IDB has launched several programmes to assist member countries in a number of areas (Khan, 2007). Introduction of Islamic banking will avail Nigeria (a member of IDB) the opportunity to benefit from IDB programmes in at least three ways: (i) support for establishment of a network of institutions that would perform Shariah compatible charity activities such as Zakah and Waqf that Islamic banks can use to discharge part of their social responsibility role; (ii) support for Islamic financial institutions with expertise through the technical assistance and training programmes of Islamic Research and Training Institute (IRTI), a specialised unit of the IDB; and (iii) extension of assistance to students and provision of scholarships in the disciplines of IBF and Islamic Economics.

- **EMPLOYMENT**: Islamic banking is expected to provide employment opportunity for many of the educated unemployed. Existing conventional banks that may wish to open window or subsidiary of Islamic banking will have to recruit new staff that will complement their existing workforce or even specialize in Islamic financial products and services. New entrants that will be licensed to operate mainly Islamic banking on their part will need staff members from cashiers to managers, cleaners to security guards, marketers, and Information Technology (IT) staff.

- **FUND MOBILISATION**: Accordingly, Joseph (2011) observes that the practice of Islamic banking will no doubt help mobilize savings and provide more investible funds to the financial system in view of lots of idle funds in the economy, interest-free banking practice will help mobilize for business purpose. Successes in these directions would spur the country toward developing competitively priced high quality goods and services for the export markets. The goods and services should move up the value chain and the transition encouraged by friendly government policy.

- **CONTROL OF EXCESSIVE CREDIT CREATION**: Packaging a large amount of debts in a bundle of CDOs, that was the initial cause of the present crisis, would not have been possible if sale of debts was disallowed. The Islamic financial system is more stable due to the elimination of debt financing. It also reduces inflation in the economy as the supply of money is not permitted to go above the supply of goods.

- **DECREASE OF MORAL HAZARD AND ADVERSE SELECTION**: Islamic banks will stay away from financing prohibited activities i.e. Harmful goods and activities are not permissible e.g. alcohol, gambling, pork, pornography, arms etc. Also wasteful use and extravagances undesirable usage which harms public interest or the environment is to be avoided.

**Conclusion**

This study was carried out to establish the sustainable trend that Islamic Banking can provide to economic meltdown in Nigeria. It strived to explore the crisis facing Nigerian economy, background, its causes and views of Islamic banking as a medium to battle the crisis. Since, the financial system in Nigeria is basically on interest rate
resulting from financial crisis and Islamic Banking has gained a momentum across the world through the elimination of interest.

Islamic finance is now among the fastest growing financial segments in the world, with an estimated annual growth of 20 percent. Its volume has reached almost $1.5 trillion. Based on its principles, Islamic finance has experienced major transformations and growth especially since 2000.

A true Islamic principle prohibits the paying or receiving of interest (riba) as well as the artificial creation of money via the process of fractional reserve. The emergence of more diverse Islamic finance institutions and the development of Islamic finance markets, the scope of Islamic finance business has been expanded to include private equity, project finance, the origination and issuance of sukuk (bonds), and fund, asset, and wealth management activities.

The global financial crisis is already causing a considerable slowdown in most developed countries and this fractional reserve creates a huge problem in the economy as very little equity can be used as collateral to borrow large sums of money; this is what creates a financial bubble. The financial crisis has proven very clearly that the apparent strength of modern financial markets was illusionary.

Furthermore, financial crisis was accompanied by rising inflation – as demand for oil and food pushed prices up globally. This crisis has stunned both political spectrum and the different economic schools of thought respectively. In the midst of such an unprecedented crisis with a recession already in place in most developed countries, Nigeria and other developing countries should try and come up with policies that will minimize the spread of this crisis to their economy.

The financial institutions should encourage business and trade activities that generate fair and legitimate profit. In Islamic finance, there is always a close link between financial flow and productivity.

The Islamic finance system with proper checks and controls introduces greater discipline into the economy and links credit expansion to the growth of the real economy. Many economists and policy makers have suggested more regulation and transparency, with only a few highlighting the role greed and speculation played.

However, both the capitalist and socialist systems share certain elements with Islam, such as encouraging people to work, to be productive and earn as much as they can. Islam promotes an awareness of the hereafter in the hearts and minds of believers and instructs them not to be overcome by greed or excessively attached to money.

It is high time for introduction of universal Islamic values to the market players, economists, commentators and the general public. They should be shown that Islam is much more than the prohibition of interest (riba) and alms (zakah), but is a comprehensive system to fulfill society’s basic necessities (food, clothing and shelter). Islam makes people and their needs, rather than production, the central question. In presenting Islamic economic policy, all the Shariah rules supplement each other. This means Islam is more than capable of being applied and, in fact, has a successful history of dealing with economic problems.
Although, Islamic Banking in Nigeria is facing a lot of challenges but if the government can play an important role in providing a conducive environment for Islamic banks to operate, introducing appropriate rules and regulations to protect both banks and customers, and create mass awareness by publicizing the significant benefits and opportunity that can be gained. Islamic Banking can be a lasting solution to the present and future economy.

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A Working paper exploring the meaning of Development in Islamic perspective and suggestions regarding possible utilization of Islamic banking for development of Pakistan

UNITED NATIONS 2009 The Global Economic Crisis: Systemic Failures and Multilateral Remedies. Report by the UNCTAD Secretariat Task Force on Systemic Issues and Economic Cooperation


http://www.islamic-banking.com/ibanking/ifi_list.php


Abstract

This study aims to conduct a comparative analysis of performance of the impact of global financial crisis on Islamic and conventional banking in Pakistan during the period the 2007-2010.

Three performance indicators have been considered for this purpose namely Profitability, Liquidity & Soundness. This study covers a four year period from 2007 to 2010. Based on the performance of 2007 the impact has been analyzed by using financial ratios as analysis tool. The financial ratios like Return on Assets (ROA), Return on Equity (ROE), Loan to Asset Ratio (LAR), Loan to Deposit ratio (LDR), Assets Utilization (AU), Debt to Equity ratio (DER) and Income to Expense ratio (IER) are used to evaluate performance of sample banks. Primary data was also collected through survey by using a closed ended questionnaire.

The study explores two main findings (I) there seems no major variation in liquidity and profitability of both types of the commercial banks (II) the Islamic banks hold more liquid assets than conventional banking counterparts, which affected their liquidity.

While analyzing, it was also concluded that cost of deposit on conventional side increased as compared to Islamic Banking and Non Performing Loans were increased after multi year stability and control on healthy loans on conventional side.

Key Words: Global Financial Crisis, Islamic, Conventional Banks, Liquidity, profitability, Non Performing Loans

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Introduction:

The main objectives of this paper are to review the growth of Islamic banking with respect to its counterpart conventional banking during the global financial crisis which started in US subprime mortgages and engulfed the entire globe. While the degree of economic damage varied across the countries, economists are of the same opinion that the current recession is the worst since the Great Depression of 1930. These are in essence credit crisis which are direct result of collapse of the mortgage market in United States.

The study is basically aimed to evaluate and analyze the performance of conventional banking against Islamic banking in Pakistan during the period 2007-2010. Specifically, focus is on two banks viz a viz Meezan Bank Limited and Bank Alfalah Limited one from Islamic side and other from conventional side based on their deposit base, network and products and services provided. Data was collected from their annual reports. In this era of modern technology and very much competitive financial market, it is pretty common to use this technique of analysis for comparison of Bank’s performance.

Bird’s eye view of Global Financial crisis

The financial crises got extraordinary impetus during the period from 2004 to 2007, stock markets witnessed slow down and many large banks of the developed economies applied for bailout to evade collapse.

During 2009 global output dropped by 2.2 % percent and the unemployment rate increased by 7 % percent and global output declined by 2.2 per cent resulted into more than 35 million people being laid off.

The main causes of crises were imprudent lending for a pretty long period of time, fair value of collateral accepted was ignored, repayment capacity of borrowers was ignored even down payment was ignored, relaxation of regulations by US government particularly repeal of the Glass-Steagall Act of 1933, improper rating was awarded by rating agencies against attractive incentives and risk rating mechanism was totally ignored.

Impact of Global Financial Crisis on developed economies

It caused collapse of Financial Institutions globally, includes giant financial and insurance institutions like Lehman Brothers, American International Group Inc, Fannie Mae, Freddie Mac etc. Central Banks in weak economies like IceLand turned out to be bankrupt, investors lost enormous amounts, globally severe liquidity crunch and credit squeeze for the financial sector occurred.

House prices declined by 20% from a peak in 2006 and home equity valued at $13 trillion in the Unites States reached at lowest level of $8.8 trillion in the mid of 2008. Many banks applied for bailout to avoid bankruptcy which led to a situation of layoffs and resulted into unemployment which reached its peak level in 2008.

Impact of Global Financial Crisis on Pakistan

A strained global economic recession has seized FDI (Foreign Direct Investment) which declined by 47.5 % during the period July-April 2008-09. However remittances by workers’ from abroad remained unaffected which were around US $ 6.4 bln. Pakistan was unable to raise funds from capital markets of the world as entire globe was gripped...
due to such unprecedented global financial crisis. Literally Pakistan’s presence was very much limited in the international capital markets during 2008-09.

**Overall Impact on Banking Industry in Pakistan**

Keeping in view the demands for financial and economic globalization, banking system of Pakistan also initiated to link itself with global financial market.

Consequent upon rumours spread over the country regarding seizure of lockers and freezing of Foreign Currency Accounts (FCY) Pakistan’s financial sector experienced some shocks, which resulted into noticeable withdrawals of deposits and liquidity problem. To lubricate the market suffering from liquidity crunch the central bank of Pakistan injected round about $ 100 million in the market and also lowered its statutory requirements by 4%.

**Review of Literature**

There is a lot of empirical literature regarding the root causes of the Global Financial Crisis and its impact on banking industry and world economy as well. A number of reports and research papers attempted to examine the implications and effects of Global Financial Crisis. In case of Pakistan very little empirical literature is available on the various financial and operational dimensions.

An attempt has been made to analyze and explore the causes and consequences of Global financial Crisis on various dimensions of Banking industry in Pakistan particularly performance of sample banks with respect to their liquidity, solvency and profitability. The existing literature explores the causes globally and is reviewed as under.

According to T Schuermann & A.B.Asherstaff, et al, 2007, the root cause of the crisis is the process of collateralization, which gave birth to the global financial crisis. Near about 75 per cent subprime mortgage loans were linked directly with the securitization process. Financial derivatives played vital role in securitization of the loans in special compartment of CLOs (collateralized loan obligations) and CDOs (collateralized debt obligations).

Dr Umer Chapra -2008 in his research regarding financial crisis has claimed that the current global economic recession is worse than the Great Depression of 1929. He further argued that the growth of banking industry will remain slow and effects of crisis may remain for longer period of time. He further explained on credit problem, he analyzed that more profit means more lending and high leverage is the reason which makes excess lending possible and results into artificial boom in prices of assets and gives rise to speculative investment and consumption. Such high leverage is difficult to unwind and this vicious cycle of selling ultimately leads to steep decline in prices rather to downturn and outcome is financial crisis.

Lowenstein (2008) explores that the regulators and central banks have allowed the recurrence of crisis, by failing to display financial discipline even forgetting the past events from which lessons should be learnt. It was need of hour to recognize the early warning signals so that financial derivatives could be managed more firmly and tightly. Rather they promoted such risky business instead by behaving in a speculative manner and looked for bailout.

Nicholson, 2008 confirms that global financial crisis which started from United States has engulfed the entire world. The crisis was so severe that it not only affected US
financial industry but crashed stock exchanges of many countries of Asia & Europe. Global Financial crisis also affected Socialist economies apart from capitalist, Russian stock Market also dropped significantly during May 2008.

Bartlett (2008) has expressed his point of view on the causes of financial crisis, he stated that the crises which started with the fall of sub-prime mortgage industry in states but the intensity was so severe which engulfed the globe. According to him losses were unprecedented in the history ,on such risky assets (MBOs, CLOs, CDOs and subprime securities) accounted for about US $945 billion during March 2008 which he confirmed that these losses are biggest one even in comparison of banking crisis of Japan accounted for to US$ 780 billion approximately during 90s,During Asian crisis the losses were accounted for around US $ 420 billion during 90s and Saving & Loan Disaster of United States were around US $ 380 billion during 1986-95

JPMorgan et al, 2006, explored that Mortgage-Backed securities which were highly risky has witnessed a tremendous expansion after 1998 although it initiated growth in 70s but its use was very much limited in mortgaged backed industry before late90s.

Wim Naude has very clearly expressed that there were several causes of global financial crisis which include inter alia weak regulatory checks ,easy access to cheap money, irresponsible, imprudent and aggressive lending, rise in housing prices with the start of the century which unduly facilitated the mortgage backed loans around one trillion US dollars particularly to those households who otherwise were not entitled to avail the facility on the basis of very little repayment capacity, the risk so arising was covered by securitization. The predictable income from such infected finances were packed with other securities like CDO (Collateralized Debt Obligations) and were sold onward by getting required rating of AAA from world famed rating agencies for which they were offered handsome incentives. Moral Hazards and Conflicts of interest were common all over in the system.

Yilmaz (2008) has clearly fixed responsibility on U.S mortgage industry that extended mortgage finance facilities to sub prime clients thus resulted into occurrence of severe nature of financial crisis, initially anticipated the losses in the range of US $ 300 To 600 billion which later were accounted for about US $1 trillion.

Research Methodology

Ratio Analysis

In this study Banks’ performance have been measured by using ratio analysis technique, the main advantage of this method is to remove disparity based on their size of deposits ,advances and network and brings the banks at par. This method was also used by other researchers such as Ahmed & Hassan (2007),Sabi(1996) and Chen & Shimerda (1981).

Financial Analysis by using Ratios

Profitability Ratios

Return on Assets (ROA):

This ratio is indicator of evaluating managerial efficiency as to how bank management uses its assets profitably. Higher ratio is better managerial efficiency indicator and shows better performance and vice versa.

Formula used for ROA is, Return on Assets = Net Profit/Total Assets
Return on Equity (ROE):
This ratio is also indicator of managerial efficiency and shows how well a bank invests its capital to generate income. It evaluates efficiency at generating profits from every unit of equity. Higher ratio is better managerial efficiency indicator and shows better performance and vice versa.

Formula used for ROE is, Return on Equity = Net Profit/Equity

Credit Risk Performance

Equity to Total Assets (ETA):
It measures the credit risk of banks, it shows as to how bank protects against its assets and investments. Basically it tells about capacity of shock absorbance arising out of potential losses of loaned assets and investments. Higher ratio is better indicator of maintaining the loan losses.

Formula used for ETA is, Equity to Total Assets = Common Equity/Assets

Capital Adequacy Ratio (CAR):
It measures banks capital against its Risk Weighted Assets (RWA)/Credit Exposure. Higher ratio does not always mean good performance but indicates that large amount of capital is maintained to meet risks arising from its credit exposures. There are three types of risks, Credit Risks, Market Risks & Operational Risks.

Formula used for CAR is, Tier-I capital + Tier Two capital / Risk Weighted Assets

Management Efficiency

Income Expense Ratio (IER):
This ratio measures the amount of income earned in comparison to operating expenses. This is very common ratio used by bank management to improve efficiency by controlling operating expenses which results in better income generation. Higher ratio means better performance in terms of profit with respect to operating expenses.

Formula used for IER is, Income Expense Ratio = Total Income/Total Operating Expenses

Management Ability

Asset Utilization (AU):
This tells how effectively bank’s management uses its assets for revenue generation. Higher ratio is indicator of better use of assets to generate income & vice versa.

Formula used for AU is, Asset Utilization = Total Revenue/Total Assets

Loan to Deposits Ratio: This ratio indicates that how a Bank utilizes its deposits by extending loans, relatively low ratio contributes higher liquidity and results in low profits and low ratio creates stress for managing liquidity but higher profits.

Formula used for LDR is, Loan to Deposits Ratio = Total Loans/Total Deposits
**Loans to Assets Ratio**: This ratio measures what percentage a bank has invested in the shape of loans, the higher ratio indicates less liquidity and vice versa. But it is pertinent to mention that high ratio leads to better profitability with risk of solvency.

Formula used for LAR is, Loan to Deposits Ratio = Total Loans/Total Assets

### ROA

<table>
<thead>
<tr>
<th>Bank</th>
<th>Year</th>
<th>Mean</th>
<th>Standard Deviation</th>
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<tbody>
<tr>
<td></td>
<td>2007</td>
<td>2008</td>
<td>2009</td>
</tr>
<tr>
<td>MBL</td>
<td>5.35</td>
<td>5.85</td>
<td>7.85</td>
</tr>
<tr>
<td>BAL</td>
<td>22.73</td>
<td>8.90</td>
<td>4.53</td>
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</tbody>
</table>

Return on Assets of Meezan Bank limited (MBL) quite stable as compared to Bank Alfalah Limited (BAL) as shown from above figures, ROA of BAL was 22.73% in 2007 which immediately declined to 8.90 % and 4.90 % in 2010 whereas MBL remained stable and improved in 2009 mean remains improved.

### ROE

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<tr>
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<td>2007</td>
<td>2008</td>
<td>2009</td>
</tr>
<tr>
<td>MBL</td>
<td>0.46</td>
<td>0.43</td>
<td>0.57</td>
</tr>
<tr>
<td>BAL</td>
<td>0.95</td>
<td>0.37</td>
<td>0.23</td>
</tr>
</tbody>
</table>

Return on Equity of MBL remains almost unchanged and it varied 0.95 % in 2007 to 0.24 % in 2010 which shows impact of crisis on BAL as compared to MBL which remained resilient.

### ETA

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<th>Standard Deviation</th>
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<tr>
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<td>2007</td>
<td>2008</td>
<td>2009</td>
</tr>
<tr>
<td>MBL</td>
<td>8.51</td>
<td>7.44</td>
<td>7.32</td>
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<tr>
<td>BAL</td>
<td>4.18</td>
<td>4.18</td>
<td>5.08</td>
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</table>
It measures the credit risk of banks, in case of BAL it has declined from 8.51% in 2007 to 6.94% in 2010 but remained almost unaffected in case of MBL which shows strength of Bank to absorb shocks of crisis or crises have no effect on its ETA position.

### IER

<table>
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<td>2008</td>
<td>2009</td>
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<tr>
<td>MBL</td>
<td>336.61</td>
<td>285.91</td>
<td>331.35</td>
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<tr>
<td>BAL</td>
<td>383.90</td>
<td>364.47</td>
<td>370.32</td>
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</table>

It tells that both banks have maintained control over its operating expenses in respect of income, in otherwise crises has not affected operating expenses position significantly though have affected BAL from 363.90% to 331.17% but MBL remained comparatively stable.

### CAR

<table>
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<th>Mean</th>
<th>Standard Deviation</th>
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<tr>
<td>MBL</td>
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<td>10.03</td>
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<td>BAL</td>
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<td>8.03</td>
<td>12.46</td>
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</tbody>
</table>

CAR is basically cushion of capital against its Risk Weighted Assets, Position of MBL improved but it was slightly affected in case of BAL. CAR of MBL was 10.84% in 2007 which was improved to 12.41% in 2010 whereas in case of BAL it was immediately affected in 2008 and regained in 2009 but was slightly declined in 2010 which shows instability.

### AU

<table>
<thead>
<tr>
<th>Bank</th>
<th>Year</th>
<th>Mean</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2007</td>
<td>2008</td>
<td>2009</td>
</tr>
<tr>
<td>MBL</td>
<td>8.81</td>
<td>8.80</td>
<td>9.45</td>
</tr>
<tr>
<td>BAL</td>
<td>9.67</td>
<td>10.39</td>
<td>10.47</td>
</tr>
</tbody>
</table>
Both banks remained alert and used its assets in a better way but standard deviation of MBL is 0.40008 in comparison to 0.326 of BAL.

### LDR

<table>
<thead>
<tr>
<th>Bank</th>
<th>Year</th>
<th>Mean</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2007</td>
<td>2008</td>
<td>2009</td>
</tr>
<tr>
<td>MBL</td>
<td>63.34</td>
<td>56.28</td>
<td>41.57</td>
</tr>
<tr>
<td>BAL</td>
<td>62.67</td>
<td>64.06</td>
<td>55.43</td>
</tr>
</tbody>
</table>

LDR of BAL was affected considerably from 63.34 % in 2007 to 41.34 % in 2010 whereas MBL declined slightly but liquidity seems better .Mean of MBL is 50.6575 in comparison to BAL that is 59.4325.

### LAR

<table>
<thead>
<tr>
<th>Bank</th>
<th>Year</th>
<th>Mean</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2007</td>
<td>2008</td>
<td>2009</td>
</tr>
<tr>
<td>MBL</td>
<td>51.46</td>
<td>46.35</td>
<td>33.58</td>
</tr>
<tr>
<td>BAL</td>
<td>52.05</td>
<td>55.20</td>
<td>46.26</td>
</tr>
</tbody>
</table>

There seems no liquidity problem at MBL as Loan to Assets ratio is within manageble limit and better than its counter part BAL.

**Besides above following ratios also sheds light on performance of both banks.**

### PBT Ratio

<table>
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<tr>
<th>Bank</th>
<th>Year</th>
<th>Mean</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2007</td>
<td>2008</td>
<td>2009</td>
</tr>
<tr>
<td>MBL</td>
<td>27.74</td>
<td>17.22</td>
<td>17.30</td>
</tr>
<tr>
<td>BAL</td>
<td>5.78</td>
<td>2.86</td>
<td>2.85</td>
</tr>
</tbody>
</table>
Profit before Tax ratio of BAL and MBL has significantly affected during the period under review though the mean of MBL is quite better.

### Gross Spread Ratio

<table>
<thead>
<tr>
<th>Bank</th>
<th>Year</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Mean</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>MBL</td>
<td>2007</td>
<td>46.39</td>
<td>50.80</td>
<td>46.25</td>
<td>35.54</td>
<td>44.745</td>
<td>6.4901</td>
</tr>
<tr>
<td>BAL</td>
<td>2007</td>
<td>35.54</td>
<td>30.67</td>
<td>30.67</td>
<td>33.98</td>
<td>32.715</td>
<td>2.4457</td>
</tr>
</tbody>
</table>

Gross Spread ratio has also been affected in case of BAL due to increase in Mark up expense and decrease in Markup income however it remained somehow better in MBL.

### Non Interest Income

<table>
<thead>
<tr>
<th>Bank</th>
<th>Year</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Mean</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>MBL</td>
<td>2007</td>
<td>38.85</td>
<td>23.74</td>
<td>23.74</td>
<td>39.72</td>
<td>31.51</td>
<td>8.9819</td>
</tr>
<tr>
<td>BAL</td>
<td>2007</td>
<td>39.72</td>
<td>32.21</td>
<td>32.20</td>
<td>25.61</td>
<td>32.435</td>
<td>5.7665</td>
</tr>
</tbody>
</table>

Noninterest income (fees, commission and dividend income etc) was affected for both banks.
Weighted Average Cost of Deposits

<table>
<thead>
<tr>
<th>Bank</th>
<th>Year</th>
<th>Mean</th>
<th>Standard Deviation</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>2007</td>
<td>2008</td>
<td>2009</td>
</tr>
<tr>
<td>MBL</td>
<td>4.97</td>
<td>4.64</td>
<td>5.37</td>
</tr>
<tr>
<td>BAL</td>
<td>5.94</td>
<td>6.84</td>
<td>6.83</td>
</tr>
</tbody>
</table>

It is very much clear that cost of deposits have risen significantly in case of BAL with respect to MBL which means deposits were mobilized at high cost to keep their financial position particularly Balance sheet intact in the eyes of stake holders.

Primary Data

Primary Data was collected from management of commercial banks and from SBP officials, a closed ended questionnaire was developed and results were analyzed. A five point Likert scale was used as tool to gauge all the factors (1 for strongly disagree & 5 for strongly agree).

Overall Response – By 185/200 respondents

Results

Primary data were collected from 185 out of 200 respondent also confirms that the Global Financial Crisis has affected the conventional banking industry of Pakistan in terms of Profitability, liquidity and NPL increase.
Conclusion

This study is aimed at investigating the performance of both Islamic as well as conventional banks in Pakistan, sixth largest bank from conventional side and first established bank from Islamic were studied in terms of financial ratios.

It was revealed that conventional banks remained under pressure to maintain their deposits position, mobilized costly deposits which badly affected its profitability. Moreover liquidity was tight for which SBP reduced SLR+CRR from 34 % to 30% besides injecting $ 20-100 millions to lubricate the financial sector. Islamic banks were not affected as much as conventional due to investment in real assets instead of cash which was limited exposure. Overall performance of Meezan Bank Limited remained stable and resilient as compared to Bank Alfalah Limited.

References:
Alan Zibel, “‘Liar loans' threaten to prolong mortgage crisis” (2008)


Mutuality based Islamic Insurance

By
Abdul Azim Islahi *

Abstract

Dr. Muhammad Hamidullah (1908-2003) on mutuality based Islamic Insurance is well-known for discovery, editing and bringing to light a number of rare and invaluable Islamic manuscripts. A significant aspect of his contribution is his pioneering writings on Islamic Economics. He authored more than a dozen essays related to Islamic economics. He is the first to use this term as early as 1936 in his work “Islam’s Solution to the Basic Economic Problems – the Position of Labour”. He is also a pioneer writer on mutuality-based Islamic insurance, now known as 'takāful'. After surveying the development of Islamic insurance, the present paper studies and evaluates Dr Hamidullah's contribution to mutuality-based insurance.

Key Words: Mutuality based Islamic Insurance, Problems, Investment, Ideas, Development

Introduction

Dr. Muhammad Hamidullah (1908-2003), the last citizen of Hyderabad as he is sometimes called, spent major part of his life in Paris, engaged in research and academic works and died in Jacksonville (USA). Hamidullah's major areas of interest, sīrah (biography of the Prophet), history of the codification of Hadīth, and Muslim International Law are known to all. But very few know that he was also among the early writers on Islamic economics. He authored more than a dozen papers on Islamic Economics. It was he who coined the term "Islamic Economics" (Hamidullah, 1936, p. 217). He was also first to write on mutuality-based Islamic insurance. The present paper notes Dr. Hamidullah's objection on the conventional insurance and discusses his model of mutuality-based takāful. At the ends it shows the relevance of these ideas.

Contributions to Islamic Insurance: Hamidullah is among the pioneer writers on Islamic economics. He is also pioneer writer on mutuality-based Islamic insurance. Perhaps he was first to write on Islamic insurance in English as early as 1946 and he was first to point out basis of Islamic mutual insurance in ma āqīl provision of early Arab-Islamic system which was based on mutual cooperation. In his treatise "Islam and communism" (first published in 1950), Hamidullah wrote a brief note: "From the time of

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the Prophet, we come across a sort of social insurance of the community, insurance against tort entailing payment of damages beyond individual capacities. This insurance was called _ma āqil_ (Hamidullah, 1981, p. 20). The next year he explained the idea in an article entitled “Islamic Insurance”. He discussed it again in his paper "Haidarabad's Contribution to Islamic Economics" (Hamidullah, 1955b, pp. 73-78). And finally he wrote a section on social security in the Chapter on "the Economic system of Islam" in his famous book _Introduction to Islam_ (Hamidullah, 1957).

Before we examine in details Dr. Hamidullah's views on Islamic insurance it is worthwhile to note briefly provisions of insurance in early Islamic system and survey its development in the past. This will provide a background for better appreciation of his ideas on the subject.

**Provisions of insurance in early Islamic System**

Protection of property and riches is among the objective of Sharī'ah. In Islam there are various provisions that aim to safeguard them. For example:

**Zakah** is the most important source of social security in Islam. It is levied on every adult Muslim who is in possession of minimum exemption limit of assets (nisāb). The Prophet (peace be upon him) said that it should be collected from the rich and reimbursed on their poor. While there are enough reasons that zakah payment will have favourable effect on the growth of the property of zakah payers, it works for the poor as social security and helps the zakah receivers in several ways.

**Sadaqat al-fitr:** It is obligatory on every Muslim, male or female, minor or major. Every individual has to pay it on behalf of himself and his dependents if he has more than subsistence for himself and his dependents on the night of Eid al-fitr. As against zakah, there is no prescribed minimum exemption limit (nisāb) for Sadaqat al-fitr. Thus, Sadaqat al-fitr is obligatory on even those who may themselves be legally reckoned as poor but they pay to those who are poorer. In this way it is directed towards the poorest of the poor. It is security for the need fulfillment of the poor on the day of festival.

**Endowment (waqf):** It may be defined as taking the corpus of any property from personal ownership, transferring it permanently to the ownership of Allah and dedicating its usufruct to others. Waqf has been used extensively to provide lodging, clothing, water resources, health care, education, etc. Permanence and irrevocability are two essential characterization of awqaf. At present it has been proposed by some scholars like Mufti Taqi Usmani to organize Islamic insurance on the basis of waqf.

**Khilt (mixing up available means):** This is a mutuality based method of sharing by mixing together whatever little food, drink and other necessities of life the members of a community have and sharing equally irrespective of their contribution. This is known from a Hadīth in which the Prophet (pbuh) praised the people of Asharī tribe who used to practice it at the time of difficulties.

**Ma āqil:** The āqilah is a clan committed, by an unwritten law of the Arabs originating in the early stages of Islam, to pay blood money for each of its members. If somebody unintentionally commits a murder, and the granting of blood money became the clan’s final verdict, then that blood money would be spread across his āqilah (the supportive clan). This system is referred to as _ma āqil_. Usually the āqilah would collect the needed sum for compensation after the defendant had committed the crime.

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is reported that Caliph Umar initiated deduction in advance from every soldier’s salary for future diyah claims, thus making the combat unit the āqilah of the soldier. The same is understood from Hamidullah’s (1969) statement that "in the time of the caliph 'Umar, the branches of insurance were organized on the basis of the profession, civil or military administration, to which one belonged (or even of regions)". As noted above and will be discussed in details below, Dr. Hamidullah suggested his model of mutuality-based insurance on the pattern of āqilah.

In his article "Insurance and Semi-Insurance Transactions in Islamic History Until the 19th Century", Rispler-Chaim includes čamān (guarantee), čamān khaṭār al-ʿarīq (a guarantee against travel hazards), walā’ al-muwālāt, diyah, muḍārabah and jizyah among the transactions and institutions which functioned in a way similar to certain types of insurance.

Modern development of Islamic Insurance

Modern insurance, now called in Arabic as "ta'mīn", was mentioned for the first time in Islamic sources under the name sūkaraḥ (security), by the Hanafi jurist Ibn Abidin (1783-1836) in the 19th century. In the year 1240H (1824/1825) his opinion was sought about a kind of insurance in which one party gets protection from risk of robbery or piracy on payment of premium. Ibn Abidin tried to solve the problem within the framework of opinions expressed by the past jurists (Majmūʿah 2: 177-8). As he was opposed to ījtihād (fresh and creative thinking), he did not think over the problem of insurance independently. Had he done so, he must have reached to some of the conclusions to which scholars of twentieth century did in their discussion of ta’mīn.

Rifāʿah Rāfiʿ al-Tahtāwī (1801-1873), an Egyptian Azharite scholar, who lived in France for five years during 1826-31, in his account of people and economy of Paris mentions insurance which is called by him as “partners in guarantee” (al-shurakāʾ ʿīl-čamān). This association guaranteed to help those who contributed to it in case of a calamity or accident (Takhlīṣ, p.149). It is not clear how al-shurakāʾ ʿīl-čamān functioned and what was al-Tahtāwī’s stand regarding insurance. However the term indicates that it might have been mutuality-based insurance which is considered at present by majority of ulamāʾ as the only permitted form of insurance in Islam.

At the end of the 19th century the first insurance company in the Islamic world was founded in 1890 in Egypt (Rispler-Chaim, 1991, p.158) and to promote its business the company wanted to get a fatwā from Abduh (at that time the grand mufti of Egypt). There is no mention of the word ‘insurance’ in its query. It was presented as a form of investment. It means that people had doubt about the Islamicity of the functioning of the company and they did not show enthusiasm towards it. Perhaps the manager of the company tried to get the fatwā to convince people regarding the legitimacy of its functioning. The questionnaires are very brief and so is the reply of Abduh. It is not very explicit that it was a matter of life insurance (although it appears to be so). The query is simply in terms of installments contributed for a specific period for investment purpose based on muḍārabah technique, and at the end of the period the whole amount plus the profit is paid to the contributor if he is alive, otherwise it is paid to the inheritors or nominated person. No question of uncertainty, riba or gambling has been raised, which are raised these days. There is no reference to losses if happened in the investment. It is also not made clear whether the profit will be a fixed amount or a ratio of it. Again, it is not clarified if the amount to be paid after expiry of the period will be the total amount
determined at the beginning of the contract or only the total of paid installments. There are indications that it was not a simple muḍārabah partnership. It was a new issue of insurance. The muftī also did not ask clarification of those norms which are prescribed in our time. Perhaps people were not so awakened about various Sharīah issues involved in insurance. As simple was the question, so was the reply. However, during the first half of twentieth century most of ulamā considered insurance as un-Islamic. They prohibited all kinds of it (al-Dasuqi, 1967 p. 83). But they did not present in this period a satisfactory substitute to conventional insurance.

With the political, intellectual and economic awakening after mid twentieth century, expression of individual opinion and collective debate started on the institution of insurance in Islam. By organizing the Week of Islamic Jurisprudence in 1961 and fixing the topic of Islamic insurance as one of its themes, it brought the subject of insurance into focus. Many top Muslim scholars, such as Mustafa Zarqa, Abu Zahirah, Abd al-Rahman Isa, Ali al-Khafif, Siddiq al-Darir, participated in the discussion. They were sharply divided on the issue. While majority of them discarded life insurance, they accepted in principle the other kinds of insurance. However, they rejected the conventional insurance because of its involvement of ribā (interest), gharar (excessive uncertainty), maysir (gambling) and jahālah (ignorance) (Usbū al-Fiqh al-Islāmī, 1963). Two minority extremes were also found – one which rejected insurance altogether considering it violation of taqdir (destiny), tawakkul (trust in Allah), ribā'l-fadāil and ribā'l-nasīrāh and violation of inheritance law, while the other minority refuted these objections and accepted all kind of insurance provided the element of ribā (interest) and gharar fāḥsh (extreme uncertainty) were eliminated. We find that in the discussion of various seminars and conferences that were held one after another (International Fiqh Academy of OIC, International Fiqh Academy of Muslim World League, Council of Great Scholars of Saudi Arabia, etc.) and writings of various scholars and ulamā mostly the same arguments and counter arguments have been repeated.

Broadly speaking insurance has been classified into three categories - Commercial insurance which is run by joint stock companies with the motive of profit, Social insurance whereby the state protects workers from dangers to which they are exposed as part of their work, and mutual insurance which a group of individuals or associations organize to compensate themselves if they face losses. Now majority of scholars prohibit commercial insurance – including life insurance – because of its involvement of interest, gharar and maysir (Uways n.d. p. 98). As far the second and third types of insurance are concerned, there is near-consensus on permissibility if they are based on Sharī ah principles (al-QurahDaghi n.d. p. 15; El-Gamal 2006).

In the Muslim scholars conference held in Cairo in the year 1385 A.H. (1965 AD), and the one held in 1392 A.H. (1972 AD) legal advisory opinions were given while permitting mutual cooperative insurance. These matters were also approved by the first international conference on Islamic economics organized by King Abdulaziz University at Makkah al-Mukarramah in 1976 (Saqar, 1980, pp. 553-554). The same was confirmed by a fatwā issued by the Hayʾat Kibār al-Ulamā (higher council of Saudi Arabian Ulamā) in 1974, as well as by a fatwā of the Fiqh Academy of the Muslim World League in the following year and by a fatwā issued by Jeddah based Islamic Fiqh Academy of the Organization of Islamic Conferences in 1985. For us it will suffice to note here the ruling of the Islamic Fiqh Academy of the Organization of Islamic Conference (O.I.C.), now Organization of Islamic Cooperation:
1. The commercial insurance contract, with a fixed periodical premium, which is commonly used by commercial insurance companies, is a contract which contains major elements of deceit, which void the contract and therefore is prohibited (*haram*) according to Shariah.

2. The alternative contract which conforms to the principle of Islamic dealings is the contract of cooperative insurance, which is founded on the basis of charity and cooperation. Similarly is the case of reinsurance, based on principles of cooperative insurance.

3. The academy invites the Islamic countries to exert effort toward establishing cooperative insurance institutions and cooperative entities for reinsurance, in order to liberate Islamic economy from exploitation, and put an end to the violations of the system which Allah has chosen for this Ummah (Islamic Fiqh Academy (2000)).

At present bulk of discussion on Islamic insurance revolve around the questions how to remove *gharar* and *jahālah*, how to make it perfectly cooperative and mutual, how to utilize its idle fund, how to meet deficit, what to do with the surplus, and how to arrange re-insurance. Following is a brief account of each:

**How to remove gharar and jahālah:** Uncertainty is inherent to insurance. It cannot be imagined without uncertainty. This requires that the insurance should be based on such a provision where *gharar* and *jahālah* are not effective. Three ways out have been suggested: consider the contribution and help to the affected person as *tabarru* (voluntary donation) on the pattern of Maliki school according to which *gharar* is not injurious to an act of *tabarru*. *Hibat al-thawāb* (gift in return of gift) is another way. Contributors to insurance fund gift the money in return of money that they would receive. A third way to avoid *gharar* in *takāful* is to establish a *waqf* for it. It may be noted that no provision is free from criticism and the effort is still going on to find an agreeable alternative (al-QurahDaghi 2011, 15).

**How to make Islamic insurance perfectly cooperative and mutual:** Efforts and suggestions are made to establish a really speaking mutual cooperative insurance. In many cases joint stock companies or banks establish *takāful* insurance as their subsidiaries which were not owned by the contributors. In mutual *takāful*, the contributors themselves should be owner of the establishment. In Saudi Arabia, Bank al-Jazirah has done it by establishing a mutual insurance company and working for it as an agent.

**How to utilize its idle fund:** Generally two ways are suggested for utilization of idle fund. Since there may not be expertise of investment which can utilize the funds available with a *takāful* company, it can hire an experienced skilled firm for investment of *takāful* fund on the basis of *wakālah* charging a fee for it. Another possible way is to make a contract with such a company to utilize the available fund on the basis of partnership acting as *muḍārib* for the *takāful* company (Obaidullah 2005).

**How to meet deficit:** Deficit in the *takāful* fund is also a worrisome issue. Recently in a seminar al-QurahDaghi (2011, pp. 34-5) has dealt this topic and suggested the following possibilities for consideration:

1) The *takāful* concern may borrow money through a permissible way.

2) The members should be required to contribute to meet this deficit. That is also the spirit of mutuality.
3) The takāful companies should establish a fund to meet such emergencies.

4) A third party may take the guarantee to help in such a situation.

5) The agreement may be concluded with the re-insurance company to bear such risks.

**What to do with the surplus:** It is not only deficit but the surplus fund also which is left after meeting all the obligations is a problem. Who should take it or how it should be utilized? The Islamic International Foundation for Economics and Finance (IIFEF) organized a workshop in 2011 in which one of the themes was application of insurance deficit and surplus (al-Qari, 2009; Haydar, 2009). In the opinion of Khorshid (2004, p. 70) the main feature of mutual insurance and commercial interest is that in takāful the insured have, a proportional interest in the surpluses while, in commercial insurance, the surpluses go to the owners of the enterprise who are the shareholders.

**How to arrange re-insurance:** Like insurance, reinsurance has also been a theme of discussion among the ulamā and scholars. Many think that the re-insurance will also be established on the pattern of takāful. Naturally the same controversies have to be resolved in case of re-insurance as well (al-Khalifi, 2011, pp. 45-7).

**Hamidullah’s model of mutuality-based Islamic insurance**

In this section we shall see the model of insurance which Dr. Hamidullah presented more than half a century ago. In view of his ideas being scattered and generally remaining unnoticed, we think that it would be useful to give lengthy citations from his works, so that the reader could know his ideas in his own words. To Hamidullah (1951, p. 45) "Insurance essentially means the distribution of a burden or hardship over as large a number of people as possible, thus lessening the burden of each as much as practicable so that none of them feels it".

According to him early Muslims needed only protection from payment of blood money and ransom from captivity. Their other life requirements were so simple that they did not feel need for general insurance. They needed insurance against risks involving heavy charges such as captivity and assassination. He says:

Among the Arabs at the commencement of Islam, daily ailments were unknown and the cost of medical care was practically nothing. The average man built his house with his own hands, and did not pay even for the major part of the material. Thus, it is easy to understand why one had no need of insurance against sickness, fire etc. On the contrary, insurance against captivity and against assassination were a real need. Already in the time of the Prophet (pbuh), this point had received attention, and certain dispositions were made which had the elasticity of further development and adaptation to circumstances "(Hamidullah, *Introduction to Islam* P. 128).

It was so urgent a matter that when the Prophet (pbuh) reached Madinah, he paid attention to it and in the first year of his migration, he made provisions for it in the Constitution of the City-State of Medina. He based this insurance on the ma āqil system. It worked in pyramidal hierarchy. Hamidullah gave its modus operandi:

“If someone was made a prisoner of war by an enemy, payment of ransom was needed to procure his liberation. Similarly, all bodily torts or culpable homicides required payment of damages or blood money. This often exceeded the means of the individual concerned, prisoner or criminal. The Prophet organized insurance on the basis of
mutuality. The members of a tribe could count on the central treasury of their tribe, to which everybody contributed according to his means. And if the treasury of the tribe proved inadequate, other related or neighbouring tribes were under obligation to render aid. A hierarchy was established for organizing the units into a complete whole" (Ibid.).

This hierarchy was to reach to the state.

"If somebody was found guilty of involuntary homicide, and was unable to pay the blood money required by law out of his own means, the government came to his help under this heading of the budget, as is evidenced by several cases of the practice of the Prophet" (Ibid. p. 129).

He further says:

"Later in the time of the caliph 'Umar, the branches of insurance were organized on the basis of the profession, civil or military administration, to which one belonged (or even of regions). Whenever needed, the central or provincial government came to the succour of the branches" (Ibid.).

Dr Hamidullah is against the conventional insurance. To him it "falls under the same prohibition as interest. One sided risk and gain without proportionate responsibility in such a commercial contract are reasons thereof" (Haidarabad's Contribution p. 76). At another occasion he likens it with the game of chance. He observes:

“Without entering into technical details, it may be pointed out that capitalistic insurance, in which the insured person does not participate in the benefits of the company in proportion to his contributions, is not tolerated in Islam as this would constitute a form of game of chance” (Hamidullah, Introduction to Islam p.129).

He is in favour of "an insurance company, not on capitalistic but mutuality basis" (Haidarabad's Contribution p. 76), as the system of insurance organized by the Prophet (pbuh) was also based on mutuality. According to Hamidullah

"Insurance signifies essentially the repartition of the burden of an individual on as many as possible, in order to lighten the burden of each. Instead of the capitalistic companies of insurance, Islam preferred organising insurance on the basis of mutuality and cooperation, aided by a pyramidal gradation of the branches culminating in the central government" (Hamidullah, Introduction to Islam P.129).

In his note on “Islamic Insurance”, Dr. Hamidullah presents an example of mutual insurance that was in practice in Hyderabad state:

“From time immemorial the Hyderabad cavalry of Naẓm Division has retained it under the name of the "Ahdi System". It was necessitated on account of the fact, that on first employment the Government supplied the soldier with a horse, yet, if it died, the soldier had to replace it at his own expense. Of course this was beyond his capacity. So they paid to the common pool a small sum of, say, two rupees annually. The thousands of rupees thus collected were utilized for all accidents against which the contribution insured the horseman” (Islamic Review, March-April 1951, pp. 45-46).

On the same pattern he recommended formation of a mutual insurance company for increasing number of motorists in Hyderabad which was basically suggested in 1946, by an expert body consisting of those well-versed in insurance business and those who knew
Muslim legal and economic theories thoroughly. The body was set up by the Economic Committee of the Osmania Graduate Association. Following was its suggestion:

“Let us begin with insurance against motor accidents. Supposing of the 20,000 motor cars in the city of Hyderabad only one thousand insured with us. The accidents causing damage to cars of our 1,000 clients might be 25 per annum, demanding a sum of Rs. 5,000 for repairs. If the admission fee was fixed at Rs. 6 and the premium to be paid by our clients at only Rs. 8 per mensem, the annual income would be Rs. 6,000, which may cover not only the cost of repair but also working expenses of the office, along with one year’s income as a reserve in hand through the admission fee. Even these annual six thousand rupees need not lie idle, but should be invested in profitable concerns provided they are interest-free and allowable under Muslim laws of company and partnership” (Ibid.).

However, this could not be experimented because of political upheaval.

Dr. Hamidullah does not ignore the possibility of nationalization of insurance business by the state:

“It goes without saying that these elements of mutual aid could insure against all kinds of risks, such as accident of traffic, fire, loss in transit, and so on. Also, it goes without saying that the insurance business is capable of being "nationalized" for all or certain kinds of risks (i.e. temporary motives such as the dispatch of parcels, etc.” (Hamidullah, *Introduction to Islam* P.129).

Hamidullah has discussed not only mutuality-based insurance but he has also elaborated how Islamic banking can be established on the basis of 'mutual co-operation' (Hamidullah, 1955a). However, this is not our theme at this time.14

According to Hamidullah, Western insurance works "through speculating and gambling and taking risk in expectation of greater benefits", where "the risk is one-sided, i.e., on the side of the company". On the contrary, Islamic insurance operates "in a spirit of mutuality, fellowship and avoidance of one-sided risks". Islam is against the contract that is "based on one-sided risk" (ibid.). Islamic provisions of insurance "were called *ma ḍāqil*, and concerned mainly insurance against tort and legal damages" (Hamidullah, 1951, p. 45).

He notes that in January, 1950, just before the General Election, the Labour Party's proposed for mutualisation of insurance. But the precarious Labour majority left this proposal in abeyance. He expressed his hope that Pakistan would present such a model (ibid.).

To Hamidullah "Insurance essentially means the distribution of a burden or hardship over as large a number of people as possible, thus lessening the burden of each as much as practicable so that none of them feels it" (ibid.). He was first to introduce to English readers a model of Islamic insurance based on mutuality and risk-sharing.15 As noted earlier, perhaps he was motivated to write upon Islamic insurance by the existence of such a system in Hyderabad and unfinished joint effort of Hyderabad's Majlis-e Ulama and Economic Committee of the Osmania Graduate Association. We have seen above, before its theoretical presentation its simple shape was already in practice in Hyderabad state while in rest of Islamic world mutuality based insurance was established much later first time in Sudan in 1979 (Lal-Din, Muhammad Akram and Buharawah, Sa’id 2011).
Hamidullah criticized the conventional insurance on the same basis on which most of ulamā rejected it – ṛibā (interest), gharar (excessive uncertainty) and maysir (game of chance). As noted above, much before our contemporary Ulamā, Hamidullah suggested establishment of insurance on the basis of mutuality as an alternative of conventional insurance. In spite of so many discussions individually and collectively no commonly acceptable substitute could be found. There is near consensus that mutuality is the way of Islamic insurance.

Reciprocal inter-insurance exchange vs. mutual insurance

The model of mutual insurance which had existed in Hyderabad and which was reported by Hamidullah is known in the insurance terminology as "reciprocal inter-insurance exchange".¹⁶ There is no difference of opinion on its permissibility among the Muslim scholars. But the term "reciprocal inter-insurance exchange" is not very common among the writers on Islamic insurance. Being a form of mutual insurance, a few writers have called it as the simple mutual insurance. Hamidullah presented both models of insurance – simple and compound without making any distinction between the two. His example of “ahdi system” and motorist union comes under "reciprocal inter-insurance exchange" or simple mutual insurance while his general explanation refers to compound mutual insurance. Hamidullah puts both types of insurance – simple and compound – in the same category. However, the detailed description of Islamic insurance which he presented comes under mutual insurance.

Advantage of Mutuality: Flexibility and focus upon the policyholder are the two important advantages of a reciprocal insurance arrangement. It is owned by members and controlled by members, and can be structured as desired. Generally operating profits from reciprocals are retained for future liabilities and expansion. Mutual and mutuality being known all over the world, has set rules and regulation. Thus, to base the Islamic insurance on mutuality and use the term mutual will be internationally advantageous. El-Gamal (2006, p. 153) sheds light on some other advantages of Mutuality as he observes: "the mutual structure of insurance companies serves other (more direct economic) interests: Managers of a stockholder-owned insurance company answer to the stockholders, and hence aim to maximize profits, which translates into seeking loss ratios that are not advantageous to the insured. In contrast, shareholders of mutual insurance companies are themselves the insured parties, and hence managers will aim to provide them with better insurance value for their premiums. There is indeed a well-documented empirical regularity of mutual insurance companies providing better loss ratios for the insured parties". Some Western writers do not consider a reciprocal inter-insurance exchange as a "mutual insurance company" because the former is an unincorporated association of subscribing members who exchange contracts of indemnity with each other while the latter is generally "incorporated". Dr. Hamidullah does not go in such details.

Problem of terminology: As noted in preceding pages, the word for insurance in modern Arabic is "ta'mīn" which is in the sense of Italian term siguare and the Turkish sigorta meaning security or securité. Islamic insurance is called as "al-Ta’mīn al-Islāmī", or "al-Ta’mīn al-Ta’awunī". But now a single word "al-takāful" is used for all kinds of Islamic insurance which has the meaning of mutual sponsorship. Still sometimes some other terminology is used to give an impression of having a different concept of Islamic insurance while in reality it remains the difference of terminology only. Dr. Hamidullah used the word 'mutual 'and' mutuality' along with the term 'Islamic insurance'. He also used the word "ma ʿāqil" a term of early Arab-Islamic origin which has the meaning of
being tied within close relation. However, as the Arabian proverb says there is no problem to use any terminology so far connotation is one and clear and it is not meant to confuse others.

**Use of Fund and Distribution of surplus**

As indicated in preceding pages, investment of takāful fund and distribution of its profit or surplus amount is one of the hottest topics of Islamic insurance. Basically as an organization of mutual cooperation, Hamidullah thinks that there is no harm to invest the collected amount in some economically profitable activities so that the capital is enhanced:

"Such a branch could engage in commerce with the help of unutilized funds remaining at its disposal, so that the capital is augmented. A time might come, when the members of a branch could be fully exempted from paying further contributions, or might even receive amounts of the profits of commerce" (Hamidullah, 1969, P.129).

Thus, he does not enter into a discussion whether the mutuality based Islamic insurance is an act of exchange (mu' awdah) or voluntary donation (tabarru'), and whether a gharar is involved that might render the deal as invalid. Perhaps he thinks the element of gharar is so insignificant that it would not lead to a dispute or result in a big loss to any party – contributors or beneficiary. It is the nature of mutuality that makes the gharar tolerable. This gharar becomes effective and turns into a game of chance if the insurance is organized by a capitalist to earn profit who deprives the policyholder from profit or surplus of insurance company. He says:

"Without entering into technical details, it may be pointed out that capitalistic insurance, in which the insured person does not participate in the benefits of the company in proportion to his contributions, is not tolerated in Islam as this would constitute a form of game of chance" (Ibid).

In the above passage by capitalistic insurance he means conventional commercial insurance in which profit goes to stockholders. As far as policyholders are concerned, they get only compensation for losses incurred.

**Concluding remark**

At the conclusion we may note that since Hamidullah initiated his discourse on Islamic insurance, though substantial advancement has been made throughout these years in terms of re-insurance schemes, various provisions of meeting deficits, suggestions regarding the use and distribution of insurance surplus, different interpretations of relations between contributors and beneficiaries, and clarity of related concepts, the overall ideas remain the same. Elimination of riba, maysir, gharar fāṭish from takāful is still regarded the most important element of Islamic insurance. Mutuality is considered as the most accepted method. Augmentation of insurance fund through investment methods is justified. Sharing in benefits of insurance - monetary or qualitative - is generally allowed. On all these issues Hamidullah offered insights. Of course he did not engage in hair splitting. That is how we can benefit from his ideas.
End notes

1. Its revised edition was published at Paris in 1975 which was republished from Hyderabad in 1981.


9. This has been stated by Rispler-Chaim (1991, p. 146) with reference to Afzalur-Rahman, Banking and Insurance, 1st edition, London 1979, p, 73.


11. Abduh’s fatāwā dated 1.2.1319/6.5.1901, and dated 3.12.1320/7.3.1903, have been quoted by Imarah (1993) in al-A`māl al-Kāmilah li-Muḥammad Abduh part 2: 503-504.

12. The proceeding of the Uṣbū` al-Fiqh al-Islāmī (Islamic Jurisprudence Week) which was published in 1963 included papers of the following scholars on Islamic insurance:

13. Mustafa Ahmad al-Zarqa, Muhammad al-Qalqili, Muhammad al-Amin, Abd al-Rahman Isa, Bahjat Ahmad Hilmi, and Muhammad Umaruddin.

14. An “ahdi system” seems to be a system of covenant (ahd) which the new recruits made that he would maintain the horse supplied to him and replace it if lost.

15. This is an idea which still awaits scholars to ponder upon. Among the modern scholars El-Gamal (2006) has strongly advocated it. According to Hamidullah in the mutuality based banking system "members paid a small percentage monthly towards expenses of the establishment, like stationery (the staff consisting of honorary workers). The surplus of this was preserved as reserve fund, to cover unforeseen losses. This reserve fund was later put to enhanced utility: a store as organized on commercial basis, where members of the society purchased on credit
their requirements in non-perishable goods. The benefit was used to remunerate the workers and also to strengthen the reserve fund further." (Haidarabad's Contribution … p. 75).

16. At present there is no dearth of writing on Islamic insurance in English. But it took about 25 years since Hamidullah first wrote on Islamic insurance in 1946 to appear another work in English on the topic of Insurance by Muslihuddin Siddiqi (1969). Interestingly, he also belonged to Hyderabad.

17. It has been defined as "an insurance company owned entirely by its policyholders. Any profits earned by a mutual insurance company are rebated to policy-holders in the form of dividend distributions or reduced future premiums." http://en.wikipedia.org/wiki/Reciprocal_inter-insurance_exchange Accessed on 25. 09. 2013.

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Abstract

Islamic banking in Mauritius is a very new industry introduced only in late 2007. Mauritius is a secular country with mostly people from Hinduism faith and only around twenty percent are Muslims. In such an environment, Islamic bankers would need to know whether the Mauritian population is willing to accept this new form of banking. This study attempts to investigate the willingness of the people of Mauritius to patronize Islamic banking and whether religion plays a significant role upon this issue. A survey was conducted and a logistic regression was carried out. The results show that Muslims are more willing to choose Islamic banking as an alternative. Interestingly, respondents perceived that Islamic banking is meant for everyone and not only for people of Islamic faith and these respondents have a higher likelihood to patronize Islamic banking than those who perceived otherwise.

Keywords: Islamic banking, Mauritius, religion, patronize behavior

1. Introduction

Mauritius, a small island comprising of 1.3 million population only is situated around 2000 km off east of South Africa. The country is considered as one of the most developed ones among African countries according to a World Economic Forum’s report. Mauritius is also known as a country with a robust financial system where the banking sector forms the major part of the country’s financial sector which was resilient against the recent financial crisis according to the IMF.

Islamic banking in Mauritius was introduced in 2007 when the government had required changes in the banking act. The main objective of the government was to transform the island into an Islamic financial hub. The country is already well known as
being an international offshore financial centre and has a number of double taxation avoidance treaties with different countries such as China, India and Singapore and this acts as an advantage for the country especially to attract investors.

In 2007 the government introduced the Finance Act 2007 which amended several other acts in order to incorporate and recognize Islamic banking legally in the country. The main acts which were amended were the Banking Act 2004, and the Bank of Mauritius Act 2004. The Central Bank of Mauritius also issued its own set of guidelines for all institutions intending to carry out Islamic Banking Business. Furthermore, the Public Debt Management Act 2008 and the Value Added Tax Act 1998 were amended in 2009 in order to allow the government to issue sovereign sukuk and to exempt murabaha transactions from double taxation. HSBC was the first bank to launch an Islamic window in 2009 and the first Mauritanian Islamic Bank was set up in 2011. The country also became a member of the IFSB in 2009 and a member of IILM in 2010.

This research was conducted in order to investigate Mauritian Islamic banking patronizing behavior and to examine the Mauritian population beliefs on whether Islamic banking can suit the whole population or it is somehow a belief that it is only for the Muslims. Although the Mauritian government has put in significant efforts in order to make Islamic finance an important part of the Mauritian economy, it is important to know the factors affecting the population of the country to get involve in the Islamic banking industry.

This study will not only contribute to literature but also help in understanding the behavior of the population of Mauritius with regards to Islamic banking. It will also shed light on whether there is potential for Islamic banking to grow and play a major role in the country’s economic development.

2. Literature Review

Consumer behavior would usually differ from country to country. With regards to Islamic banking especially, there are different factors which can determine consumer attitudes. For instance, Imtiaz et.al. (2013) discovered in Pakistan that religion was the main factor why consumers would choose Islamic banking. However, they also learned that customers are also unaware about the mechanisms of Islamic finance and what exactly the contracts are. The reason behind this is that banks do not provide proper information to customers who come to them. The consumers in Pakistan know only the basic that interest is haram and therefore, choose Islamic banking in order to avoid the haram.

On the other hand, Abduh and Omar (2012) and Selamat and Abdul-Kadir (2012) conducted their study in Malaysia to determine bank selection criteria in a dual banking system. Malaysia’s financial system comprises of both the conventional and the Islamic systems operating on a parallel basis. Their results show that in Malaysia consumers go for fast and efficient service provided by the bank compared to religion. Customers in Malaysia both Muslims and Non-Muslims would actually rank customer service as their primary criteria in choosing a banking product. Other factors that would push customers into choosing a bank in Malaysia are the facilities offered by the bank such as credit cards, overdraft facilities, and internet banking among others.

In Mauritania and Dagestan, Mahmoud and Abduh (2014) and Abduh and Idrisov (2014), respectively, conducted a study on the role of awareness, attitude and subjective norms upon people acceptance and support towards Islamic banking services. Both
studies confirmed the significant role of awareness and subjective norms upon their acceptance towards Islamic banking services.

However, Hamid et.al. (2011) and Razak and Abduh (2012) revealed that there is no significant difference in awareness on Islamic finance between Muslims and Non-Muslims in Malaysia. Their study was actually more focused on Islamic home financing which is the most popular Islamic banking product in Malaysia. The results showed the factors that actually determined customer awareness were education and age group. However, religion was not a determining factor. On the contrary, based on survey done in Jakarta, Indonesia, the study done by Abduh (2011) had found that Shari’ah aspects is one of the most important factors that could maintain Islamic bank customers with their bank in Indonesia.

Similar to Malaysia, in terms of demography, Mauritius might not be a Muslim majority country, but the country’s population comprises of people from different religious backgrounds. The first largest religion is Hinduism followed by Islam, Christianity and Buddhism. This kind of situation may create different attitude among Mauritian people towards Islamic finance. According to Ramdhony (2013), it seemed to be a common perception that Islamic banking is meant only for Muslims. His study demonstrated that there is a relationship between awareness and being a Muslim. However, the results also showed that a very low percentage of Muslims actually understood the Islamic terms such as Riba and Shariah. Furthermore, the author also found out that more than two thirds of the Muslim respondents would base their choice for Islamic banking both on religion and high returns. With regards to Non-Muslims though, most of them are mostly profit driven.

Based on the above literature, it can be seen that in other countries, most of the customers do not go for Islamic finance owing only to religious reasons. The literature leads to believe that both Muslims and Non-Muslims can pick Islamic banking as a product irrespective of the reason behind it. Hence, the purpose of this study is to figure out whether Islamic banking has a potential in Mauritius, with its various characteristics and religion inside, by looking at willingness of the customers to patronize Islamic banking.

Hence, the hypotheses developed in this study are:

H1:  Religion has a significant influence on Islamic bank patronizing behavior in Mauritius

H2:  Perceptions on Islamic Banking has a significant influence on Islamic bank patronizing behavior in Mauritius

This study contributes not only to the knowledge and discipline by adding a literature on consumer behavior towards Islamic banking in a country which has never been mentioned in the past, but also to the industry of the country by providing an insight on patronizing behavior of its potential customers.

3. Data and Methods
3.1 Data

Primary data is used for this research and was collected through a survey in Port Louis, the capital city of Mauritius. Convenience sampling technique was implemented
with following criteria of respondents: (i) currently is adopting bank’s services and (ii) has basic information on Islamic banking. Questionnaires distributed were 400, however, usable questionnaires are only to 172 due to a number of respondents did not respond to the survey or they have missed a significant number of questions in the questionnaire.

3.2 Method of Analysis

As far as method of analysis is concerned, logistic regression is used. Logistic regression is suitable for data with dichotomous responses as dependent variable, which is binary in nature, compared to normal regression methods.

Garson (2010), however, said that unlike OLS regression, logistic regression does not assume linearity of relationship between the independent variables and the dependent and does not require normally distributed variables, does not assume homoscedasticity, and in general has less stringent requirements. It does, however, require that observations be independent and that the independent variables be linearly related to the logit of the dependent. The predictive success of the logistic regression can be assessed by looking at the classification table, showing correct and incorrect classifications of the dichotomous dependent. Goodness-of-fit tests such as the likelihood ratio test are available as indicators of model appropriateness, as is the Wald statistic to test the significance of individual independent variables.

In linear regression, we assume that the mean may be expressed as an equation linear in x (or some transformation of x or Y), such as

\[
E(Y | x) = \beta_0 + \beta_1 x
\]

(1)

This expression shows that it is possible for \( E(Y | x) \) to take any value as \( x \) ranges between \(-\infty\) and \(+\infty\). However, in logistic regression model, the specific model used is:

\[
E(Y | x) = \pi(x) = \frac{e^{\beta_0 + \beta_1 x}}{1 + e^{\beta_0 + \beta_1 x}}
\]

(2)

where, \( e \) = euler’s number (2.7183)
\( \pi(x) \) = function of \( x \) in logit model

And in order to give a meaningful interpretation, \( E(Y | x) \) is transformed with logit transformation to become:

\[
g(x) = \ln\left[\frac{\pi(x)}{1 - \pi(x)}\right] = \beta_0 + \beta_1 x
\]

(3)

The significance of this transformation is that \( g(x) \) now has many of the desirable properties of a linear regression model. The logit, \( g(x) \) is now linear to its parameter. Hence, the relationship of dependent – independent variables in this study is expressed in the following equations:

\[
p = \exp[a + b_1 x_1 + b_2 x_2]/(1 + [a + b_1 x_1 + b_2 x_2])
\]

(4)

\[
\log[(p / 1 - p)] = a + b_1 x_1 + b_2 x_2
\]

(5)
Where:

\[
\text{Log}\left[\frac{p}{1-p}\right] = y, \text{ represents the independent variable (1 = will patronize Islamic bank, 0 = Otherwise)}
\]

\(x_1\) represents Religion (1 = Muslim, 0 = Otherwise) and;

\(x_2\) represents “perceive that Islamic banking is meant only for Muslims” (1 = Yes; 0 = Otherwise).

4. Findings and Discussion

4.1. Descriptive Analysis

Among all respondents, 36% were Muslims and 64% were Non-Muslims. Another interesting point to be noted is that the majority of respondents actually believed that Islamic banking was not meant only for people of Islamic faith and 47% of them were Non-Muslims and 33% were Muslims. The rest actually believed that Islamic banking is intended for Muslims only.

4.2. Reliability Test

Table 1 shows a Cronbach alpha of 0.733 for all of the questions which indicates a desirable level of internal consistency especially considering the fact that the variables are nominal (dichotomous, yes-no questions). However, after conducting the reliability test only for the questions concerning awareness and willingness to patronize Islamic banks, the Cronbach alpha increases to 0.951. These values show an acceptable internal consistency level of the instrument.

<table>
<thead>
<tr>
<th></th>
<th>All Questions</th>
<th>Questions Concerning Awareness and Willingness to Patronize Islamic Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cronbach alpha</td>
<td>0.733</td>
<td>0.951</td>
</tr>
</tbody>
</table>

4.3. Logistic Regression

A logistic regression was conducted to predict willingness of using Islamic banking with explanatory variables as religion and respondents’ believe that Islamic banking was meant only for Muslims. The model shows that both the independent variables are significant and the accuracy of the model is 70.6%, which shows 70.6% of the ability of the model to match correctly between predicted values and real values, which is considered as quite good.

Table 2 gives two important columns, the ‘sig.’ column and the ‘Exp(B)’ one. The former shows significance of the independent variables and here both variables have values less than 0.05 which implies they are both significant and the latter represents the odds ratio which measure the strength of association between two variables. Thus, it confirms the two hypotheses proposed in the previous section of the paper.
The equation derived from Table 2 is as follows:
Log (Odds) = 0.968 + 1.719 x_1 – 2.422 x_2

The equation demonstrates that every one unit increase in x_1 increases the log-odds of willingness by 1.719 units, but each unit increase in x_2 reduces the log-odds of willingness by -2.422 units.

The result shows that each one unit increase in religion (from 0 to 1, meaning from Non-Muslim to Muslims) will increase the likelihood of willingness by around 5 times. In simpler terms, Muslims are 5 times more likely to use Islamic banking than Non-Muslims. On the other hand, since its odd ratio is lower than 1 (i.e. 0.089), hence, those who perceive that Islamic banking is only for Muslims have a lower likelihood to use Islamic Banking than those who perceive that Islamic banking is for everyone.

The research objective was to look at the prospect for Islamic banking in Mauritius and whether Non-Muslims there have the willingness to accept this new form of banking. Interestingly, the findings showed that even Non-Muslims can find Islamic banking appealing in Mauritius if they are properly informed and educated on the system.

Therefore, Islamic bank could focus first on Muslim community in Mauritius to persuade them with Islamic banking as the best alternative for banking in Islamic way. Afterwards, Islamic bank can undertake strategies to penetrate broader market by providing proper advertisements showing the universality of Islamic banking.

5. **Conclusions**

Islamic banking in Mauritius started barely 7 years ago. Therefore, it might have taken some time for the population which consists mostly of Non-Muslims to accept this
new sphere of financing. Interestingly, this study found that majority of respondents perceive that Islamic banking is not only meant for Muslim and religion is not the main factor influences Mauritian to choose Islamic banking even if the results showed that Muslims are most likely to go for it as compared to Non-Muslims.

This study is not without limitations. Among the limitations identified are (i) small sample size due to the reluctance of people in Port Louis to give their time to fill up the questionnaire and (ii) too few of independent variables tested which was caused by too many questions left with no responses. Therefore, in order to obtain more robust findings, future researches are suggested to increase the sample size and broaden the research scope to other cities. Furthermore, incorporating other relevant theories and variables in bank patronizing behavior is one of the imperative contributions in the case of Mauritius.

6. References


Insights on Islamic Finance (Part - two)

By

Imran Hussain Minhas

Abstract:

Riba, the major driving force and key element in conventional banking, is one of those items which have been strictly forbidden and declared as Haram in Islam. The convention banking and finance system is not meant for the Muslims and Islamic societies. Practicing riba based banking and financial system is sinful and destructive for the Muslims for which the State and its Organs are primarily responsible. It is true that the modern economies cannot survive without a sound financial system but it is not necessary that it should be based on conventional banking practices and riba. Shariah compliant solution to the riba based conventional or modern financial system is not a dream now.

Key Words: Riba, Islamic Finance, Shariah compliant, Shariah principles

Islam is a complete code of life and it has laid down comprehensive set of rules to run the social, political and economic system of an economy. The subject of Islamic economics, banking and finance is covered under the Muamulat. Ijma and Qiyas are the methodologies being used by the Shariah scholars to provide Shariah compliant solutions to the financial needs of the modern age. It is believed that the creation of this world is based on goodness and utility; and like Islam, every religion has goodness and utility as its basic principles. Being Muslims we believe that whatever is declared Haram (forbidden) by Allah (swt), does not hold utility for the people in this world and hereafter and the one who follows the forbidden path, generates the curse of sins much greater than the utilities he receives.

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To address and eliminate the riba from banking and financial system, Islamic jurists have introduced an Islamic banking and finance (IBF) system which encourages entrepreneurship, trade and profits by discouraging the Riba. IBF is the value system which is governed by the principles and rules established by the Quran and the Sunnah. In addition to the conventional good governance and risk management rules, it operates with the objectives to implement and materialize the economic and financial ideology of Shari’ah. IBF is allowed and approved by the Islamic jurists as riba free and Shari’ah compliant alternative for the Muslim societies.

The Islamic banking and finance model is based on economic justice and is free from the element of Riba, Gharar, Maysir, and from Haram (forbidden) business activities. In fact the prohibition to engage in such transactions that extract surplus value in unfair ways through the elements of riba and gharar, stems from concerns of justice and fairness. For a financial or business transaction to be viable economically and ethically, Shariah measures may include the following principles:

(i) risk - sharing – The parties involved in a financial transaction must share the risk of loss of the business transaction as well;
(ii) materiality – The financial transaction must be linked to a real economic transaction;
(iii) no exploitation – a financial transaction should be exploitation free; and
(iv) business activity must be Halal (permitted) no funding to ‘haram’ or sinful activities.

In the current scenario, Islamic banking, as a suitable alternative to conventional banking, has its acceptance worldwide. Today, there are more than 600 Islamic financial institutions, including government run banks, private banks, investment companies, mutual funds, takaful companies and modarabas operating in more than 75 countries of the world. As of 2014 around US $2 trillion of the worlds financial assets are Sharia-compliant (the Economist). According to Ernst & Young, from 2009 to 2013 the Islamic banking assets have grown at an annual rate of 17.6% and they are expected to grow by an average of 19.7% a year to 2018.

**History of Islamic Finance**

History of Islamic finance is as old as Islam is. Some of the products like Modaraba and Musharakah were being practiced before the era of the last Prophet ﷺ. In addition to these modes, Salam has also endorsement of Muslims since the time of Holy Prophet ﷺ.

However, the initial work on riba free banking transactions was started in 1920’s by the Eastern Bank, the predecessor of Standard Chartered, when the ruler of Bahrain asked that the bank’s proposed branch on the island would only be allowed if it avoided all interest based transactions. At the same time the National Handelsbank of the Netherlands, the predecessor of ABN-Amro, was allowed to establish itself in Jeddah to provide money changing services for pilgrims from Dutch, Indonesia etc., the condition being that it should avoid all interest based transactions. [Rodney Wilson, Banking and Finance in the Arab Middle East, Macmillan, London, 1983 p.87]
An early form of Islamic capitalism was developed between the eighth and twelfth centuries and the economy of the period was based on currency in the form of gold dinar. Some other forms and concepts of Islamic enterprises apart from the state were also adopted during that period. At the time of the Ottoman’s, the Middle Eastern traders practiced financial transactions that were based on Shari’ah principles.

In the 20th century, Islamic scholars perceived "necessary evil," and proposed a banking system based on the concept of Mudarabah. Specific work on the subject of interest-free banking was conducted in 1955 onwards and the basis of modern Islamic banking and finance was provided by the first Shariah compliant saving bank which was established in the Nile Delta town of MitGhamr a rural area of Egypt by an economist, Ahmad Al NaJJar in 1963, as “MitGhamr Saving Project”. The idea was not advertised for fear of being seen as Islamic fundamentalism during the regime of Jamal Nasser. The “MitGhamr Saving Project” was shut down by the government in 1968; later on it was merged with the Nasser Social Bank in 1971. **The Bank failed but the idea succeeded.**

Soon after the experience of MitGhamr Saving Project, many commercial banks in Egypt started following MitGhamr. The wave of modern Islamic banking also started in other parts of the world as in the year 1963 Malaysia introduced the Malaysian Pilgrims Fund Board (Tabung Haji) as a first Islamic investment fund. Islamic Development Bank, with the head office at Jeddah, was also established in July 1975 to foster the economic development and social progress of member countries individually as well as jointly in accordance with the principles of Shariah. The first modern commercial Islamic bank, Dubai Islamic Bank, also started its operation in 1975.

At the same time Pakistan achieved fourth position in the world to introduce Ribā free financial system in the country by taking the following steps:

1. The local Council of Islamic Ideology (CII), consisting a panel of bankers, Shari’ah scholars and economists, was set up on September 29, 1977 which prepared a blueprint of interest free economic system and submitted its report in February 1980, highlighting details for eliminating interest from the economy.

2. Islamic finance started its journey, through presidential orders, and the Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980 was promulgated which enabled business groups to setup SME Modarabas in the country. It was a great breakthrough, to establish full fledge Islamic financial institutions under the Modaraba Ordinance.


4. The conventional banking converted into profit and loss sharing banking by making amendments in the Banking Companies Ordinance (BCO), 1962 and on January 1, 1981, interest free counters were established in all the public and one foreign bank operating in Pakistan and their interest bearing deposits were converted into profit and loss sharing deposits. But foreign currency deposit and debts remained on conventional interest bearing system.
5. In November 1991 the Federal Shariat Court (FSC) declared the system of profit and loss sharing adopted in the banking sector as not being in accordance to the teachings of Islam. However, the regulatory framework under the Modaraba Ordinance was not declared as un-Islamic. Against the order of the FSC, a request was made in the Shariat Appellate Bench (SAB) of the Supreme Court of Pakistan (superior court) to review the order.

6. On 23rd of December 1999, i.e. after eight years, the Supreme Court rejected the appeal by declaring the efforts towards Islamic banking as un-Islamic and that the interest based system shall cease to have effect by 30th of June, 2001. The Supreme Court gave its decision that currently interest based system would be shifted according to the principles of Shariah, as soon as possible.


8. On June 24, 2002 the SAB reversed its own decision of 1999 and remanded the case back to the FSC for re-determination. Legal Counsel for the Federation argued that the FSC had no jurisdiction to declare riba illegal or impermissible; the Constitution makes it the duty of the Federal Government (not the FSC) to eliminate riba. He stated also that, in pursuance of the SAB’s judgment of 1999, the government had formed a Commission and two task forces to direct the transformation of interest-based government borrowing to Islamic modes of finance, to effect a transition in the financial sector, and to establish a legal and regulatory framework for an Islamic economy. In an affidavit to the SAB, the government stated that after its best efforts to find ways to implement the SAB’s directives, it had found that implementation was neither practical nor feasible, and if attempted would pose great risk to Pakistan’s economic stability and security.

9. In the meantime, the Government of Pakistan (GoP) formed a Commission for Transformation of Financial System (CTFS) under the supervision of State Bank of Pakistan. The CTFS submitted its final recommendations in August 2001, for creating a legal Shariah compliant infrastructure for shifting of the economy and conversion of the entire financial systems in accordance with Shariah and interest free system in a phased manner without causing any disruptions to the economy and banking system. Separate Islamic banks were allowed to operate in parallel to conventional banks.

10. Recently, in the year 2013 the GoP has formed a ‘Steering Committee for promotion of Islamic Banking’ to speed up work on Islamization of financial system, banking and capital markets of Pakistan.

As per the constitution of Pakistan it is an Islamic republic. Article 38(f) of the Constitution of Islamic Republic of Pakistan, 1973 (“the Constitution”) prescribes that the state shall “eliminate riba as early as possible”. Article 227(1) of the Constitution says that:

“All existing laws shall be brought in conformity with the Injunctions of Islam as laid down in the Holy Quran and Sunnah, in this part referred to as the Injunctions of Islam, and no law shall be enacted which is repugnant to such Injunctions”
Accordingly, it is the responsibility of the state organs to bring the laws and regulations in conformity with the injunctions of Islam whose foundation is the Quran and the Sunnah which are the basis of Islamic Shariah. Among others, the Shari’ah requires that the Islamic economic system and our businesses must be free from Riба (interest, usury or any other form), Qimar (Gambling), Gharar (Speculation), Support from Business Prohibited by Shari’ah (e.g. Drugs and Alcohol, Tobacco, Pork related items, etc.).

SECP and State Bank of Pakistan are working on the development of Islamic banking and Islamic capital markets in Pakistan. In 2003, the central bank established an Islamic Banking Department and issued Policies for the Promotion of Islamic Banking. In December 2003 the central bank established a Shariah Board to ensure Shariah compliance, and to advise banks on modes, procedures, laws and regulations for Islamic banking. The SBP Shariah Board, among other work, approved Shariah inspection manual, Islamic modes of financing, fit and proper criteria for the Shariah advisors, and Shariah Governance framework for the banking industry.

SECP is regulating the Modarabas, which are the pioneering Islamic Financial Institutions in Pakistan, Islamic Mutual Funds, Islamic Pension Funds and Takaful industry of Pakistan. For the development and growth of Islamic finance sector and moving the economy towards riba free environment SECP has recently established an Islamic finance department. Prior to this, SECP has issued three Islamic financial accounting standards, twelve model Islamic financing agreements in 2008, Shariah audit and Shariah compliance mechanism in 2012 which includes Shariah governance mechanism, fit and proper criteria and duties for the Shariah advisors and Shariah internal auditors, Shariah screening process for investment in the securities and shares, and dividend purification policy. SECP has also approved Sukuk regulations in February 2015.

Further, the central bank and SECP is also working on the awareness programs on Islamic Banking and Finance. Apart from issuing guidelines and publishing print material, various training programs, seminars and conferences are also arranged for the purpose.

Due to the above efforts, presently Islamic banking and financial institutions exists in the following forms in Pakistan.

1. Modaraba Companies and Modarabas
2. Full-fledged Islamic Banks
3. Islamic banking windows at conventional banks
4. Dedicated branches for Islamic banking at conventional banks
5. Islamic Mutual Funds
6. Islamic Pension Funds
7. Takaful Companies

The early establishment of Islamic brokerage houses and other types of Shariah compliant entities in the country are essential.

Disclaimer: "These views and opinions are my own, and not that of my employer"
Potential of Halal Industry for Maghreb Countries

By
Mohd Ali Mohd Noor*
Mohammed Rizki Moi

Abstract

The world halal market is a fast emerging sector that has received positive response. The potential of this market is being explored and such potential is not only associated with the total population of Muslims that constitutes 23 percent of the total world population but also takes into account the fact the non-Muslims countries domination on the trade of halal meat and processed food products and the demand of halal food. Halal products include both food and non-food items. This study aims to focus on the potential of halal industry in Maghreb countries namely Algeria, Libya, Mauritania, Morocco and Tunisia where majority of their Muslims population practices Maliki school of thought. Muslim population in these countries is nearly 100 percent that is a good indicator for a ready halal product market. Despite the huge number of Muslims population, their contribution to the world halal market, is rather scarce and insignificant. This study involves primary and secondary data which was analysed using the SWOT analysis to indicate the potential and the treatment for each country. The main finding implies that only four out of five Maghreb countries have potential to develop halal industry namely Algeria, Libya, Morocco and Tunisia on the ground that their net exports are positive. This study confirms that being the countries with majority Muslim population is the driving factor of the halal industry.

Keywords: potential; halal industry; Maghreb country; SWOT analysis

1. Introduction

The world halal market is fast becoming recognized as a vitaly important emerging market sector. Halal industry shows a significant potential either in domestic or international market (Aziz & Vui, 2012). It is fast becoming a new market force and brand identifier and is now moving into mainstream markets, affecting and changing perception on how business should be conducted (Lada et. al, 2009). With a global
consumer base of about 1.6 billion i.e. 23 percents of the world population (Note 1), the world halal market is estimated to be worth USD 2.3 trillion of which USD 700 billion is food (Note 2). Although this figure is based on world Muslim population, we cannot under estimate the potential of non-Muslim (cross over markets) halal demand (Global Halal Food Market Brief, 2008; MITI, 2010). With the onslaught of global trade and changing lifestyle, non-Muslim countries are dominating the trade of halal meat and processed food products.

Halal means what is permissible in Islam. Halal food is tayyib; i.e. slaughtered according to the specific parameters of Islamic law, good, wholesome, healthy, untainted during the stages of processing, packaging, storage, transportation and cooking. The concept of halal also covers non-food industries including services. Halal products include both food and non-food items. Halal food is not only meat and poultry but also other food items such as halal services and finance. The previous studies mention six areas where halal concept can be implemented namely halal food value chain, non-food halal products, halal services, halal certification, halal traceability and tracking system in food value chain and halal park and regional halal hub.

Maghreb countries consists of Algeria, Libya, Mauritania, Morocco and Tunisia. The total population for these countries are more than 93 million (2013). Almost 100 percent of the population is Muslims where majority of them practice Maliki school of thought.

Table 1. Muslim Population of Maghreb Countries, 2010–2013 (million)

<table>
<thead>
<tr>
<th>Countries</th>
<th>Total Population\textsuperscript{a}</th>
<th>Muslim Population (%)\textsuperscript{b}</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>37.062 to 37.763 to 38.482 to 39.208</td>
<td>99</td>
</tr>
<tr>
<td>Libya</td>
<td>6.041 to 6.103 to 6.155 to 6.202</td>
<td>97</td>
</tr>
<tr>
<td>Mauritania</td>
<td>3.609 to 3.703 to 3.796 to 3.890</td>
<td>100</td>
</tr>
<tr>
<td>Morocco</td>
<td>31.642 to 32.059 to 32.521 to 33.008</td>
<td>99</td>
</tr>
<tr>
<td>Tunisia</td>
<td>10.549 to 10.674 to 10.778 to 10.997</td>
<td>98</td>
</tr>
<tr>
<td>Total Population</td>
<td>88.903 to 90.302 to 91.732 to 93.305</td>
<td></td>
</tr>
</tbody>
</table>

Source: \textsuperscript{a} World Development Indicators (2014), and Food And Agriculture Organization of United Nations (2014), \textsuperscript{b} CIA World Factbook (2014)

The economic size of these countries was USD 300,027 million (2010) and increased to USD 351,631 million (2012). The average per capita income for the region also increased from USD 3,099 for 2010 to USD 3,398 for 2012. The purchasing power among four countries (excluding Libya) is not so diversified except for Mauritania which is the least developed among the rest (see Appendices A, Table 2).

As the dynamics within the Muslim world change and globalisation trends continue to shape people’s tastes, habit and spending patterns across the world, we are likely to see moves in the developing halal markets having increasingly influential roles in the established markets of the Middle East and Asia. From a market perspective, the traditional major target markets remain in Asia and the Middle East (West Asia).
Northern African region, specifically Maghreb countries, have almost 100 percents Muslims, therefore are ready markets for halal products. However, in terms of their contribution to the world halal market, they are not so significant. Furthermore, with respect to the demand, their import is also relatively small. They import more halal related products rather than offering them to the world market. This is due to the countries supply less output to the world as compared to their GDPs. Most of the products imported are food and food related products. Relatively, Algeria, Libya and Mauritania have larger portions of import in term of food and food related products.

On the other hand, this condition does not rule out the potential of demand for halal products and services in this region. This region can play a major role as the gateway to growing number of Muslim population in Europe as well as emerging African countries like Nigeria. In addition, there is a need to create more awareness on halal standards and certification. Currently no halal standards or certification exist in these countries. Hence, there is a good prospect to export halal products and services to the Maghreb countries.

Therefore, the main objective of this study is to discover the possibility of Malaysia to penetrate halal industry in Maghreb countries through knowledge transfer. Specifically, it tries to clarify “halal standard” that is acceptable in Maghreb countries, identify potentials of halal industries in Maghreb countries and discover the possibility of Malaysia to penetrate halal industries in Maghreb countries. In addition to the absence of the single halal standards or certification procedures, there are another two problems observed in the literature review. Firstly, introducing the concept of halal food in Maghreb countries seems to be limited by the small volume of import and secondly the supply and value chains problems exist.

2. Literature Review

The Northern African region, specifically Maghreb countries (Algeria, Morocco, Libya, Tunisia and Mauritania), in which almost 100 percent of them are Muslims, is a ready markets for halal products (World Development Indicators, 2013; CIA World Factbook, 2013). However, in terms of their contribution to the world halal market, is rather scarce and insignificant. In addition to the existing demand, their volume of import is relatively small. These countries import more halal related products rather than exporting them to the world market (International Trade Map, 2013). Fortunately, Algeria, Libya and Mauritania have better portions of import in term of halal food compared to the rest of Maghreb countries. This is a reason why halal export is small and is not a lucrative market for export.

In addition, only Tunisia has halal logo and certification among these countries. This might be due to the majority of Muslim population in the country i.e. consumers and producers in which halal certification does is not really needed for the local market. In a way, the concept of halal according to the school of Maliki is rather lenient. In case of food, only pork and bacon physically is unlawful (haram). Other than that, either in a form of extraction, additives, powder or even DNA are basically halal.

However, Maghreb countries can play a major role being a gateway to a growing number of Muslim emerging populations in Europe as well as in a new African countries. However, there is neither a worldwide authority on halal nor is there a consistent halal trademark with over 15 halal logos in the world market although harmonisation efforts
have begun (Minkus-McKenna, 2007). Hence, there is a need to improve one of the most
important halal value chains in Maghreb’s i.e. halal standard and procedures.

By focusing on the value chain namely halal standards and procedures, Maghreb
countries in long run benefits will actually strive for increasing competition and
innovation as an element of strategy, evolving governance for the extended enterprise, the
trend towards globalization of supply and production, benefits already wrung out of
manufacturing and the supply chain analysis and trends in management discourse.

Due to a tremendous disparity of income with other countries resulting from supply
and value chain problems, Maghreb countries emerge to be poor (except Libya)
compared to countries like Malaysia, Thailand, Singapore, Australia and New Zealand
(World Development Indicators, 2013). The latter countries have more comparative
advantage especially in halal food and meat industries. Not only are they good in supply
chain procedures but also have good value chain integration in terms of product
innovation and marketing strategy. These situations do not exist in Maghreb countries
resulting in an absence of preparing a new platform to strengthen halal industries
domestically.

Malaysia is a leader in halal food benchmarking. The United Nations has
acknowledged Malaysia as the world’s best example for benchmarking of halal food in
accordance to the Codex Alimentarius Commissions in Geneva in 1997. This
Commission adopted the Codex General Guidelines for the use of halal term. This is
because the Malaysian Standard has become the basis for the development of the world
halal food industries (SME Annual Report 2006, 2007). In addition, a single halal
standard is applied throughout the country.

In addition, Malaysia also has been identified to have seven advantages in
strengthening halal value chain. This includes the global halal logo and standardized
certification procedures (Rezai et. al, 2012), regulatory framework, (Alam & Sayuti,
2011), halal laboratory facility infrastructure and support services, supporting
government and private agencies, marketing and promotion and education on halal
business (Azman et al., 2012). These seven advantages are the result of the establishment
of the framework and operational structure of the halal industry designed by the
authorized bodies in Malaysia. The strength of Malaysia in this field could benefit both
Maghreb countries and Malaysia in term of knowledge transfers and economic growth for
the benefits of halal industry.

3. Method

This study involves primary and secondary data. The former was collected by
means of conducting focus group interviews. Information on the halal concept and its
potential in Maghreb countries were gathered from two Malaysian respondents
possessing Shariah background and have been engaging with halal industry locally and
internationally. Information was also obtained from one respondent, who is a Master
student from Libya. The latter was collected from official and commercial reports,
newspapers reports and articles. Data was analysed using the SWOT analysis.
4. Findings

4.1 SWOT Analysis

Generally, SWOT analysis is a structured planning method used to evaluate the strengths, weaknesses, opportunities and threats involved in a project or business. The SWOT analysis is a commonly employed framework in the business world for analysing the factors that influence company’s competitive position in the marketplace with an eye to the future. As for this research, this approach can be used in the analysis of a country’s strategic position, or for analysing strategic management policy of organization in creating halal industry for benefits of ummah.

SWOT Analysis on Possibility to Penetrate Halal Industry in Maghreb Countries

<table>
<thead>
<tr>
<th>Analysis</th>
<th>Strengths</th>
<th>Weaknesses</th>
<th>Opportunities</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>Country</td>
<td>Characteristics of the business or project that give it an advantage over others</td>
<td>Characteristics that place the team at a disadvantage relative to others</td>
<td>Elements that the project could exploit to its advantage</td>
<td>Elements in the environment that could cause trouble for the business or project</td>
</tr>
<tr>
<td>Algeria</td>
<td>Majority are Muslims</td>
<td>Productivity stagnation due to changes in farm ownership and management</td>
<td>No halal certification body</td>
<td>Europe-Algeria-Free Trade Area (2017-2020)</td>
</tr>
<tr>
<td></td>
<td>Low operations costs</td>
<td>Domestic price policy giving negative incentives to producers</td>
<td>Lenient concept of halal</td>
<td>252 agriculture, fisheries and food manufacturer product benefit from EU market</td>
</tr>
<tr>
<td>Access Preference</td>
<td>Tariff</td>
<td>Demand for evidence and credibility by decisions making</td>
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<td>-------------------</td>
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<td>--------------------------------------------------------</td>
<td></td>
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<tr>
<td>Supportive government</td>
<td>Lack of management ability</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Familiarity with local cultures and industry practices</td>
<td>Poor financial capacity</td>
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<tr>
<td><strong>Libya</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large Muslim population</td>
<td>Politically unstable.</td>
<td>No halal certification body</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Been a ‘police country’ for quite some time (Muammar Gaddafi era)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>OPEC and OIC member</td>
<td>Small value of export (2012): USD59,000</td>
<td>GDP per capita (PPP) USD12,300</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Low economically active population in agriculture</td>
<td>Potential of Islamic finance</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Absence of Halal certification body</td>
<td>More open post Muammar Gaddafi era</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>The area is Mostly desert (Sahara)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Mauritania</strong></td>
<td>Muslim (official) 100%</td>
<td>Population density: 8 people per square mile</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>10% to 20% of the population lives in slavery</td>
<td>Military rule</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>The legal system is based on Islam</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Literacy rate: 51%</td>
<td>Mauritania is a huge and largely empty country in the Sahara Desert</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Unemployment: 30%</td>
<td>The government banned political parties</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Exports partners: Japan 12.5%, France 12.1%, Spain 11.4%, Italy 10.4%, Belgium 7.8%, Germany</td>
<td>Racial tensions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Morocco</td>
<td>Tunisia</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---------</td>
<td>---------</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Women are the privileged target - reference for producers of food, major consumers of cosmetic</td>
<td>More liberalized market compare to other parts of Maghreb countries</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Attitudinal problem - halal food is a personal choice</td>
<td>Lack of security and political stability between new emerging Islamic party and former liberal party</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Halal certification regulation (inspired by the Malaysian model) has been in place since 2010</td>
<td>Has established relationship with Malaysia regarding halal industries in 2012.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canada, US are the primary competitors– Canada is rated as ‘best’ in terms of quality, service and safety of agri-products</td>
<td>Tunisia signed a free trade agreement in European Free Trade Area (EFTA) in 2005</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Malaysia is one of its trade members</td>
<td>More fertile land (may focus on agricultural production)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High living cost (possibly cost of production is also high)</td>
<td>Export in food are high compared to other Maghreb countries</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>National Institute of Standardization and Industrial Property (INNORPI) has granted halal certificate</td>
<td>As a gateway to muslim community in Europe and Africa (have agreement with neighbouring country like Egypt, Morocco,</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Natural resources:** Fish, copper, iron ore, gypsum.

**Agriculture products:** Dates, millet, sorghum, rice, corn, cattle, sheep.

Percentage living on less than $2 per day: 44%

Imports partners: France 16.8%, Spain 7.7%, China 6.3%, Belgium 5.1%, Germany 4.9%, Japan 4.3%, UK 4.1%, USA 4% (2003)

7.4%, Russia 5%, Cote d'Ivoire 4.2%, Netherlands 4% (2003)
### 4. Conclusion and Recommendations

The main finding implies that only four out of five Maghreb countries have potential to develop halal industry namely Algeria, Libya, Morocco and Tunisia on the ground that their net exports are positive. This study confirms that being the countries with majority population Muslims is the driving factor of the halal industry. However, the success of the halal industry cannot solely depend on this factor. The different schools of thought (mazhab) which results in a lenient concept of halal, the perception that halal food is more towards personal choice rather than religious obligation, poor financial capacity, competitions from Canada and US, certain EU tariff policies imposed on agricultural products imported from Maghreb countries and political instability and are among the barriers that Malaysian halal experts must be carefully aware of. However, the opportunities do exist for Malaysia to expand the halal food market in Maghreb countries since Tunisia has initiated a process of certification of products and halal service after establishing a relationship with Malaysia regarding halal industries and Morocco has developed halal certification regulation in 2010 which is inspired by the Malaysian model. The absence of the halal standards or certification procedures might be due to the majority of Muslim population in the country i.e. consumers and producers in which halal certification is not really a need for the local market. In a way, the concept of halal according to the school of Maliki is rather lenient. With regard to food, only pork and bacon in the physical form are unlawful (haram). Other than that, either in a form of extraction, additives, powder or even DNA are basically halal. The potential of the halal food market in Maghreb also relies on the fact that their agriculture products involve low cost of production which makes the product much cheaper.

The future direction offers vast opportunities for collaboration between Malaysia and Maghreb. Malaysian contribution could be in the following forms such as guidance in halal certification and procedure, providing training to improve the skill and productivity of the human factor and promoting halal industry in Maghreb countries through Islamic banking and finance services since there is huge demand in this sector.
References


**Notes**


**Appendix A**

Table 2. Real Per Capita Gross Domestic Product (GDP) of Maghreb Countries, 2010–2012, USD in 2014 Price (Current Price)

<table>
<thead>
<tr>
<th>Countries</th>
<th>GDP (million)</th>
<th>Per capita GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>161,207.304</td>
<td>199,070.864</td>
</tr>
<tr>
<td>Libya</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Mauritania</td>
<td>3,671.380</td>
<td>4,273.232</td>
</tr>
<tr>
<td>Morocco</td>
<td>90,770.671</td>
<td>99,211.339</td>
</tr>
<tr>
<td>Tunisia</td>
<td>44,377.742</td>
<td>46,434.616</td>
</tr>
<tr>
<td>Totala</td>
<td>300,027.097</td>
<td>348,990.051</td>
</tr>
<tr>
<td>Average</td>
<td>75,006.774</td>
<td>87,247.513</td>
</tr>
</tbody>
</table>

Note: na, not available,

aLibya is excluded due to data unavailability.

Source: World Development Indicators (2014)
<table>
<thead>
<tr>
<th>Countries</th>
<th>Type of Products</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>All products</td>
<td>57,050.974</td>
<td>73,436.306</td>
<td>71,865.749</td>
</tr>
<tr>
<td></td>
<td>Food and food related products</td>
<td>319.512</td>
<td>358.634</td>
<td>319.883</td>
</tr>
<tr>
<td></td>
<td>Pharmaceutical products</td>
<td>1.332</td>
<td>0.931</td>
<td>1.788</td>
</tr>
<tr>
<td></td>
<td>Cosmetics products</td>
<td>4.890</td>
<td>5.836</td>
<td>1.148</td>
</tr>
<tr>
<td></td>
<td>Other products (halal applied)</td>
<td>19.258</td>
<td>32.305</td>
<td>24.323</td>
</tr>
<tr>
<td>Libya</td>
<td>All products</td>
<td>36,440.414</td>
<td>18,713.711</td>
<td>57,753.232</td>
</tr>
<tr>
<td></td>
<td>Food and food related products</td>
<td>0.693</td>
<td>9.176</td>
<td>14.993</td>
</tr>
<tr>
<td></td>
<td>Pharmaceutical products</td>
<td>0</td>
<td>0.329</td>
<td>0.076</td>
</tr>
<tr>
<td></td>
<td>Cosmetics products</td>
<td>0</td>
<td>0.233</td>
<td>0.326</td>
</tr>
<tr>
<td></td>
<td>Other products (halal applied)</td>
<td>0.456</td>
<td>1.1254</td>
<td>11.244</td>
</tr>
<tr>
<td>Mauritania</td>
<td>All products</td>
<td>725.370</td>
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Source: International Trade Map (2013)
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Source: International Trade Map (2013)

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Adoption of AAOIFI Accounting Standards:
Case of Pakistan

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI):

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is an independent body dedicated to the development of international standards applicable for Islamic financial institutions. The Bahrain-based organization was registered as an international autonomous nonprofit making corporate body in 1991 and started producing standards in 1993. AAOIFI is supported by institutional members including central banks, Islamic financial institutions, and other participants from the international Islamic banking and finance industry. To date AAOIFI has developed standards related to accounting (26), auditing (5), governance (7), ethics (2) and Shariah (45) for Islamic financial industry.

AAOIFI Accounting Standards for Islamic Financial Institutions

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in its objective of bringing standardization and harmonization has issued 26 accounting standards by now. These standards cover areas General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions, Murabaha and Murabaha to the Purchase Orderer, Mudaraba Financing, Musharaka Financing, Disclosure of Bases For profit Allocation Between Owners’ quity and Investment Account Holders, Equity of Investment Account Holders and their Equivalent , Salam and Parallel Salam, Ijarah and Ijarah Muntahia Bittameek, Zakah, Istdinsa’a and Parallel Istdinsa’a, Provisions and Reserves Disclosure of Bases for Determining and Allocating Surplus or Deficit in Islamic Insurance Companies Investment Funds, Provisions and Reserves in Islamic Insurance Companies, Foreign Currency Transactions and Foreign Operations , Investments, Islamic Financial Services offered by Conventional Financial Institutions, Contributions in Islamic Insurance Companies, Deferred Payment Sale, Disclosure on Transfer of Assets and Segment Reporting.

Various countries are adopting these standards at their own discretion. Pakistan by now has issued three Islamic financial accounting standards related to Murabaha, Ijara and Profit and Loss Sharing of Deposits.

* Source: State Bank of Pakistan, Quarterly Islamic Banking Bulletin
Adoption of Accounting Standards in Pakistan

Institute of Chartered Accountant of Pakistan (ICAP) following the judgment on riba of Shariah Appellate Bench of 1999 constituted a committee on accounting and auditing standards of interest-free modes of financing and investment. This committee of ICAP works in collaboration with Security Exchange commission of Pakistan (SECP) along with active support of SBP for rolling out of AAOIFI accounting standards in Pakistan; ICAP issues standards, SECP notifies these through statutory notification (SRO) while SBP issues regulatory instruction for its implementation by Islamic banking institutions (IBIs).

Till now SECP has notified three Islamic Financial Accounting Standards (IFAS) to be implemented by financial institutions offering Shariah compliant services;

1. IFAS-1 -Murabaha

SECP through its SRO No 865(I)/2005 has notified the very first IFAS on August 24, 2005 while its has been made effective with effect from January 2006. This standard on Murabaha is applicable to financial statements prepared in the context of historical cost convention in accounting for Murabaha transaction undertaken by a bank.

Following this Islamic banking institutions have been obligated to prepare their quarterly statements in line with the issued standard on Mudaraba with effect from September 30, 2007\(^1\). This instruction was applicable to only normal Mudaraba while for credit Mudaraba accounting was not standardized. To address this issue SBP has issued following instructions for credit Mudaraba which are in line with the spirit of IFAS-1 and have been effective for Islamic banks since June 29, 2012\(^2\)

i. The cases wherein IBI purchases the goods on supplier’s credit and sells the same on credit under Murabaha, the transaction shall be booked as on-balance sheet item by appropriately recording ‘Payable to supplier’ and ‘Receivable from customers against Murabaha’ for the said credit purchase and credit sale respectively.

ii. The CRR/SLR and capital adequacy requirements on the said liability and financing respectively shall be applicable as per prevailing SBP instructions, issued from time to time.

Profit on the said transaction will be recognized as per the provisions of IFAS-1.

2. IFAS-II- Ijara

This standard applies in accounting for Ijara agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. However, this standard does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

SECP has notified this standard through SRO No 431(I)/2007 in May 2007 to be followed by companies and mudarabas while accounting for Ijara (Lease) transactions as

\(^{1}\) IBD Circular Letter No. 03 of 2007
\(^{2}\) IBD Circular No. 02 of 2012
defined by the Standard. Following this SBP has allowed implementation of this standard with effect from January 01, 2009.

3. **IFAS-III -Profit and Loss Sharing on Deposits**

SECP notified IFAS-3 “Profit and Loss Sharing on Deposits” through S.R.O 584/2013 in June, 2013, however, SBP has not issued its regulatory instruction for implementation of this standard yet.

This standard provides accounting principles to be followed by institutions offering Islamic financial services (IIFS) for recognizing, ensuring, presenting and disclosing the transactions relating to equity (‘funds’) of unrestricted investment/(profit/Loss Sharing) LS deposit account holders and their equivalents.

This standard aims at two main issues;

i. The accounting principles relating to funds received by IIFS for investment in its capacity as Mudarib at the IIFS’ discretion, in whatever manner the IIFS deems appropriate (funds of unrestricted investment account holders/PLS deposit holders); and The disclosure of bases for profit allocation between owner’s equity and that of unrestricted investment /PLS deposit account holders as applicable to the financial statements published by IIFS to meet the common information needs of the users of such statements.

This standard is not applicable to any funds received by IIFS on basis other than Mudaraba and/or Musharaka contract.

**Sources:**


Editor Desk:

Book Review
“Capital in the Twenty First Century”

“Capital in the Twenty-First Century” is a famous 2014 book by French economist, Thomas Piketty. The book has been widely read since the publishing of its English version. It has stirred a lot of debate in economic circles as well as achieved remarkable reception from other disciplines of social sciences.

One of the main arguments of the book is that over a long-run period, the rate of return to capital ‘r’ is greater than the rate of economic growth. The hypothesis seems to be consistent with empirical evidence in post-WWII developed economies of the world which the book has attempted to analyze.

It is striking to note that 60% of the increase in US national income in the 30 years after 1977 went to just the top 1% of earners. The only section of the US population that has done better than the top 1% is the top 10th of that 1%.

The other revealing statistic cited in the book is that the top 0.1% of Americans claim 9% of income which is up from 2% at the middle of the twentieth century. The top 0.1% holds a near-record 22% of the wealth while the top 0.01% claim a bigger income share than at any other time in history. It is also astonishing that corporate profits have swelled in post WWII period and the average CEO earns as much as earnings of 331 workers, up from a 24 to 1 ratio in the 1960s.

The book argues that the world today is returning towards "patrimonial capitalism", in which much of the economy is dominated by inherited wealth. While the top 10% have amassed more wealth in the last 50 years, America's bottom 90% is falling deeper and deeper into debt.

The author argues that Capitalism does not self-correct towards greater equality. The author recommends that governments should adopt a global tax on wealth to prevent soaring inequality. This will foster wealth mobility and keep concentration under control.

Another very interesting analysis in the book is that lower growth might worsen inequality. It goes contrary to the famous Kuznet’s hypothesis which attributed high income inequality to high economic growth. The author is also critical of supply side economics and suggests punitive income taxes and wealth taxes to curb concentration of wealth.

The book is an excellent attempt to bring the issue of soaring income inequality to the forefront. Even if we look beyond the aggregate numbers on income inequality, some spending patterns and budget allocations on non-essential goods are striking to say the least, at a time when the world faces poverty at a massive scale and soaring income inequalities even in developed countries after years of sustained economic growth.

Budget on some films and video games is more than development spending in some countries. Some individual persons own more wealth than entire countries GDP. Income earned by the top 10 showbiz personalities together are more than entire
combined production value of 7 countries of the world. 10 persons selling entertainment earn more than what all people together earn in 7 countries! Top in that list earns more than GDP of at least 4 countries of the world.

Yet what these celebrities provide in the market system is adjudged efficient allocation of resources as long as the other rich people can put up dollar votes for buying them at offered market prices.

There are approximately 1 billion poor in the world. If it takes Rs 3,000 to feed a poor person for a month, then Rs 3,000 billion can feed all of the world’s poor for one month. If exchange rate is Rs 105 per USD, then with USD 3.7 trillion – the combined net worth of 300 wealthiest people at December 31, 2013, can feed all of the world’s poor for 10 years at least. 300 people only can feed all of the world’s poor for 10 years!

What the economics profession needs is a new premise to combat social problems of poverty and inequity. The new premise according to Nobel Laureate Amartya Sen’s empirical evidence is that rather than scarcity, it is the inequitable distribution of resources which is the main cause of economic miseries.

Interestingly, the world produces enough food to feed everyone. According to FAO, world agriculture produces 17 percent more calories per person today than it did 30 years ago, despite a 70 percent population increase. Hence, the problem is not with absolute scarcity. The problem lies in inequitable distribution of resources.

Capitalism, the way it is practiced as an economic system, has largely allowed and provided legal cover to certain exploitative institutions and their operations based on free market philosophy. Such institutions have been chiefly responsible for much of the distributional inequity in the world today.

Interest based financial intermediation in fractional reserve banking with fiat money has resulted in increased concentration of wealth in the world. To put the matters in right perspective, income inequality even in OECD (Organization for Economic Cooperation & Development) countries is at its highest level for the past half century. The average income of the richest 10% of the population is about nine times that of the poorest 10% across the OECD, up from seven times 25 years ago. OECD countries represent developed world with sophisticated financial markets in which interest based financial intermediation through banks and other complimentary institutions is the hallmark of the overall financial architecture.

Past growth experience of Japan and USA or even recent growth experience of India and China has resulted in increased income inequality in these countries. Economic growth has failed to improve income distribution in these countries.

Income inequality can result from wealth inequality when there is fixed return on loanable wealth in the form of interest. Interest based financial intermediation brings concentration of wealth eventually in every society by granting private right of fiat money creation to central bank and allowing fractional reserve system which gives the legal right to the private banks to create credit money. This money capital can be loaned out and fixed interest can be earned on it. Hence, financial capitalists will be immune to losses, fluctuations and uncertainty of business cycles to a large extent. But, the other factors of production cannot have that luxury as their compensation from the productive activity is either linked with the provision of services (in the case of labor) or the
provision of assets (land or physical capital) that have intrinsic value, but they are scarce and they also lose ‘use value’ with the passage of time unlike the loaned amount of money capital.

It is a fact that people have different tolerance for risk, different innate abilities, different attitude towards progression in life and career, different levels of ambitions and as a result, they exert different levels of effort in acquiring education, skills set and thus their productivity levels are different. The difference in characteristics highlighted above may not necessarily be a result of exploitative institutions or historical processes. Most of these reasons could be controlled and shaped by individuals through their intertemporal economic choices. But, as the author argues that it is the inequality sustaining itself from inherited wealth which gives a clear historical advantage to the elite and which cannot be effectively checked in Capitalism without bringing in necessary redistributive mechanisms.

Bringing an Islamic Economics perspective on the issue of income inequality, we see that Islam disallows interest based earnings and closes the door for systematic increase in inequality of income resulting from wealth inequity.

The author notes that the annual value of inheritances in France has tripled from less than 5% of GDP in the 1950s to about 15% now. In contrast, the inheritance laws of Islam ensure that the wealth of the deceased is distributed widely among the members of the family of the deceased and this permanently and systematically ensures doing away with the concentration of wealth in every generation.

In an Islamic economy, Zakat on wealth redistributes assets too, independently of the business cycles and helps stabilize the extremes of the business cycles. Transfer payments to the unemployed, poor, needy and debtors continue even if the economy faces a recession.

We need a worldview that expands the responsibility of human beings to society, future generations, and other living species on the planet with accountability for every intentional act done by every human being. We need a worldview that regards humans as trustees for whatever material resources and mental faculties they come to possess in this world. We need a worldview or economic system that regards market as an instrument rather than give it the role of allocating every resource in whichever way the rich people desire with the most dollar votes. That requires balance between socialism and unfettered market principles. Economists not only need to search for right policies, but also explore which institutions and worldviews can compliment them.

Islamic worldview based on Tawhid and belief in afterlife accountability deeply influences preferences, behavior and choices. It not only asks for change in some choices and giving religion a place in time and resource allocation, rather it presents a worldview where a human being is freed from following anyone except Allah and where a human being is equipped with spiritual rationality to act in ethical ways for the eternal bliss and for social harmony in this ephemeral world.
Country Model: Brunei Darussalam

Islamic financial services began in Brunei with the establishment of Tabung Amanah Islam Brunei (TAIB), the country’s first Islamic trust fund in 1991. Since then Islamic banking and finance industry in the Sultanate has witnessed significant growth. By 2013, the number of Islamic banking institutions in Brunei was 2 while the number of Takaful operators was 4. Islamic banking assets are estimated to be US$ 6.0 billion, gross Takaful contributions US$ 220.3 million while total Sukuk issuance is US$ 4.71 billion. Islamic banking has a share of almost 45% in overall retail banking in the country higher than established countries like Malaysia and Indonesia. It is expected that Brunei Darussalam will increase the share of Islamic banking in the domestic banking above 50% by 2020.

The starting point and motivation for Bruneian Islamic finance industry was a decree by His Majesty the Sultan of Brunei Darussalam in 1990 in which he stressed that the establishment of an Islamic bank is important referring to it as a ‘fard kifayah’ (obligation) for every Muslim country. As a result Islamic financial services in Brunei were formally initiated in 1991 when Tabung Amanah Islam Brunei (TAIB), the country’s first Islamic trust fund was established to help Brunei’s local Muslims undertake their pilgrimage to Mecca. In 1993, Island Development Bank was converted into the first full-fledged Islamic bank in Brunei under the name of the Islamic Bank of Brunei. In 2000, another conventional bank was converted into full fledged Islamic bank and was named Islamic Development Bank of Brunei (IDBB). However in 2005, Islamic Bank of Brunei and Islamic Development Bank of Brunei were merged into one big bank named Bank Islam Brunei Darussalam.

Despite the beginning of Islamic financial services in 1991, Islamic finance industry in Brunei gained momentum in 2006. The major landmarks witnessed in 2006 include the constitution of national Shariah board and issuance of Brunei’s first sovereign Sukuk by the Ministry of Finance. In terms of legislations important changes were made in 2008 after Islamic Banking Order 2008 and Takaful Order 2008 were enacted. These legislations were aimed at better regulation and supervision of Islamic finance in the Sultanate. A special secretariat to deal with Islamic banking institutions and Takaful operators has been created in the Monetary Authority of Brunei Darussalam which started operations in 2011.

Analysis of Sukuk Market in Brunei reveals that the government launched a rolling short term sukuk al ijarah programme to boost liquidity for banks in 2006. In this regard, Sukuk Holding Properties Incorporation and Sukuk (Brunei) Incorporation were set up by

* Source: State Bank of Pakistan, Quarterly Islamic Banking Bulletin
the Ministry of Finance to issue sukuk. These Sukuk are short term in nature with maturity of 91 days. The latest Sukuk of this series was 113\textsuperscript{th} and was issued on November 20, 2014.

For improving human resource for the financial industry in the country, The Centre for Islamic Banking, Finance and Management (CIBFM) has been established by the Ministry of Finance. The center’s role is focused on providing learning and development programs focusing on Islamic finance. As a Centre of Excellence, it provides professional learning and development solutions in major disciplines such as Banking, Finance, Insurance, Capital Market as well as Management and Professional Studies. The Centre works closely with many international partners such as the Islamic Research and Training Institute.

Brunei has also been seeking help from important regional players for strengthening cooperation in the financial sector. In this regard, the central banks of Brunei and Malaysia have signed a memorandum of understanding (MoU) having Islamic finance development as one of the agenda. Similarly the Securities Commission of Malaysia and the monetary authority of Brunei, have also signed memorandum of understanding (MoU) to further facilitate cross-border activities, especially in Islamic capital markets.

Going forward, with an increased focus of Islamic banking and finance by the government of Brunei in presence of a large Muslim population with an increasing demand for Islamic financial services, Brunei is well placed to create an important place for itself in the international Islamic banking and financial industry.

Sources

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- http://www.reuters.com
**NEWS MONITOR**

**Pakistani Islamic Banks post Rs9.4bn profit**

The Islamic banking industry posted a profit of Rs9.4 billion in July-September 2014, a substantial rise compared to Rs5.6bn earned by the industry during the same quarter of 2013.

Assets of the Islamic banking industry grew by 1.3 per cent to Rs1, 102bn during the quarter compared to Rs1, 089bn in the previous quarter. Similarly, its deposits rose to Rs934bn during the quarter. Net investments of the Islamic banking industry declined to Rs354bn by end-September 2014 from Rs358bn by end-June 2014, reflecting an on-quarter fall of 1pc. “The decline in investments was mainly due to non-issuance of any new sukuk during the quarter that has generally been the key investment option for Islamic banking industry,” In terms of share, nearly 60pc of investments made by the industry are contributed by Islamic banks and 40pc by the Islamic banking departments of conventional banks. Deposits reached Rs934bn by the end of the quarter, posting a quarterly growth of 0.2pc. However, fixed deposits in Islamic banks have been increasing faster than any other deposits. “Within customers’ deposits, fixed deposits as well as saving deposits registered positive growth during the period under review, though fixed deposits grew at a faster pace compared to saving deposits,“

**Source:** Pakistan Today

**Meezan Bank and Pak Kuwait Takaful Joins Hand For Takaful Coverage of Housing Finance Properties**

Karachi: Pakistan's largest and leading Islamic bank, Meezan Bank and one of the country’s most prominent Takaful operators, Pak Kuwait Takaful Co Ltd have entered into an agreement whereby Pak Kuwait Takaful will provide Takaful (Islamic Insurance) coverage for the properties financed by Meezan Bank through its housing finance product ‘Easy Home’.

At the memorandum of understanding signing ceremony, Mr. Muhammad Raza, Group Head Consumer Banking & Marketing at Meezan Bank said that “Meezan Bank is committed to providing a completely Shariah-compliant and comprehensive product menu”.

Syed Waqar Azeem, Head of Marketing & Sales of Pak Kuwait Takaful said that “We are delighted to be partnering with Meezan Bank, which has the largest Islamic Banking branch network in the country and is one of the leaders in the Home Financing sector in Pakistan”.

**Source:** The News

**Meezan Bank ranked as Prime Islamic Bank of Pakistan by 'The Banker'**

In a special report on “Top Islamic Financial Institutions” published by renowned international magazine The Banker, being published from the UK. Meezan Bank is ranked as the Top Islamic Bank in Pakistan. This ranking was given to Meezan in recognition of impressive growth of its branch networks to becoming the largest Islamic
Bank in Pakistan and its contribution to developing world-class Shariah-compliant financial products for Pakistan’s Islamic Banking market.

Meezan Bank has been on a very fast growth trajectory since its inception in 1997 and has not only grown to be the largest Islamic Bank in Pakistan but is also ranked 8th amongst all banking institutions in the country. The year 2014 was an eventful year, where Meezan crossed the landmark of increasing their branch network to more than 400 branches in 115 cities across Pakistan and additionally took over the Pakistan’s operations of HSBC.

Source: International Magazine ‘The Banker’

Central Bank of Pakistan and Islamic Banking Industry Launched the Second phase of Mass Awareness Campaign to promote Islamic Banking in Pakistan

In a well attended ceremony attended by Shariah Scholars, Senior Bankers, Academics, Central Bankers, Deputy Governor of State Bank of Pakistan Mr. Saeed Ahmed launched the second phase of mass awareness campaign to promote Islamic banking awareness in the country and to encourage the majority population to shift toward Islamic banking to have an Interest free and permissible (halal) banking system. The campaign is supported by 5 full-fledged Islamic Banks and 18 Islamic banking windows of Conventional banks and is fully endorsed by the Central Bank that is keen to promote Islamic Banking system in Pakistan.

Speaking on the occasion Mr. Irfan Siddiqui - CEO of Meezan Bank highlighted the theme and importance of the message given in the campaign. He also appreciated the keen support of Islamic banking by Central bank and hope that Islamic banking will continue its growth and more people will come to Islamic banking as a result of this industry wide joint efforts to promote Islamic banking.

Source: The News Website

Pakistan's K-electric Eyes 7-year Tenor for Largest Corporate Sukuk

Karachi-based utility K-Electric will test a seven year tenor for its latest Islamic bond, a 22 billion rupee ($217 million) transaction that would be Pakistan's largest corporate Sukuk to date. Issuance of corporate Sukuk is gathering pace, helping broaden Pakistan's Islamic capital market, which in recent years has relied on the government for the bulk of such deals.

Proceeds from the Sukuk will help refinance debt, with approximately 18 billion rupees to be repaid to senior lenders including the International Finance Corporation and the Asian Development Bank, K-Electric said in a bourse filing. Meezan Bank Limited was joint Shariah Advisor of K-electric Sukuk transactions. Last year, the utility raised 6 billion rupees through a three-tranche Sukuk, investment certificates which follow Islamic religious principles such a ban on interest and gambling.

Source: Reuters

SECP Establishes Department on Islamic Finance

The Securities and Exchange Commission of Pakistan (SECP) has established a specialized department to regulate the Islamic finance market.
The Islamic Finance Department (IFD) would carry out the functions of Shariah regulations and compliance, product development, market awareness, Shariah securities market development and international liaison and networking.

The SECP is entrusted with regulating a spectrum of Shariah-oriented companies ranging from Modarabas, non-bank financial institution, Takaful and non-financial firms.

The total Islamic financial assets of Pakistan have reached over Rs1.7 trillion, around 10 per cent of the total banking assets, and 40pc of which are directly or indirectly regulated by the SECP.

**Source: Dawn Newspaper**

**Pakistan, Brunei Investment Company to Launch Modarba Fund**

The Pak-Brunei Investment Company is in final stages to launch its Modarba fund as its special future venture, Managing Director (MD) of the company said. Company's MD Ayesha Aziz informed Finance Minister during a meeting here that the first fund, based on Private equity model, will be established by March 2015 adding the company also has plans for establishment of specialized vehicles for warehousing/collateral management. The Pak Brunei Investment Company is an Investment Finance Company established as a joint venture between Government of Pakistan and Brunei Investment Agency (BIA) that commenced operations in August 2007.

The Company has active platforms for Project and Lease Finance, Corporate Finance and Advisory Services, SME Finance, Private Equity, Trust Services, Capital Market Operations, and Fixed Income Trading and Distribution activities.

MD Ayesha Aziz informed the Minister that the company started operations almost 8 years ago with a capital of Rs. 3 billion. The company has a current equity of Rs, 9 billion while its first SME branch was inaugurated in Lahore in October 2014.

**Source: Business Recorder**

**Pakistan Issues Sukuk Rules as Corporate Issuance Revives**

Pakistan’s capital market regulator has published long-awaited rules for the issuance of Sukuk, or Islamic bonds, as part of efforts to strengthen governance and broaden their appeal to investors. The regulator first drafted the rules in October 2012, but efforts have accelerated under a five-year plan that authorities hope will double the industry’s share of the banking sector to 20 percent by 2020. The rules come at a time when issuance of corporate Sukuk in Pakistan is gathering pace, helping broaden an Islamic capital market which in recent years has relied on the government for the bulk of such deals.

Under the rules, Sukuk will have to be structured to comply with standards of the Bahrain-based Accounting and Auditing Organization for Islamic Finance Institutions (AAOIFI), as well as those set by the local regulator.

**Source: Reuters**

**AAOIFI Issues New Accounting Standard on Investment Accounts**

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has issued a new accounting standard on investment accounts – Financial Accounting Standard No. 27 (FAS 27) Investment Accounts. The new FAS 27 updates and replaces
two of AAOIFI’s previous accounting standards relating to investment accounts – FAS 5 Disclosure of Bases for Profit Allocation between Owners’ Equity and Investment Account Holders as well as FAS 6 Equity of Investment Account Holders and Their Equivalent.

This standard applies to investment accounts based on Mudaraba contracts which represent “equity of investment account holders” and on Mudaraba contracts that are placed on “short term basis” (overnight, seven days, one month basis) by other financial institutions as “interbank-bank deposits” for the purpose of liquidity management. However, it is not applicable to own equity instruments, Wakala contracts, reverse Murabaha, Musharaka or Sukuk.

The new standard will be included in the next publication of AAOIFI standards scheduled for early 2015

Source: AAOIFI Website

BoK Committed to Cater Islamic Banking Requirements

The present Provincial Government gives policy guidelines on banking, finance, trade and investment and assured that the Government is committed for the well being of common man with its resources.

BoK is committed to cater the Banking requirements of Islamic Banking as well as conventional in a befitting manner in order to encourage the economic developmental activities in the region.

BoK have increased our net-work by establishing 116 new branches by December 2014 and it will further enhance in 2015.

Source: The Nation Online

This is a prime responsibility of BOK to provide Shariah Compliance schemes which are now getting encouraging results from the clients.

Malaysian bank merger plan collapses

A plan to combine three Malaysian banks to create one of Southeast Asia’s biggest financial groups has been scrapped, dealing a blow to efforts to create banking champions in one of the few areas of the world still enjoying relatively strong economic growth.

The deal, unveiled in July last year, envisaged a combination of CIMB, the country’s second-biggest bank, with RHB Capital, a smaller bank, and Malaysia Building Society (MBSB). With combined assets of Rm613bn ($188bn), it would have overtaken Maybank as the largest banking group in the country.

The collapse of the proposed deal is a blow to the region’s aspirations to create banking groups with the financial heft to help drive the further economic integration of the 10-nation bloc known as the Association of Southeast Asian Nations (Asean). The countries of Asean are expected to grow by a combined average of 5.3 per cent this year, according to the Asian Development Bank.

The failure of the deal also scuppers the creation of what would have been a new “mega-Islamic bank”. Malaysia, Southeast Asia’s third-largest economy after Indonesia.
and Thailand, is by far the largest centre in Asia for Islamic finance, driven by its majority Muslim population and strong financial and political links with the Middle East.

Source: Financial Times Website

**Azerbaijan Bank to target UAE for $300m Sukuk, International Bank of Azerbaijan will issue Sukuk in the second half of 2015**

International Bank of Azerbaijan (IBA), the country’s largest and the only state-owned bank, plans to target the UAE and other Gulf investors as it plans to issue $200-$300 million debut Islamic bonds (sukuk) this year. IBA raised $252 million through an Islamic syndicated loan in 2014 from UAE-based Al Hilal Bank, Dubai Islamic Bank and Noor Bank. Other participating banks were Barwa Bank, Citigroup and JPMorgan.

The bank, 50.2 percent owned by the Ministry of Finance, holds 40 percent of banking assets in the country.

Gurbanzade told Reuters the bank would issue sukuk in the second half of this year in order to widen its credit policy, develop business and attract alternative sources of financing.

"We plan to develop Islamic finances in Azerbaijan as access to financial resources on the Western financial markets is not easy due to the current economic situation," Gurbanzade said. He said IBA’s Islamic assets rose to $526 million from $160 million in 2014.

Source: Emirates 24/7 Business Website

**Islamic banking set to grow in Canada**

Worth $1 trillion in assets, Islamic banking is being lauded by British Prime Minister David Cameron and supported by Canada’s Conservative government, major banks and credit unions, leading business schools and influential Muslims across the country.

Awareness in Canada of Islamic banking has increased dramatically in the last few years. With the federal government’s efforts in this respect, Canada’s attractiveness to Islamic finance will grow impressively.

Many Canadian Muslims are seeking Shariah-compliant banking solutions to their personal finances. They want home mortgages that are not based on conventional Western interest payments, but which operate more like a partnership.

Even though Islamic banking has some harsh critics among Canadian Muslims who consider it unwieldy with many still suffering from the 2011 bankruptcy of Toronto-based UM Financial, which offered Shariah-compliant mortgages — the movement is gaining energy.

Source: The Vancouver Sun Newspaper

**AAOIFI Standards go digital with Thomson Reuters**

In an unprecedented move in the development of the Islamic finance industry, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)
standards will be made available online through Thomson Reuters’ range of digital information platforms, including Zawya Islamic.

AAOIFI Shariah standards are approved and developed under the guidance of its Shariah Board, which comprises the world's leading Shariah scholars on Islamic finance and internationally regarded as the ultimate authority on Shariah for Islamic finance. The standards on accounting, auditing, ethics and governance are approved and developed by AAOIFI Accounting and Auditing Standards Board comprising senior representatives from major Islamic financial institutions, central banks and regulatory authorities, and international accounting and auditing firms. The standards represent the broadest consensus of rules that govern the Islamic finance industry and cover Shariah, accounting, auditing, governance and ethics.

Source: Thomson Reuters ZAWYA

Demand Grows For Islamic Finance Professionals; Will need 1 Million People with Islamic Finance Knowledge By 2020

Demand for Islamic finance professionals is on the rise and even non-Muslims are entering into the industry whose assets are set to double to $3.4 trillion by 2018.

The fast growing industry offers immense opportunities and will need 1 million people with Islamic Finance knowledge by 2020 according to a report from the Malaysia International Islamic Financial centre

The Dubai government has voiced its ambition to be a global capital for Islamic finance and Islamic banks now command a roughly 25% share of the banking market in Gulf Cooperation Council, according to an estimate by Ernst & Young, leading to a growing demand for professionals.

Dynamic growth in Islamic finance has been driven by strong economic growth of the Gulf region. Investors from the Middle East and Asia are increasingly seeking to invest in products that are compliant with their religious beliefs. Surveys suggest that half of the Muslims world-wide would opt for Islamic finance if given a competitive alternative to conventional services.

Source: Emirates247 Online

Dubai Islamic Bank Coming To Africa

Dubai Islamic Bank (DIB) received “in principle approval” from the Kenyan regulator in January 2015, Chief Executive Officer Adnan Chilwan said at a press event in Dubai. The bank still needs to get its final license and expects to be operational in Kenya by year-end. The new bank will operate under the name DIB Kenya, Chilwan said. DIB will hold 70 per cent of the bank, with 30 per cent owned by local partners.

There is growing interest in Islamic finance in Africa. GCC-based Shari’ah-compliant banks are well-placed to take advantage of that interest. Africa offers exciting growth prospects with seven of the 10 fastest growing economies in the world, including countries with significant Muslim populations, under banked either due to lack of access or for religious reasons, that should represent a ready market for Islamic finance.

Source: Bloomberg
Islamic Banking Share to Reach 20% in Turkey

Islamic banking share in Turkish banking sector is expected to increase from 5.3% to around 20% with three new Islamic banks planned to be opened by state-run lenders, the head of the Bank Association of Turkey (TBB) and state-run ziraat Bank General Manager Huseyin Aydin has said: Ziraat Bank plans to make its Islamic bank unit, known as a “participation bank” in Turkey. Operational in May and to open 20 branches by the end of this year

“Our participation banks are growing at around 20% annually right now. They need to grow faster and new players also need to become operational soon,” Aydin said.

Four Islamic financiers are currently operational in Turkey, including Albaraka Turk, Bank Asya, Kuveyt Turk and Turkiye Finans.

The country’s banking watchdog, the BDDK, recently gave permission to another state run lender.

Source: Earnst Young

Indonesia Pushes Ahead with $8 billion Islamic Megabank

Indonesian authorities are pushing ahead with a plan to create an $8 billion Islamic megabank even after a similar proposal fell through in Malaysia. A combination of the Shari’ah-compliant units of government- controlled PT Bank Mandiri, PT Bank Rakyat Indonesia and PT Bank Negara Indonesia could happen as soon as this year, Financial Services Authority Chairman Muliaman Hadad. The megabank could help drive a quadrupling in Islamic banks’ market share to 20 per cent by 2018, compared with 10 per cent without it, the Indonesia Islamic Banking Association predicts. That would approach the 21 per cent level in Malaysia, where a planned combination of CIMB Group Holdings Bhd., RHB Capital Bhd. and Malaysia Building Society Bhd. was called off last month as falling oil prices damped the economic outlook.

Source: The Jakarta Globe

New S&P Criteria Draw Line Between Sukuk Issuers, Sponsors

Credit rating agency Standard & Poor's said it had updated its criteria for Islamic bonds to distinguish more clearly between issuers of Sukuk and sponsors of them. Sukuk tend to be more complex than conventional bonds because they use structures designed to avoid interest payments. They often involve special-purpose vehicles (SPVs) which issue the paper and lend the proceeds on to the ultimate entity raising money, which is known as the sponsor.

S&P's new criteria describe the conditions under which it would rate Sukuk at the same level as the sponsor's rating. For example, Sukuk will be rated on a par with the sponsor's senior unsecured rating if they provide contractual commitments by the sponsor to make payments that ultimately cover periodic distribution and principal amounts. The agency said it did not expect the new criteria to lead to upgrades or downgrades of the Sukuk which it rates, but it might withdraw a rating if terms and conditions did not meet the criteria. It estimated this might happen for fewer than 5 percent of rated Sukuk.

Sukuk defaults are rare, but the revised criteria could help address market uncertainty about the contractual obligations of the various parties. Such uncertainty can
affect Sukuk pricings, particularly for issuers with ratings below investment grade. For situations in which a sponsor is performing on its own obligations while Sukuk payments by an SPV are not full or timely, S&P said such temporary deferrals would not be classified as defaults as long as the agency expected payment within one year.

Source: Reuters

Turkey - State to Fuel Islamic Finance Boom

New Islamic units of three state banks will accelerate Turkey’s plans to expand the share of Shariah-compliant assets, said Osman Akyuz, head of the country’s Islamic banking association.

Akyuz foresees the country’s interest-free assets increasing by 30 per cent to $60 billion in 2015, up from 1.2 per cent growth in the 12 months through November, the latest reporting period.

The government wants to increase the share of Islamic banking to 15 per cent in 2023 from about five per cent now. The three state banks -- Ziraat Bank, Vakif Bank and Halk bank have pledged to quickly set up units for Shariah compliant banking.

While “the existing players will have to review their policies and strategies,” the competition represents a healthy challenge to the four Islamic financiers, said Akyuz, who was formerly the chief executive officer of Albaraka Turk.

Source: Bloomberg
Note to contributors

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- The articles should be submitted before start of the first month of each quarter, beginning from January, April, July & October enabling review and approval of the material by the editorial board for publication in the issue in hand.

- If the editorial Board is of the opinion that the article provisionally accepted for publication needs to be revised, shortened, or the particular expressions therein need to be deleted or rephrased, such opinions will be communicated to the author for appropriate action. The author may also be requested to recast any article in response to the comments made thereon by the reviewers.

- The numbering of footnotes will be consecutive, and the footnotes themselves will be placed at the end of the article.

- The author(s) of articles published will receive 2 complimentary copies of the Journal of Islamic Banking & Finance and the IAIB reserves all rights in the material published in the Journal.

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The articles should contain well summarized abstracts between 100 to 200 words, covering the subject matter of the articles, its conclusion and the result arrived at, with key words.

Tables and Figures:
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