Journal of Islamic Banking and Finance

Global Perspective on Islamic Finance

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“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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Editor’s Note

The definition and scope of the term ‘economic development’ has gone through significant changes in the past literature. In the early literature, economic growth and economic development were synonymous terms and per capita income was considered as a sufficient measure for assessing the level of economic development. In recent decades, the emphasis was placed on human development and now the concept of development also incorporates environmental sustainability.

Achieving sustainable development rests on the availability of funds, infrastructure, inclusive growth, creation of jobs, ‘environment-friendly’ technological advancements and business processes re-engineering. All of this is not going to be possible without the availability of funds. By some estimates, around $3.5 trillion to $5 trillion is needed every year to make desirable progress on SDGs.

In the Middle East, there is immense potential to use solar energy alongside oil. In the Arab world, the annual per capita share in water resource will be less than 500 cubic meters- less than 10% of the global average. Lack of financing is one of the major obstacles for minimal use of renewable energy in developing countries. Financial sectors of developing countries are often underdeveloped and are unable to efficiently channel loans to produce renewable energy. As per World Bank, developing countries spend about $1 trillion a year on infrastructure.

An additional $1-1.5 trillion will be needed by 2020 in areas such as water projects like dams, desalination plants, power and transportation projects. Asian Development Bank estimates that emerging Asian economies alone will require $8 trillion over the next decade to satisfy growing demand in the areas of energy, water and transportation.

There is much potential for Islamic finance to promote sustainable economic development through such approaches as widening access to finance (including microfinance), financing infrastructure projects (through Sukuk), and expanding the reach of Takaful (Islamic insurance).

Global Shari’ah-compliant assets totalled $2.431 trillion at the end of 2017, according to Global Islamic Finance Report 2018. Islamic finance as a form of financial intermediation offers tremendous potential in reinforcing links between finance and the real economy. With resilient growth, effective risk mitigation and participative modes of
financial products, Islamic finance promises to play a significant role, especially in the Muslim world. Islamic finance can also enhance financial inclusion, as it incorporates people who are excluded from the traditional financial system in order to avoid usurious financial services.

Real sector based productive enterprise in Islamic finance has positive implications for the ecosystem. Risk-sharing shifts the emphasis from credit-worthiness of the borrower to be placed on the value creation and economic viability of investments that create new wealth. Innovative Islamic financial instruments especially for infrastructure development such as Sukuk can be used to mobilize resources to finance water and sanitation projects, sustainable and affordable energy and build resilient infrastructure including residential buildings.

The current research literature in Islamic finance needs to show how private financial institutions, especially the Islamic banks, help in funding the financing gap in countries where the Islamic banks have a decent footprint and where the governments are weakly funded from taxes to spend on development. The role of conventional and Islamic development finance institutions is pivotal in funding the targeted development programs timely and transparently. Finally, other than in South East Asia, the Islamic social finance institutions like Zakāt and Waqf have not been tapped and institutionalized adequately. Research is needed to find how Islamic social finance institutions like Zakāt and Waqf can be used to contribute towards scaling up efforts in commercially non-viable, but socially vital projects and programs in the developing Muslim world.

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.

The First paper “Academic Sociology: The Alarming Rise in Predatory Publishing and its Consequences for Islamic Economics and Finance” by Prof. Dr. Zubair Hasan explores the causes and impact of predatory online publishing on Islamic economics and finance and takes a literature scan to identify the origin and expansion of predatory publishing, as references listed in the paper show. The personal experience and observation of the author over the decades of teaching at various universities endorse the evidence. Its originality lays in initiating discussion on an issue of significance so far remaining unattended in the field of Islamic economics and finance. It not only explores the impact of the affliction on the discipline but also suggests ways to curb the malady.

The second paper “A Review of Islamic Commercial and Social Finance in Pakistan” by Dr. Salman Ahmed Shaikh, Dr. Mohd Adib Ismail, Dr. Abdul Ghafar Ismail, Dr. Shahida Shahimi and Dr. Muhammad Hakimi gives an overview of Islamic finance in Organization of Islamic Cooperation (OIC) member country of Pakistan. It gives a brief overview of Islamic banking which enjoys a central place in the umbrella of Islamic financial services globally as well as in Pakistan. It also looks at the progress and performance of Islamic capital markets in Pakistan, especially Shari’ah compliant
equities and Sukuk. Furthermore, the paper provides a brief account of Islamic asset management sector in Pakistan. Finally, the paper explores the footprint of Islamic microfinance sector and gives an account of the contribution of third sector redistributive institutions like Zakat and Waqf in Pakistan.

The third paper “Faisal Laureate Muhammad Nejatullah Siddiqi: Life and Works” by Dr. Nasir Nabi looks at the contribution of Prof. Dr. Muhammad Nejatullah Siddiqi. Prof. Dr. Siddiqui occupies a position of esteem amongst the founders of the nascent discipline of Islamic economics. He has sought to respond to the many challenges that the modern economic system poses for Muslims. Prof. Dr. Siddiqui is also amongst the few economists who initiated research and dialogue on the interest-free economy before the issue came to the fore in the context of reconstruction of Islamic economy. He is one amongst such Islamic economists who have shown genuine flexibility and creativity necessary for the evolution of a new discipline along with a strong sense of history, moral integrity and intellectual commitment to Islam.

The fourth paper “Can Shari’ah Governance Framework be the Way Forward for Islamic Finance?” by Md Akther Uddin attempts to give a brief overview of existing Shari’ah Governance framework in Malaysia, compare it with AAOIFI and IFSB standards and guidelines, identify current issues, and recommend measures to improve existing practices. The study finds that a great number of researches have been carried out to study the Shari’ah governance framework in Malaysia, Indonesia, GCC, MENA, UK, and other OIC member countries. The author concludes that the plurality in Shari’ah governance practice across regions and countries may ensure success and support innovation in the short run, but, in order to establish credibility and promote Islamic Finance as a comprehensive financial system in the long run, uniformity is desirable. A sustainable and viable Shari’ah governance framework, which will not only provide credibility to IFIs but also ensure transparency, trust, ethical behavior, underlying faith and belief and ethics and also help to protect the stakeholders right and fulfill the broader principle of Maqasid al-Shari’ah (foundational goals of the Shari’ah).

The fifth paper “The Ends of Development in Islam: Seven Overlapping Concepts” by Dr. Junaid Qadir and Prof. Dr. Asad Zaman articulates Islamic developmental ideals and outlines the various ends of Islamic development. It provides a list of seven overlapping concepts that together define the Islamic ideal of human development. The authors argue that in contrast to the purely materialistic conceptions of human development in modern economics, Islamic human development ideals entail the seven overlapping concepts of (1) Purification (Tazkiyah); (2) Freedom (‘Uboodiyah); (3) God-consciousness (Taqwa); (4) Excellence and Beauty (Ihsān); (5) Felicity or Happiness (Sa’ādah); (6) High Morals (Akhlaq); and (7) Civilization (‘Umrān).

The sixth paper “Shariah Governance Framework in Oman: Issues and Challenges”, contributed by Muhammad Iman Sastra Mihajat, Phd and Head of Shari’a, Al Yusr Islamic Banking - Oman Arab Bank, presents the while Oman entered into the Islamic Banking field later than its GCC neighbours, it has developed its governance
structure well. The Central Bank of Oman has issued the “Islamic Banking Regulatory Framework” (IBRF) which comprises of 7 essential control techniques to ensure Shariah Compliance. These include induction of shariah experts in advisory and executive capacities. The author discusses the issues arising from following the provisions of IBRF, AAOIFI and IFSB and how in particular issues of IBRF can be addressed by CBO through clarifying certain points of the IBRF.

Finally, the last paper in the issue, Mastura Mohd Shafie, post graduate student, Mat Noor Mat Zain and Nik Abdul Rahim Nik Abdul Ghani, both Senior Lecturers at Centre for Contemporary Fiqh and Shariah Compliance at National University of Malaysia, in their article entitled “Managing Displaced Commercial Risk in Dual Banking System: A Challenge Ahead” discuss the difficulties Islamic banks face in keeping their products competitive with conventional banks where conventional banks are offering guaranteed and predetermined interest whereas Islamic banks are unable to do so. They present past research to show that conventional interest rates do impact profit rates of Islamic banks. They discuss that the practice adopted by Islamic banks to keep themselves competitive by using profit or investment equalization reserves have been declared non shariah compliant posing a huge challenge to Islamic banks and thus they suggest that alternate tools must be developed if Islamic banking is to stay competitive in Malaysia.

Disclaimer

The authors themselves are responsible for the views and opinions expressed by them in their articles published in this Journal.

The opinions, suggestions from our worthy readers are welcome, may be communicated on

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By Zubair Hasan *

Abstract:
This study explores the causes and impact of predatory online publishing on Islamic economics and finance and takes a literature scan to identify the origin and expansion of predatory publishing, as references listed in the paper show. The personal experience and observation of the author over the decades of teaching at various universities endorse the evidence. Its originality lays in initiating discussion on an issue of significance so far remaining unattended in the field of Islamic economics and finance. It not only explores the impact of the affliction on the discipline but also suggests ways to curb the malady.

Keywords: Predatory publishing; Econometric modeling; Islamic finance; Sociology of economics

Introduction
The term ‘predatory publishing’ originated in the writings of Jeffrey Beall, a researcher and librarian at the University of Colorado. It refers to the growth of academic articles of little merit, published in dubious open access journals against payment. A group of writers in a paper published in the prestigious science journal Nature, in fact, voiced grave concern at the explosive proliferation of predatory publishing. The number of such journals in the field shot up to over 10,000 within a few years (Kolata, 2017).  

* Author: Professor Emeritus, International Centre for Education in Islamic Finance (INCEIF), K.L

Rick Anderson (2017) had earlier questioned the term ‘predatory’. He found its meaning unclear and usage deficient as it focused only on one kind of predation: “author-pays open access (OA)” He suggests shunning the term as it generates more “heat than light” (Elliott, 2012).
Predatory journals tend to mushroom in the natural sciences, but social disciplines like economics are not free of increasing incursions.² Fake journals give imitative writings the imprimatur of originality.

Rick Anderson (2017) had earlier questioned the term ‘predatory’. He found its meaning unclear and usage deficient as it focused only on one kind of predation: “author-pays open access (OA)” He suggests shunning the term as it generates more “heat than light” (Elliott, 2012).

Indeed, Beall started polishing the list of such journals, his first being in 2010. He also devised and made public his criteria for including a publication in his list. He suddenly took his list off the line in 2017 without explanation but later explained that it was due to intense pressure from his employer (Ravindranath, 2017).

John Bohannon, writing for the reputed journal *Science*, targeted the open access system for testing in 2013. He reported sending a fake medical paper to a number of journals. Of them, some 60 percent accepted the paper, while the remaining 40 percent declined to publish it (Bohannon, 2013). A few other experiments of the sort were made to identify the predators and their modus operandi. Latest in the list, Cabell’s International—a company doing scholarly publishing analytics and providing other scholarly services—announced the probable launching of a blacklist of predatory journals, with access by subscription. The company had started working on its blacklist criteria in early 2016 (Anderson, 2017).

The objective of this paper is to draw attention to the prolific expansion of predatory publishing from natural sciences to social studies in the West. It explores the consequences of predation for Islamic economics and finance and seeks to suggest remedial measures to curb the menace. For this purpose, the paper is divided into several sections including the introduction. The second section explains why predatory publishing is on the rise. The next three sections briefly list the key features of predatory operations and examine the impact of predation on the content and characteristics of Islamic economics and finance research. The section that follows highlights the bifurcation that arose between Islamic economics and Islamic finance. The paper then carries the discussion forward to elaborate the consequences for research methods employed in the discipline, especially with econometric modeling. It then explains what injury predation has inflicted on the development of Islamic finance. The last section summarizes the discussion and suggests measures to get rid of the malady.

**Causes of Proliferation**

Predatory open access publishing is on the ascendancy as a platform for the higher education institutions of developing economies. Anyone can scan through the names and

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² Indeed, Beall started polishing the list of such journals, his first being in 2010. He also devised and made public his criteria for including a publication in his list. He suddenly took his list off line in 2017 without explanation but later explained that it was due to intense pressure from his employer (Ravindranath, 2017).
locations of contributors to these journals over the recent years to check the validity of this contention. The reason is the imitative legacy of the colonial period on which these institutions are patterned and the criteria of excellence they seek to meet. The curricula format and course designs follow the colonial tradition and norms. For instance, Ahmad (2012) states:

We keep on teaching Western theories developed by the Western writers, through Western textbooks producing graduates and experts who know more of Western economy and markets, more than their own countries (p. 208).

Initially, the practice had some infrastructural advantages. Continuing the approach and methods of research of that era was inexpensive and educative as well. However, things continued unchanged for decades even after independence. Over time, some vested interests developed in the systemic freeze; for the Western-educated elite had captured the centers of power. A PhD soon became imperative for faculty positions in universities. Apparently, this was a welcome development. However, the emerging socio-political structures in newly emerging countries were not always conducive for implementation of the program. A troublesome feature of the requirements was the insistence on the publication of faculty research in refereed journals of international repute and recognition. The developing countries, being latecomers to modern education, had few journals that met the international requirements for recognition that came from external bodies, mostly Western. Thus, the sole outlets for cognizable publishing for reward were foreign journals. It was hard to get into them for a variety of reasons, including quality and cost. It was hard to get into them for a variety of reasons, including quality and cost hurdles. This especially applied to natural sciences, but it was also not easy in social studies like economics. The slogan “publish or perish” unceasingly echoed loud and clear in the corridors of higher education. Many sought publication with local avenues, but that was considered only as the exposure of their blemishes. Such cases led to the revision of the adage to read: “publish and perish”. Western journals like Quarterly Journal of Economics, Journal of Political Economy, Review of Economics and Statistics, and Economic Journal, to name a few, give priority to those issues that are of prominent concern in their societies. These trends prevail not only in the social sciences but also in the natural sciences (Ahmad, 2012, p. 208).

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3 Teachers, researchers, economists or social scientists rarely got or get recognition based on their own merit in their own countries of origin in the developing world unless they have works published in places like London, New York, Paris and Stockholm or their articles in journals of the West (Ahmad, (Ahmad 2012, p.208).

4 Western journals like Quarterly Journal of Economics, Journal of Political Economy, Review of Economics and Statistics and Economic Journal, to name a few, give priority to those issues that are of prominent concern in their societies. These trends prevail not only in the social sciences but also in the natural sciences (Ahmad, 2012, p. 208)
Today, competition in academics is fierce to get published in leading foreign journals of economics—the focus of concern in the present article. At less prestigious tiny institutions dotting the firmament in most developing countries, the overworked faculty with little or no funding for research provides green pastures for predatory online publishers to thrive. For some, it is a case of supply meeting demand, as Kolata (2017) puts it:

Call it a case of supply meeting demand. Universities and colleges insist that faculty publish scholarly research and the more papers the better. Academics and the schools they teach at rely on these publications to bolster their reputation and with an oversupply of PhDs vying for jobs careers hang in the balance.

Arising to meet the demand are online journals that will publish almost anything for fees ranging into hundreds of dollars per paper. Even well-meaning academics are at times duped into working with them, unsuspecting of their dubious ways. This system also puts a premium on collaborative writing. It encourages authors to lighten the payment burden per head through sharing the charge in emerging economies.

The present author receives not less than one call for paper submission almost every day from one or another journal published online, styled as in Figure 1. Blanks are used to conceal the identity of the journal. The call is regularly repeated.

**Figure 1: Call for Paper Submission**

International Journal xx xxxxxxxxxx xxxxxxxxx xxxxxxx 13.12.17
ISSN: 0976-4xxx
Volume Number: 8
Doi: 10.15xxx/ijxxx
ICV 2016 = 77.xx
Submit your paper at editor@ijxxx.xx
Dear Authors/ Colleagues & Researchers,
IJxxx is an open access, peer-reviewed, international journal that provides rapid publication (monthly) of research articles, review articles and short communications in all subjects. Every article published in IJxxx is provided with unique DOI and provides rapid publication of articles in all areas of Social Sciences, Humanities,

IJxxx is indexed and abstracted in Chemical Abstracts, Index Copernicus, DOAJ, Open J-Gate, NewJour, Science Central, and Google Scholar.
Frequency: 12 issues per year
Visit our website: www.ijxxxx........... for online manuscript submission
You can also submit your paper at editor@ijxxx.xx
With best regards
The Modus Operandi

Wikipedia lists the following deceptive practices of predators, which are reproduced here for two reasons. First, each is supported in their article with authentic documentation. Second, most of these are valid, based on the personal experience of the author.

- Accepting articles quickly with little or no peer review or quality control including hoax and nonsensical papers.
- Notifying academics of article fees only after papers are accepted.
- Aggressively campaigning for academics to submit articles or serve on editorial boards.
- Listing academics as members of editorial boards without their permission, and not allowing academics to resign from editorial boards.
- Appointing fake academics to editorial boards.
- Mimicking the name or website style of more established journals.
- Misleading claims about the publishing operation, such as a false location.
- Improper use of ISSNs.
- Fake or non-existent impact factors.

Islamic Economics and Finance

Wikipedia has noted that accusations of predation heaped on open access journals have kicked up an outcry in their defense. The eye of the storm has been the list of predatory journals Beall once published. That list has since been withdrawn, but the debate on it has continued. There is no need to enter that debate or classify journals on that criterion. What is important for us is the impact of predation on the method, content, and relevance of the research in Islamic economics and finance. Paid-for publishing is a byproduct of our putting a premium on the act in faculty evaluations.

Trading in education, as in other commodities, kept the scales tilted in favor of the developed West for historical reasons. Higher education facilities in terms of infrastructural provisions and quality teaching staff were limited in developing countries during the centuries of colonial rule. Universities and colleges when established followed the curricula patterns, course structures and reading materials prescribed in the ruling countries.\(^5\)

\(^5\) To illustrate, in the 2017 syllabi for the prestigious BA (Honors) in Economics Course (University of Delhi), one finds that almost all the required readings are from foreign writers, the courses on the Indian economy being an exception. It is an irony that only a few of the over 6000 faculty in the colleges of the university plus that of the reputed Delhi School of Economics could write textbooks for their students.
Sometimes teachers too were imported. Those from the richer classes of the country went out to obtain foreign degrees that carried a high premium in the local employment market. The lingering process created a psyche that discounted what was local. Thus, even as lands had become free, intellects remained occupied.

To illustrate, in the 2017 syllabi for the prestigious BA (Honors) in Economics Course (University of Delhi), one finds that almost all the required readings are from foreign writers, the courses on the Indian economy being an exception. It is an irony that only a few of the over 6,000 faculty members in the colleges of the university plus that of the reputed Delhi School of Economics could write textbooks for their students.

That psyche continues to dominate education policies in the developing world. However, it has created some additional problems in Muslim countries as education in social sciences, especially economics, has expanded. The freedom movements in most of these countries were led by clerics who fed the mass aspirations on hopes of erecting an Islamic social order 7 paradise after independence. However, the colonial rulers transferred political power at the dawn of independence to the secular elite, not to the movement leaders. For instance, in Pakistan, it was Jinnah & Co. not Mawdudi’s legion of Jamaat-e-Islami who succeeded the British. This had unsavory consequences. The community got divided between the so-called modern and the orthodox groupings, who engaged in acrimony that the Western powers fanned to their advantage. In the ensuing chaos and instability, orthodoxy in most cases could extract only some financial and other concessions from the ruling elite, especially in the field of education.

The clerics leading the freedom movements across countries had already launched a comprehensive global program for looking at knowledge from the Islamic prism. For brevity of expression, they called it the Islamization of knowledge program, albeit a misnomer. Arabs in the Middle-East, Jamaat-e-Islami in the Indian Sub-Continent and Malays in South-East Asia, for example, led the program that received massive popular support for public funding.

After the mid-1970s, Islamic economics emerged as the centerpiece of this program, when following a well-known conference in Jeddah the subject was launched as a formal academic discipline across the Muslim world. Educational institutions, scholarly journals, research work and funding arrangements rapidly emerged on the scene in various countries. The control and regulation of the developments understandably remained essentially with the movement people, who had admirably done the pioneering work in the area. However, this control had to unwind with the expansion of the studies and research over time. Doors had to be opened for academics and support staff from the mainstream secular discipline. Not all of them had the needed knowledge of Islamic jurisprudence. Most of the teachers were educated in the Western tradition at universities abroad and had a rationalistic, value-neutral view of economics; their toolkit was full of mathematical and econometric techniques. This group gained added ascendancy as finance rapidly eclipsed other areas in Islamic economics. This was a tilted and unwelcome development.

Apart from the reasons noted above, the control of the movements over the education system started weakening with the expansion of its financial segment. This was in addition to its 8 increasing technical complexities and the pace of change under
pecuniary allurements. Of course, there were jurists who were well equipped to adapt to the change. Indeed, they found the rapid expansion of the sector quite lucrative as the demand for Sharīḥah (Islamic law) advisement in financial institutions ran far ahead of its supply. However, most Islamic economists working in higher education echelons across countries could not take advantage of the change.

The Bifurcation

The ascendency of Islamic finance left vast areas like public economics, distributive justice, economic development, monetary issues and social welfare almost unexplored. This led to some sharp divisions among Islamic economists. The broad bifurcation was between the old guard imbued with the classical puritan tradition and the later entrants from modern economics, who mainly handled finance. The traditionalists, presumably to regain the lost ground, chose to attack the modernists for infesting Islamic economics with mainstream pollutants. Theirs is a concerted effort to pull the subject back to its historical tracts. To restore the old edifice, they plead for opening the discussion from the methodology end. They argue that it is the use of an inappropriate methodology that has brought Islamic economics to its present demise. However, the methodology is a vexed escapade and a receding subject in mainstream economics itself, and a digression here on methodological issues is not warranted. Relevant to the present context is the methodology that has almost exclusively occupied dissertation writing at the graduate level as a mark of quality in prestigious institutions of higher learning across the world.

Indeed, dissatisfaction with their current state is a common property of both disciplines of economics – Islamic and mainstream. For instance, in 2009 Krugman attempted to explain: “what went wrong with economics and how the discipline should change to avoid the past” (Sadat, 2017). Four years later Akram Khan (2013) went book length to explore “what went wrong with Islamic economics”, analyzing the present pitfalls in order to design the future agenda to avoid them. Thus both disciplines are in crisis, sailing in choppy waters, not finding their moorings. However, despite their failure, academics have their ideological contentment in either case and continue to teach the subject from the same textbooks and sources unmindful to the crises the subject faces.

An inept consequence of such a situation is notable. Even the leading journals of Islamic economics now prefer econometric oriented articles have submissions evaluated

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6 See the writings of Nasr (1992), Choudhury (2009) and Zaman (2012) as illustrations of insistence on the adoption of this approach to rehabilitate Islamic economics. They also insist on reverting to the puritan classical methodology for developing Islamic economics. The problem with the puritan insistence of the group is that the resultant economic order they paint has not yet been shown to operate even on a miniature scale anywhere in the Muslim world. Ironically, Islamic finance claims an edge over the mainstream in being firmly linked to the economy on the ground.

7 The rising tendency toward formalization in modern economics has deemphasized empiricism, adding to the methodological confusion in the discipline (Blaug, 1992).
by mainstream scholars, often working abroad. This practice has two limitations. First, not all such reviewers are adequately aware of the Islamic position they are approached to comment on. More than that, they find contributions obsolete due to mainstream advances. The rejection deprives Islamic economics of addition to its meager and lacking knowledge stock. What looks obsolete from the mainstream prism could look pretty in the Islamic mirror.

Research Methodology

Predatory publishing in Islamic economics owes its recent emergence and proliferation to the increasing entrance in the Islamic higher education institutions of teachers who have studied and worked in foreign universities. Their conditioning in the mainstream thought processes has convinced them that the way to raise academic standards to global levels in Islamic economics is to imitate the Western structures and methods in teaching and research. The conviction has proved misleading, especially the penchant for mathematical/empirical formalization.

Arguably, mathematics helps fix ideas, especially to precisely spell out the optimization conditions for economic agents and entities under a variety of complex situations. The advantages led in the 18th century to the proliferation of formal economic modeling based on a differential calculus that made optimization feasible. Economics became increasingly mathematical during the interwar period and the later entry of new techniques like game theory allowed wider generalizations. The use of newer tools became fashionable, a symbol of knowledge and scholarship. The developments promoted caustic divisions in the profession and accentuated the formalization of the subject.

However, the unwanted formalization of the discipline could not go unchallenged. No one denied the utility of mathematics for economics, but it did not take long for its overuse in the subject to awaken criticism. Some noted economists like J. M. Keynes, Robert Heilbroner, Friedrich Hayek and others expressed concern over the increasing spread of mathematical models for exploring human behavior. They were candid that some economic choices, especially involving moral and ethical norms, were irreducible to mathematical symbolism. Abstract models for explaining human behavior do not meaningfully submit to mathematical manipulations, they argued. Furthermore, most political problems such as budgetary allocations, fighting over the tax structure, welfare reform, international trade, or concern for the environment have economic aspects. Both the voters and the leaders they elect can fulfill their role more effectively if they have an understanding of basic economics; mathematics will only confuse them. Still, there are well-known Islamic economists who enjoy unleashing that confusion.

Econometric Syndrome Impact

An advanced form of mathematical propagation in Islamic economics is the craving for the use of econometric modeling. Illustrative of the emphasis is the compulsive use of such modeling at the prestigious global institutions of Islamic finance. The following narrative is based on the personal experience of the author as a faculty member at an institution for years. Typical was the case of a student the author worked with as a
supervisor for her master’s project paper worth three credit hours with the title *Sukuk: definition, structures and Malaysian experience*. A high-powered Graduate Studies Committee with the supervisor as an invited member had to evaluate the work. The Committee appreciated the flawless language of the paper and its structuring. However, they expressed reservation to clear it as it did not have any empirical modeling. The supervisor had to plead for quite some time in defense of the student. The committee was asked: what model, if any, could the student have used in the definition or the structure sections of the work? In support of her position on Malaysian experience, the student had produced, he pointed out, appropriate and adequate supportive data in tabular form. The question was what modeling was missing? Upon the supervisor’s insistence that the work was good enough for a pass as the rules required no grading, the Committee eventually relented to clear the work.

The Committee’s obsession with econometric modeling as an imperative for acceptable research, except for topics dealing with Islamic jurisprudence, was understandable as the faculty was largely foreign educated. They had fully absorbed the econometric culture of the institutions where they studied. Some were indeed adept at employing the tools, which had advantages for them in doing and supervising research. Models of all sorts were readily available in the mainstream literature to pick up from; even foreign collaboration was not scant. Thus, research becomes relatively easy. Feed the relevant information into a computer program and torture the data until it yields what is required. The bulk of the research manuscript, save the interpretations, is machine-generated. The authors do not explain the numerous impulse impact graphs near the end of the manuscript, nor do the readers care to look at them. One rarely comes across a genuinely original model formulation in Islamic economics and finance.

The research can get an easy linkage with the mainstream authors’ networks, thanks to the mushrooming of predatory publishing journals, which have encouraged collaborative writings as the authors can share the publishing charges to lighten the individual payment burden. Some archives even tend to shelter such journals.

**The Devastation**

The above observations are not to deny the significance of empiricism in search of truth. Econometric modeling has analytical grandeur and utility; it can undo age long convictions.

No doubt, there are many reasons for believing that demand curves are negatively inclined, but there is little doubt that if the statistical evidence repeatedly ran the other way, none of these reasons would suffice to make economists believe in the law of demand

(Blaug, 1992, Preface, p. XX)

This is a casual remark in the preface which is otherwise highly critical of the mainstream methodology. It just states the utility of empirical evidence. Indeed, falsification had emerged as a leading plank of the mainstream methodology. However, the bulk of econometric work has been confirmatory, not refutative.
Reverting to our theme, the econometric oriented research for payment publishing has become a flourishing business. In the process, it is inflicting incalculable harm on Islamic economics and finance. Students come to reputed institutions from numerous academic disciplines and very divergent academic backgrounds ranging from philosophy to medicine. They do not all have the same taste or ability to absorb even the minimal econometric shock they receive after admission. Admittedly, it cannot be a case of the same-size shoe fitting all feet.

The use of econometrics in Islamic social sciences like economics poses additional problems as the issues under discussion involve value judgments in a major way. Econometric models produce period-specific results valid only over the range of data. They are invariably confirmative. Interestingly, the confirmation is often of mainstream conclusions with little Islamic relevance. Refutations absent, they add little to the existing stock of knowledge.

The majority of academics are not at home with empirical methods. Data quality is often suspect and availability scanty. Variables were chosen mostly lack the needed Islamic import. The bulk of the students and the staff remains tense and pressurized. Models employed are invariably picked up from the already published mainstream sources. These limitations aside, improvement in the quality of research is sought by repeatedly rejecting what a student does; positive helpful guidance is rare. Supervisory contribution is minimal, appropriation of credit for sound work maximal. Data mining for supervisors is a common duty of students. Completion time knows no limit. Cases where students leave without completion or shift to other institutions are not rare. However, those who go abroad often discover that the ordeal is no different from what students generally faced at home. A case reported in Appendix 1 is an eye-opener. It tells more than meets the eye. And, this is not a solitary case of Islamic economics students suffering abroad in silent frustration;

Most of the data used come from UN sources. Even the Islamic Development Bank (IDB) at Jeddah mostly reproduces data separated from the same tables for the Organization of Islamic Cooperation (OIC) member countries. Data generation in size and quality expressive of Islamic essence is conspicuous by its very absence. 13 there are several others in the author’s knowledge as they called for help.

A classic illustration of the potpourri of disjointed ideas and errors from the title to the conclusion is an article published in a refereed and listed journal by Yusof et al. (2017). For example, many tests in parametric statics, such as the sample t-test, are derived under the assumption that the data come from a normal population with an unknown mean. In a non-parametric study the normality assumption is removed. This

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8 Most of the data used come from UN sources. Even the Islamic Development Bank (IDB) at Jeddah mostly reproduces data separated from the same tables for the Organization of Islamic Cooperation (OIC) member countries. Data generation in size and quality expressive of Islamic essence is conspicuous by its very absence.

9 A classic illustration of the potpourri of disjointed ideas and errors from the title to the conclusion is an article published in a refereed and listed journal by Yusof et al. (2017).
Econometric models have explanatory power, but they are found weak, even misleading, on the prediction front. Their policy conclusions are rarely found guiding economic activity in the Muslim world. Authors must clearly explain how their findings add to usable wisdom and are applicable to improve ground realities before claims of filling knowledge gaps. Interestingly, stochastic empiricism is on the decline even in mainstream economic research: the use of non-parametric methods allowing multivariate analyses is on the rise. Unlike parametric models, non-parametric models do not require the modeler to make any assumptions about the distribution of the population and are for that reason sometimes referred to as a distribution-free method.10 This issue was discussed in an earlier paper: see Hasan (2005) and also the illuminating discussant Assad Zaman’s comments on the paper in the conference proceedings.

Econometric models for research keep students occupied with data exploration, the values of parametric variables and their significance levels. This undermines autonomy, leaving little time for creative out-of-the-box thinking. It kills the initiative. *Imitators cannot be innovators, followers, leaders.* Let intellect not remain shackled in free lands. What useful purpose is parametric research serving?11 Professor Assad Zaman (2012a) teaching econometrics at Islamabad makes a pertinent observation as follows.

> Econometric methodology is based on logical positivist principles. Since logical positivism has collapsed, it is necessary to re-think these foundations....positivist methodology has led econometricians to a meaningless search for patterns in the data. An alternative methodology which relates observed patterns to real causal structures is proposed.

> It is time for cost-benefit accounting. The apparent reward is the international recognition of *merit*, largely via predatory publications. The merit test for research articles must be the extent they promote the Islamic viewpoint and the number of people in the academic world who read and benefit from them.

### Concluding Remarks

This paper has explained how the colonial era hangover has maintained its sway over intellectual pursuits in the Muslim world. It has further shown how the religious counter-initiative to restore Muslims’ past glory and achieve their present aspirations has

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10. For examples, many tests in parametric statics, such as the sample t-test, are derived under the assumption that the data come from a normal population with an unknown mean. In a non-parametric study the normality assumption is removed.  
11. This issue was discussed thread bare in an earlier paper: see Hasan (2005) and also the illuminating discussant Assad Zaman’s comments on the paper in the conference proceedings. This issue was discussed thread bare in an earlier paper: see Hasan (2005) and also the illuminating discussant Assad Zaman’s comments on the paper in the conference proceedings.
clashed with that sway in the field of economics education and research work in the institutions of higher education in Muslim countries. The conflict has resulted in policy approaches pulling in opposite directions detrimental to the future development and progress of the discipline. The differences must be reconciled; the roadblocks must go.

There has been a growing recent realization that mathematics and econometrics are being overused in economics. Convergent with that, the recurring turmoil has been causing disenchantment with mainstream economics for its inability to resolve real-world problems. This has created an environment wherein mainstream economists may be more inclined to appreciate the ethical focus of their Islamic counterpart. The disillusion has resulted in the rise of behavioral studies in social economics. Appendix 2 provides a thumbnail sketch of the developments.

The dominance of the system by the foreign-educated elite, despite certain advantages, has created many problems for the smooth and purposive progress of Islamic economics and finance. The research objectives are stretched to look Islamic. The increasing use of mathematics and parametric empiricism is overdone to seek conformity with the mainstream requirements for facilitating publication in foreign journals, the supposed hallmark of scholarship. These factors create the temptation to participate and empower the predatory publishing ecosystem. Mostly, there is a mismatch between the definitions of data used.

The concern about the increasing use of mathematics in economics was clearly on the rise much earlier than the close of the preceding century. It was seen more as a matter of professional politics than a helpful analytical tool. Notice the title of Rosenberg’s book “Economics--Mathematical Politics or Science of Diminishing Returns”. Likewise, see Roy (1989, Chapter 9) and Mark Blaug in Hausman (1984, Chapter 21). Islamic economics, mostly based on value judgments, offers even a more restricted scope for its use from external sources and what the Islamic norms would demand, giving inappropriate and inapplicable results. The methodological approach tends to enslave intellect and kills initiative and creativity in young minds. Restraint and modifications to match Islamic norms and reflect local conditions are needed.

Likewise, orthodoxy, insisting on reversing the march of history, is not serving the cause of Islamic economics and finance. All economic activity—Islamic or secular-deals with the same are intrinsic to the divine wisdom of creation. Islam never segmented knowledge; it only seeks to pass it through prescribed filters for acceptance, modification or rejection. It is well acknowledged that there is much usefulness and validity in the mainstream version of the subject from the Islamic viewpoint. It would be naïve to throw away the baby with the bath water. Adaptation, moderation and accommodation are the way out. A reconciliatory approach urges for the development of
integrative textbooks nested in domestic socio-political environs with illustrative case studies and simple lucid language.

The following suggestions may possibly improve the utility of econometric models presented in Islamic economics and finance research work.

- Explain what Islamic values or norms are ingrained in the variables to be used and how far the data used correspond to the Islamic specification. A comment on the quality and source of data must be made explicit.

- State in plain language the objectives of research and how the results approve or reject them.

- Clearly state how the model results would help individual economic entities or have value in molding their collective behavior towards Islamicity. Explain the utility of parametric measures, especially of end-model numerous impulse impact charts, and why these cannot be eliminated from the work. An examination of the numerous working papers and journal articles at RePEc archive of a well-known professor of econometrics and finance with decades of teaching experience across the globe, including Muslim countries, reveals the little impact on Islamic finance theory or practice.

- Finally, works essentially based on econometric modeling must attach the data file used to the work. This would enable a recheck on the findings, may help other researchers in their studies and allow accumulation to a wider database for Islamic economists.

There is a need to strengthen the existing journals and launch new ones, develop a sound refereeing system, assign credits for publishing in them and start an international depository for them. The RePEc is doing laudable work but is not meeting Islamic requirements because of their organizational constraints. In an opinion/suggestion survey the archive conducted this year, the author suggested the creation of a separate field for Islamic economics and finance papers. He further recommended the listing of three journals with the archive -- one each from Jeddah, Kuala Lumpur and Karachi -- for which requests have long been pending. Prima facie, the registration requirements have all been fulfilled and what more is required can be met.

APPENDIX 1

Students’ Predicament Abroad Illustrated

A student, who had attended lectures of the author in Islamic Economics at INCEIF for her master’s degree, joined the PhD program at a well-known university abroad. She believed, like most locals, that foreign exposure and a foreign PhD would be valuable in career-building back home. Paraphrased, she narrates her predicament on that journey as under My supervisory team was not supportive at all. Many differences between them and me cropped up concerning research issues affecting my progress. I had requested the university to change the supervisory team, but they could not help as no one really
understood my topic involving Shari'ah-compliance aspects. My principal supervisor was a Muslim but I could not feel that he or others on the team had any understanding of the Shari'ah questions involved in my work; they showed no empathy either. On the contrary, I felt that they were just exploiting me. In fact, my principal supervisor had hijacked my work, publishing it in a top journal with a professor in Europe. I reported the matter to the Research Ethics and Integrity Committee of the university. They interviewed the supervisor and examined my documents. I was informed that the evidence I had produced was not strong enough to prove the allegations. Surprisingly, the Professor left the university abruptly and moved to the UK. The student has since also shifted to another university.

APPENDIX 2

The Rise of Behavioral Economics

The winner of the 2017 Nobel Memorial Prize in Economic Sciences, Richard Thaler, is known for his lifelong pursuit of behavioral economics including finance. The new and rising discipline studies economics from a psychological perspective. The idea that psychological research should be part of economics has, for years, generated hostility from the profession. However, the failure of economics to protect the wealth and well-being of mankind from the devastations inflicted on them by recurring turmoil has tended to soften the resistance.

The behavioral research program would have ethical focus and linkage with ground realities. It would establish a research trajectory for young scholars and social engineers to initiate the beginning of a real and enduring scientific revolution. Such a revolution is expected to underline the significance of Islamic economics because of its ethical bearings and emphasis on aligning with ground realities. This is provided that orthodoxy does not continue with its exclusivist approach to the subject. The temptation for imitative research and predatory publishing would also tend to wane.

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A Review of Islamic Commercial and Social Finance in Pakistan

By
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Dr. Shahida Shahimi and Dr. Muhammad Hakimi

Abstract
This paper gives an overview of Islamic finance in Organization of Islamic Cooperation (OIC) member country of Pakistan. This paper is divided into 5 subsections. Section 1 gives a brief overview of Islamic banking which enjoys a central place in the umbrella of Islamic financial services globally as well as in Pakistan. Section 2 looks at the progress and performance of Islamic capital markets in Pakistan, especially Shari’ah compliant equities and Sukuk. Section 3 provides a brief account of Islamic asset management sector in Pakistan. Section 4 explores the footprint of Islamic microfinance sector and Section 5 gives an account of the contribution of third sector redistributive institutions like Zakāt and Waqf in Pakistan.

Keywords Islamic Banking, Islamic Finance, Islamic Capital Markets, Islamic Microfinance, Zakāt, Waqf

1. Islamic Banking in Pakistan
Financial institutions aim to facilitate intertemporal finance between savers and investors by providing efficient delegated monitoring and portfolio management services (Diamond 1984). Financial institutions enable the consumers to access their potential lifetime resources when they are not readily available in different stages of their life. Financial institutions like banks and microfinance institutions provide credit services so that people can access funds in the present period. People can use their current endowments or future stream of expected incomes as collateral to access credit facilities in the present (Kahf, 1996).

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Islam allows financing and investments, but without the element of interest. Islam aims for circulation of wealth and pursuit of the productive enterprise for earning a livelihood. On the other hand, providing a fixed return to money capital leads to continuous accumulation and concentration of wealth among the wealthy capitalists. Islamic finance makes it necessary that money capital cannot get stipulated returns unless it participates in the productive enterprise by undertaking the risk. This enables circulation of capital, full employment of resources and avoids the ills of the concentration of wealth, economic stagnation, unemployment and simultaneous existence of unused resources and unmet needs. Islamic teachings discourage idleness of capital by disallowing any stipulated increase to the lending of money capital and by levying Zakāt on idle capital. This ensures capital circulation in the real economy so that the financial intermediation contributes to socio-economic development by having a direct and compulsory link with the real sector of the economy.

Globally, Islamic banking first appeared as social finance in the 1960s. Mit Ghamr Islamic Savings Bank was started in Egypt by El-Naggar in 1963. Around the same time, Pilgrims Fund Corporation or Tabung Haji started operations in Malaysia in 1963 to enable Muslims to save for meeting expenses of Hajj pilgrimage (Chachi, 2005). However, modern commercially incorporated Islamic commercial banking began in 1979 with the establishment of Dubai Islamic bank.

Since then, Islamic financial institutions had been established in many OIC regions including Middle East, South Asia, East Asia and Northern Africa. According to Global Islamic Finance Report (2017), global Islamic finance assets reached $2.2 trillion in 2016. As much as 75% of the global Islamic financial assets are held by Islamic banks and conventional banks with Islamic banking windows. Among the individual countries, the market shares of Islamic banking in national banking remains at 51.2% in Saudi Arabia, 45.2% in Kuwait, 29.3% in Bahrain, 25.8% in Qatar, 21.6% in UAE, 25% in Malaysia and 11.7% in Pakistan.

Ever since the establishment of Pakistan in 1947, there was a great zeal to introduce Islamic institutions in the socio-economic milieu of the country. Nonetheless, political turmoil in the early years did not allow adequate progress in institutional building. Afterwards, given the increased focus in the 1970s around the Muslim world to develop an Islamic financial system for Muslims, the positive effects were also felt in Pakistan. On the regulatory front, the 1973 constitution of Pakistan in Section 38(f) stated that Ribā should be eliminated as early as possible.

On the theoretical front, the Pakistan Council of Islamic Ideology in its 1980 report on the elimination of interest from the Pakistan economy clearly defined Ribā and suggested that steps should be taken to replace Ribā based banking with an Islamic alternative. The report stated:

*The term Ribā encompasses interest in all its manifestations irrespective of whether it relates to loans for consumption purposes or for productive purposes, whether the loans are of a personal nature or of a*
commercial type, whether the borrower is a government, a private individual or a concern, and whether the rate of interest is low or high.

Later on, the Historic Judgment on Interest in 1991 by the Supreme Court of Pakistan settled the debate both in academics as well as in legal sphere. Now, Islamic banking in Pakistan is an established industry with 11.7% and 13.3% market share in total banking assets and deposits respectively as at December 31, 2016. By year-end 2016, the total Islamic banking assets in Pakistan stood at Rs. 1.85 trillion ($17.65 billion) while total Islamic banking deposits stood at Rs. 1.57 trillion ($15 billion). With increased participation of conventional banks in Islamic banking industry, the branch network has swelled to 2,322 branches by year-end 2016.

2. Islamic Capital Market in Pakistan

2.1 Equity Market in Pakistan

The capital market in Pakistan, in general, has provided remarkable returns as compared to the low-risk regular income investments. Most of the people with investment motive and having adequate risk appetite prefer capital market investments in secondary market due to higher expected return and greater liquidity. Figure 1 gives a snapshot of how the broad market index (KSE-100) has moved during 1997-2016. It can be seen that the growth had been consistent with a break during 2008-10. The twin peak is observed since the stock market fell substantially in response to the global financial crisis which also had an impact on the domestic capital market.

![KSE 100 Index (1998 - 2016)](source: Karachi Stock Exchange)

Figure 1: KSE 100 Index Daily Values (Adjusted Closing) for 1997-2015

Figure 2 shows the index values of KMI-30 during 2009-2016. From plotting the KSE 100 index values for comparison, it is evident that KMI-30 index has steadily increased. The Compound Annual Growth Rate (CAGR) for the KMI-30 index has remained at 29.01% during 2019-2016.
On the other hand, there had only been 24 new long term corporate debt instruments issued during 2011-16. There are many reasons why the corporate bond market did not develop in Pakistan as per expectations. The national savings scheme instruments issued by the government of Pakistan offer 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 with no such tax exemptions.

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 1970s. Afterwards, indirect taxation and removal of import barriers had also made corporate investments more challenging in the 1980s and 1990s. 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.

### 2.2 Sukuk Market in Pakistan

For Muslim investors looking for regular long term income, Sukuk investments are a Shari’ah compliant alternative to corporate and treasury 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 in the form of profit on the sale or rental income stream on the 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. Coming to the Sukuk market, it is found that there is small, but appreciable progress in short time. In Pakistan, more than 100 Sukuk had been issued so far by the public sector companies, private sector companies and by Government of Pakistan (GOP). Innovative structures have also appeared in recent years. For instance, Meezan Bank arranged the country’s first airtime-based Sukuk. These
Sukuk use intangible assets such as minutes of mobile telephone use as the underlying asset. The structure of these 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.

3. Islamic Mutual Funds

Islamic mutual funds like their conventional counterparts provide portfolio management services to risk averse and risk neutral investors. Islamic mutual funds have to follow Shari’ah compliance criteria in their portfolio selection and revision. Furthermore, they also have to purify their non-compliant portion of income from the total earnings to make their income Shari’ah compliant.

In Pakistan, Karachi Stock Exchange (KSE) and Al-Meezan Investment Management Limited launched first Islamic Index (KMI-30) in 2008 which tracks 30 most liquid and active Shari’ah compliant stocks. The screening methodology approved by the Shari’ah advisors of Al-Meezan Investment Management Limited is explained below.

A. Business of the investee company

First and foremost, the business of the investee company should be Shari’ah compliant. Accordingly, investments in common stocks of conventional banks, insurance companies, leasing companies and companies dealing in liquor, drugs and ammunition are not permissible and hence stocks of these companies cannot be included in the portfolio. Once the qualitative screening on the nature of the business is passed, then the screening is done on quantitative indicators related to business processes, such as the use of interest based leverage, investments and share of the non-compliant portion of income.

B. Ceiling on interest based debt

The Shari’ah screening criteria stipulate that interest based debt must be less than 37% of the consolidated total assets of the investee company. Interest based debt includes borrowing through the issuance of corporate bonds, debentures, Term Finance Certificates (TFCs) and commercial paper. It also includes interest based conventional banking products, such as interest based loans, capital lease and hire purchase agreements.

C. Ceiling on interest based investments

The Shari’ah screening criteria specify that non-Shari’ah compliant investments must be less than 33% of the consolidated total assets of the investee company. Non-Shari’ah compliant investments include investments in conventional mutual funds, conventional money market instruments, corporate bonds, Pakistan Investment Bonds (PIBs), Federal Investment Bonds (FIBs), Certificate of Investments (Cols), Certificate of Deposits (CoDs), Term Finance Certificates (TFCs), national savings schemes and interest based derivatives. Furthermore, investments in the common stocks of companies that are termed non-compliant due to a violation of any of these principles are also termed as impermissible.
D. Cap on Shari’ah non-Compliant income

The Shari’ah screening criteria also require that Shari’ah non-compliant income must be less than 5% of the consolidated total revenue of the investee company. Total revenue is defined as:

\[
\text{Total Revenue} = \text{Gross Sales} + \text{Total Other Income}
\]  

(1)

Non-compliant income includes interest income from financial investments and overdue receivables. Non-compliant income also includes income from immoral activities such as gambling, nightclubs, prostitution, casino, tobacco and liquor, for instance. Dividend income from above mentioned businesses or from companies which have been declared as non-compliant due to non-compliance with any of these criteria for Shari’ah compliance is regarded as Shari’ah non-compliant income.

E. Minimum requirement of illiquid assets

The Shari’ah screening criteria further stipulate that illiquid assets must be at least 25% of the consolidated total assets of the investee company. Illiquid assets are defined as:

\[
\text{Illiquid Assets} = \text{Total Assets} - \text{Liquid Assets}
\]  

(2)

Liquid assets include cash, prepayments, advances and trade receivables. Illiquid assets include inventory and all fixed tangible assets, such as plant, equipment, machinery and furniture. In the context of these principles, all assets having some intrinsic value and which can be traded above or below par value are illiquid assets. These exclude things like currency which does not have an intrinsic value of its own and it also excludes debt which cannot be traded/re-assigned above or below principal value.

F. Minimum price of share as per Shari’ah

As per the prescribed rules, the value of the company is worth at least the amount of liquid assets it has. Minimum market price per share is given by net liquid assets per share, which is calculated as:

\[
\text{Net Liquid Assets Per Share} = \frac{(\text{TA} - \text{IA} - \text{CL} - \text{LTL})}{\text{Total Outstanding Shares}}
\]  

(3)

In equation (2.3), TA represents total assets, IA represents illiquid assets, CL represents current liabilities and LTL represents long term liabilities. Besides these screening principles, the rules of sale in Islamic jurisprudence also have to be observed which negate the use of short selling, sale of rights, options, warrants, futures sale and forward sale, for instance. In order to provide a contrast in the screening methodology applied in Pakistan as compared to globally, a summary of the quantitative screens followed in three major indices globally is provided in Table 1.

Table 1: Screening Criteria of Global Indices
Next, some developments and indicators related to the Islamic asset management sector in Pakistan are presented. As of June 2016, there are 201 mutual funds in Pakistan, out of which 82 are Islamic funds and 119 are conventional funds. Table 2 reports total AUM in Islamic mutual funds in each category of funds. It can be seen that most funds are invested in equity (42.68%) and income funds (18.85%). CAGR for Islamic equity funds during 2011-16 had stayed at 57.09%, while the CAGR for Islamic income funds had been clocked at 7.29% during the same period.

Table 2: Assets under Management in Islamic Funds (in million Rs.)

<table>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>7,027</td>
<td>8,104</td>
<td>15,349</td>
<td>23,363</td>
<td>51,167</td>
<td>67,215</td>
</tr>
<tr>
<td>Income</td>
<td>20,888</td>
<td>29,944</td>
<td>36,414</td>
<td>36,783</td>
<td>21,028</td>
<td>29,692</td>
</tr>
<tr>
<td>Fund of Funds</td>
<td>-</td>
<td>-</td>
<td>699</td>
<td>927</td>
<td>3,269</td>
<td>23,679</td>
</tr>
<tr>
<td>Asset Allocation</td>
<td>1,264</td>
<td>1,120</td>
<td>870</td>
<td>1,116</td>
<td>4,784</td>
<td>10,818</td>
</tr>
<tr>
<td>Fund of Funds - CPPI</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>11,533</td>
<td>20,671</td>
<td>9,168</td>
</tr>
<tr>
<td>Money Market</td>
<td>6,353</td>
<td>7,762</td>
<td>7,088</td>
<td>5,189</td>
<td>13,483</td>
<td>5,920</td>
</tr>
<tr>
<td>Balanced</td>
<td>2,289</td>
<td>2,334</td>
<td>2,538</td>
<td>6,955</td>
<td>3,493</td>
<td>4,822</td>
</tr>
<tr>
<td>Aggressive Income</td>
<td>725</td>
<td>688</td>
<td>1,178</td>
<td>2,253</td>
<td>2,157</td>
<td>3,209</td>
</tr>
<tr>
<td>Capital Protected</td>
<td>724</td>
<td>443</td>
<td>1,304</td>
<td>2,972</td>
<td>3,015</td>
<td>1,771</td>
</tr>
</tbody>
</table>
Table 3: Market Share in Mutual Funds Industry – 2016

<table>
<thead>
<tr>
<th>Category</th>
<th>Conventional</th>
<th>Islamic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggressive Fixed Income</td>
<td>81.41%</td>
<td>18.59%</td>
</tr>
<tr>
<td>Asset Allocation</td>
<td>50.06%</td>
<td>49.94%</td>
</tr>
<tr>
<td>Balanced</td>
<td>48.21%</td>
<td>51.79%</td>
</tr>
<tr>
<td>Capital Protected</td>
<td>61.85%</td>
<td>38.15%</td>
</tr>
<tr>
<td>Commodities</td>
<td>53.34%</td>
<td>46.66%</td>
</tr>
<tr>
<td>Equity</td>
<td>65.88%</td>
<td>34.12%</td>
</tr>
<tr>
<td>Fund of Funds</td>
<td>6.84%</td>
<td>93.16%</td>
</tr>
<tr>
<td>Fund of Funds - CPPI</td>
<td>16.44%</td>
<td>83.56%</td>
</tr>
<tr>
<td>Income</td>
<td>76.75%</td>
<td>23.25%</td>
</tr>
<tr>
<td>Index Tracker</td>
<td>33.91%</td>
<td>66.09%</td>
</tr>
<tr>
<td>Money Market</td>
<td>89.35%</td>
<td>10.65%</td>
</tr>
<tr>
<td>Total</td>
<td>66.60%</td>
<td>33.40%</td>
</tr>
</tbody>
</table>

Source: Mutual Funds Association of Pakistan

Table 3 presents the market share distribution of Islamic and conventional funds in each category of funds. Islamic funds have 33.40% market share as compared to 66.60% market share of conventional mutual funds as at December 31, 2016. In Balanced, Fund of Funds and Index Tracker categories, Islamic funds have a greater market share as compared to conventional mutual funds.

4. **Islamic Microfinance in Pakistan**

Muslim countries represent a quarter of the global population, but they are generally poorer than non-Muslims as their share in global poverty pool is almost twice as much as their share in the global population. Conventional microfinance involves interest which is prohibited in Islam just like in all monotheist religions. Voluntary exclusion due to the religious prohibition of interest is also another reason why conventional microfinance reach is low, especially in OIC countries.

Islamic microfinance is an alternative for people who wish to obtain relief in their income and liquidity constraints to smooth consumption of their own and their family members. In OIC countries, most poor people are in Nigeria, followed by Bangladesh, Pakistan and Indonesia. In all these 4 OIC member states, the poor population exceeds 20 million. Bangladesh has the highest outreach in microfinance. Along with Bangladesh, Pakistan, Nigeria and Indonesia are the other OIC countries where the microfinance
client base exceeds 1 million. Nevertheless, apart from Bangladesh, the outreach gap is more than 90% in Pakistan, Nigeria and Indonesia.

Obaidullah (2008) explains that there are two broad categories of Islamic microfinance models that are globally used, i.e. charity based not-for-profit models and market based commercial models. The former model uses Qard-e-Hasan, Waqf and Zakāt funds for providing non-compensatory loans or non-repayable grants. Market based commercial models provide micro-credit using Murabaha, micro-leasing using Ijarah and micro-equity or a composite model of microfinance which is a hybrid of these models.

*Qard-e-Hasan* based financing ensures that there is no additional stipulated increase paid over the principal amount. Thus, it enables the borrower to benefit from the loan and repay the same amount of money. This increases the chances of taking benefit of the loan and enabling socio-economic mobility rather than getting trapped in interest based compounded debt. This form of financing also protects the lender since the principal amount of money has to be repaid. Thus, while *Qard-e-Hasan* provides ease in repayment burden for the borrower, it also protects the lender from moral hazard. *Qard-e-Hasan* is a useful instrument to enable the poor client to survive and graduate to a non-poor status by providing funds which can be utilized for personal consumption needs as well as for purchasing the raw materials, tools and business inventory for productive enterprise.

The theoretical edge of Islamic microfinance has been studied by several Muslim economists. According to Ahmed (2002), Islamic Microfinance Institutions (IMFI) appear to have performed better than Grameen Bank. Ahmed (2002) expects IMFI to benefit from the social capital derived from Islamic values and principles. Ahmed (2002) reasons that IMFI can reduce high monitoring costs substantially since Islamic modes of financing involve a real transaction. The moral hazard problem arising from the use of funds for purposes other than those intended substantially reduces in Islamic contracts. Komi and Croson (2013) find significantly higher compliance rates for the Islamic-compliant contracts (profit-sharing and joint venture) than for the traditional contract (interest-based). Ashraf et al. (2014) in an empirical study provide evidence that low religious orientation corresponds to higher levels of risk and default. Citing another ethical benefit of Islamic microfinance due to its risk sharing and asset backed nature, Samad (2014) argues that if Islamic microfinance is offered in India, the mass suicides committed especially by the Indian farmers can be contained to a great extent. However, in terms of realizing the theoretical and structural potential, a sizable progress is yet to be seen.

In Pakistan, Naveed and Ali (2012) estimate that 58.7 million people in Pakistan are living in multidimensional poverty with 46% of the rural population and 18% of the urban population falling below the poverty line. Table 4 gives facts about the microfinance sector in Pakistan.
Table 4: Stylized Facts about Microfinance in Pakistan

<table>
<thead>
<tr>
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<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Number of Borrowers (million)</td>
<td>1.6</td>
<td>1.7</td>
<td>2.0</td>
<td>2.4</td>
<td>2.8</td>
<td>3.8</td>
<td>4.6</td>
</tr>
<tr>
<td>Gross Loan Portfolio (bln Rs.)</td>
<td>20.2</td>
<td>24.8</td>
<td>33.1</td>
<td>46.6</td>
<td>61.1</td>
<td>92.9</td>
<td>136.9</td>
</tr>
<tr>
<td>Active Women Borrowers</td>
<td>0.8</td>
<td>0.9</td>
<td>1.3</td>
<td>1.4</td>
<td>1.6</td>
<td>2.1</td>
<td>2.5</td>
</tr>
<tr>
<td>Branches</td>
<td>1,405</td>
<td>1,550</td>
<td>1,460</td>
<td>1,606</td>
<td>1,747</td>
<td>2,960</td>
<td>3,220</td>
</tr>
</tbody>
</table>

Source: Pakistan Microfinance Network

The number of people benefitting from microfinance is only as much as 4.6 million. According to Pakistan Microfinance Network, the share of Islamic microfinance segment in active borrowers and gross loan portfolio stands at 15% and 7% respectively in 2016. Table 5 presents the outreach statistics from the four provinces of Pakistan. It is disturbing to note that the penetration ratio is lowest in two of the most impoverished provinces of Pakistan, namely Balochistan and KPK.

Table 5: Microfinance Outreach – Province wise

<table>
<thead>
<tr>
<th>Key Indicators - Province wise</th>
<th>Sindh</th>
<th>Punjab</th>
<th>Balochistan</th>
<th>KPK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offices – Fixed</td>
<td>651</td>
<td>2,284</td>
<td>17</td>
<td>107</td>
</tr>
<tr>
<td>Offices – Mobile</td>
<td>26</td>
<td>14</td>
<td>2</td>
<td>-</td>
</tr>
<tr>
<td>Active Borrowers</td>
<td>904,892</td>
<td>3,449,902</td>
<td>5,577</td>
<td>97,239</td>
</tr>
<tr>
<td>Potential Microfinance Market</td>
<td>2,400,000</td>
<td>12,600,000</td>
<td>500,000</td>
<td>500,000</td>
</tr>
<tr>
<td>Penetration Rate (%)</td>
<td>37.7%</td>
<td>27.4%</td>
<td>1.1%</td>
<td>1.9%</td>
</tr>
</tbody>
</table>

Source: Pakistan Microfinance Network

One would expect Islamic finance to have a greater focus on social finance given the general level of higher incidence of poverty in OIC countries where Islamic finance has a relatively significant penetration. In addition to that, the philosophy and theoretical basis of Islamic finance is rooted in the socio-ethical framework of Islam. Nevertheless, Islamic finance has not been able to translate that potential and promise into practice substantially as yet.

4.1 Islamic Microfinance Institutions and Operations

Currently, there is no Islamic microfinance bank in Pakistan at the moment. Some of the more prominent organizations operating to provide Islamic micro financial services include Akhuwat, Wasil Foundation, Kashf Foundation, Naymet Trust, Muslim Aid Pakistan, Islamic Relief Pakistan, Kawish Welfare Trust and Esaar Foundation.

One of the recent success stories has been the Qard-e-Hasan model of Akhuwat. This institution with humble setup and uncomplicated procedures had disbursed Rs. 38 billion ($362 million) worth of loans by March 2017 without interest with 99% recovery rate. Out of the total beneficiaries of 1.85 million clients, 42% had been female clients.

Kashf Foundation is another organization with a sizable outreach with 237,573 clients served with a staff of 2,210 as at end-December 2016. The microcredit loan
portfolio stands at Rs. 5.9 billion ($57 million) as at December 31, 2016. Kashf had a healthy Rs. 564 million ($5.4 million) income in the fourth quarter of 2016. Kashf is the largest provider of micro-insurance in Pakistan with over 25.7% of the market share.

Wasil is another microfinance institution which provides loans using Islamic modes of financing which enable it to generate profits on sale and lease of assets. In the reported statistics for 2010, the gross loan portfolio stood at Rs. 210 million ($2.1 million) with a 91% recovery rate. Wasil provides a range of business development services delivered through the platform of Micro Enterprises Support Services and Advocacy Cell (MESSAC). The programs include vision and skills enhancement sessions, value addition to products and processes and redesigning service outlets and branding.

Naymet Trust provides loans using Qard-e-Hasan and Murabaha with respective shares of 60% and 40% of each in the financing portfolio in 2016. The total assets of the trust as at June 30, 2016 stood at Rs. 22.3 million ($213,000). Total credit portfolio was recorded at Rs. 11.3 million ($107,619) with Murabaha portfolio of Rs. 4.6 million ($44,000) and Qard-e-Hasan portfolio of Rs. 6.7 million ($64,077).

Islamic Relief is an example of an incorporated microfinance institution in Pakistan operating since 1992 with a presence in all four provinces of Pakistan, especially in the northern areas of Pakistan. Their microcredit portfolio stood at Rs. 38 million ($0.36 million) as at December 31, 2014. The institution has helped some 11 million families over its 25 year journey in Pakistan with various programs including rehabilitation of internally displaced persons, disaster risk reduction, climate change adaptation, water and sanitation, food security and health programs.

In the next and last section of the paper, a brief review of the use and contribution of Islamic redistributive institutions are provided to show that how much vibrant these institutions are in complementing the purchasing power of poor people in meeting the basic needs in Pakistan.

5. Role of Redistributive Institutions

Besides the financial institutions, Islamic redistributive institutions also have ample potential to achieve resource redistribution at the household level. There are various institutions in the Islamic framework that can play an effective role in income and wealth redistribution. Effective use of these redistributive institutions can help in the fulfilment of basic needs for all members of the society, especially the underprivileged poor people who face net endowment deficiency (Zarqa 1988). The two most prominent such non-market based redistributive institutions include Zakāt and Waqf.

5.1 Institution of Zakāt in Pakistan

In Islam, Zakāt is a religious obligation to pay a part of wealth and production to the specified heads (Al-Qur’an, Chapter Tauba 9: 60). The specified heads of Zakāt ensure the welfare of poor, needy and weaker segments of society as well as provide collective funds for public welfare and socio-political protection. In its economic effects, Zakāt is an important institution in an Islamic framework for poverty alleviation and economic welfare.
In the early empirical literature on welfare potential of ʿInfāq (charity) to alleviate poverty in Pakistan, Malik et al. (1994) use micro data to establish that ʿInfāq (charity) does have a significant impact on reducing poverty gap. In a recent empirical study for OIC countries, Shirazi and Amin (2009) estimate the resources required for poverty elimination under $1.25 a day and $2.00 a day respectively. Their estimates for Pakistan suggest that Pakistan needs 1% of GDP for poverty elimination under $1.25 a day and needs 6.77% of GDP for poverty elimination under $2.00 a day. Earlier estimates by Kahf (1989) contend that ʿZakāt to GDP ratio between 1.6% to 4.4% would be needed to deal with poverty gap in Pakistan. In a more recent study, Azam et al. (2014) in an empirical study for Pakistan establish that ʿZakāt significantly enhances the welfare of households. Akram and Afzal (2014) in an empirical study for Pakistan argue that ʿZakāt disbursement among the poor, needy, destitute, orphans and widows has played a significant role in poverty alleviation. Their results show that there is an inverse relationship between poverty and ʿZakāt disbursement both in the short run and in the long run.

Nevertheless, ʿZakāt collection at the federal and province level is very low in Pakistan as can be seen in Figure 3. In year 2015, Rs. 5.74 billion (US$ 54 million) ʿZakāt was received by the central public ʿZakāt agency. One potential reason why ʿZakāt collection is low at the central level in Pakistan is that there is a big and growing trust deficit between the central government and the people. Due to the limited availability of ʿZakāt funds collected by ʿZakāt and Ushr department, the scale of providing assistance to the poor is very low. The most vibrant ʿZakāt and Ushr department is in Punjab province, but even that is also catering to a very limited section of poor people. For instance, through Sustainable Economic Empowerment Program (SEEP), annually 30,000 young people are imparted technical and vocational training. In addition to that, scholarships to some 2,000 students are provided annually by Punjab’s ʿZakāt and Ushr department. However, these programs do not sufficiently fill the gap in the country amidst 25 million out of school children between the ages of 6 and 15. The total ʿZakāt budget for 2016/17 for Punjab was Rs. 4.15 billion ($40 million). In addition to that, the total ʿZakāt budget for 2016/17 for Sindh was Rs. 249 million ($2.4 million).
Most people usually prefer to pay their Zakāt and Sadaqāt individually to the poor people or to the organizations working for the welfare of poor people. According to Pakistan Center for Philanthropy, the total estimated charitable giving in Pakistan stands at Rs. 300 billion ($2.8 billion) in 2015. In the provincial studies, the amount contributed in the year 2013 stood at Rs. 67.9 billion ($0.65 billion) in Sindh (Pakistan Center for Philanthropy, 2013). Additionally, the amount contributed in the year 2010 stood at Rs. 103.69 billion ($1 billion) in Punjab (Pakistan Center for Philanthropy, 2010). A recent estimate by Pakistan Peace Initiative (2017) contends that people in Pakistan pay around Rs. 554 billion ($5.31 billion) in charity every year.

5.2 Institution of Waqf in Pakistan

In the institution of Islamic Waqf, an owner donates and dedicates an asset (movable or immovable) for societal benefit. The beneficiaries enjoy its usufruct and/or income. Waqf is usually perpetual, but can be temporary and partial. In the contemporary application of Waqf, it can be established either by dedicating real estate, furniture or fixtures, other movable assets and liquid forms of money and wealth like cash and shares.

In Muslim history, Awqaf provided public utilities (roads, water and sewage), educational institutions and hospitals. Kuran (2001) admits that Waqf as an institution long served as a major instrument for delivering public goods in a decentralized manner. Even in contemporary times, Awqaf can also directly affect entitlements by providing education (scholarships) and health (service and medicines) for the poor. Waqf can help in capacity building and wealth creation through building human, physical and financial capital.

In Pakistan, Waqf is mostly used in establishing mosques, maintaining shrines and in some cases, Muslim graveyards. In the province of Punjab, Awqaf Department maintains 1 hospital and 14 dispensaries. An amount of Rs. 28 million ($270,000) per annum is spent on health care at Data Darbar Hospital, Lahore as well as in 14 Dispensaries where poor and needy patients are treated freely. In addition to that, Sindh Government owns 31 Waqf properties in the Sindh province. In Pakistan, Corporate Waqf is uncommon, except for Hamdard Laboratories. The main reason for the dormant Waqf sector in Pakistan owes to the negative effects of nationalization of public property during the 1970s (Malik 1990).

Conclusion & Recommendations

Islamic finance in Pakistan is penetrating steadily in different financial sectors of Pakistan. The market share of Islamic banking is 11.7% in the overall banking assets and the market share of Islamic mutual funds is 33.40% of the overall mutual fund industry. At least 78 Sukuk had been issued to date and Government of Pakistan also meets its fiscal needs by issuing Sukuk. Nonetheless, Islamic microfinance is yet to realize its true potential and there is a significant need for micro-financial services so that Islamic finance could facilitate consumption smoothing for net endowment deficient poor people in Pakistan. Islamic redistributive institutions have potential, but their use and focus in policymaking is limited. Lack of trust between public and government has resulted in
very limited mobilization of Zakāt funds through the official government agencies in Pakistan. In addition to that, nationalization in the 1970s and non-standardization of rules has resulted in lower interest in the institution of Waqf. In the light of this overview, we present following recommendations for the promotion of Islamic finance in Pakistan.

- Islamic banks must facilitate easy opening of bank accounts for students, housewives, self-employed technicians, small entrepreneurs and tutors to increase their outreach among the general masses. Sustained growth in branchless banking is required to allow more outreach and to avoid the scale disadvantage in underprivileged areas.

- Given the fact that Islamic banks mobilize around 34% of their total deposits from customers in the form of Qard, it is important to emphasize that they shall provide at least 20% of their non-remunerative deposits as Qard to the small farmers. This initiative will enable them to showcase their contribution to social development and impact the lives of underprivileged people more directly.

- Since agriculture provides employment to more than one-third of the people in the labor force, Islamic banks need to put their focus on this critical sector and raise their financing share in agriculture.

- The government should give tax incentives for corporations to go towards Sukuk issuance for meeting their long term finance needs. Issuance of more Sukuk will assist the portfolio managers to achieve effective diversification.

- There is considerable need for enhancing the scale of Islamic redistributive institutions and creating synergies. There is a strong basis of complementarity if these institutions are integrated with each other to provide financial as well as support services in the area of human capital development and developing institutions for covering general needs of the masses.
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Faisal Laureate Muhammad Nejatullah Siddiqi: Life and Works

By
Dr. Nasir Nabi

Abstract

One of the pioneer Islamic economists in modern times is Muhammad Nejatullah Siddiqi. He occupies a position of esteem amongst the founders of the nascent discipline of Islamic economics. He has sought to respond to the many challenges that the modern economic system poses for Muslims. Dr. Siddiqi is also amongst the few economists who initiated research and dialogue on the interest-free economy before the issue came to the fore in the context of reconstruction of Islamic economy. He is one amongst such Islamic economists who have shown genuine flexibility and creativity necessary for the evolution of a new discipline along with a strong sense of history, moral integrity and intellectual commitment to Islam. In this paper, an attempt has been made to highlight his life and works that led to his immense contribution to the Islamic economics in modern times.

Keywords: Islamic Economics, Nejatullah Siddiqi, Modern Development, Islamic Economist

1. Muhammad Nejatullah Siddiqi: Early Life

Muhammad Nejatullah Siddiqi was born in Gorakhpor, India on August 21, 1931. He completed his primary and secondary level school education there. During these years he was devoted to al-Hilal and al-Balagh magazines published under the editorship of Maulana Abul Kalam Azad (d. 1958). He was also a regular reader of al-Tabligh, and was influenced by the Deobandi scholar Maulana Ashraf Ali Thanvi (d. 1943). He studied the works of Maulana Abul ‘Ala Mawdudi (d.1979) who left a deep impact on Siddiqi for the rest of his life. Under the influence of these scholars he abandoned science and the engineering career which he had planned.1 He wanted to learn Arabic and gain direct access to Islamic sources, and discover how modern life and Islamic teachings

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interacted. For this purpose he joined Sanwi Darasghah, Jamaat-i-Islami, Rampur and Madrasatul Islah in Saraimir (1950-54). The years he spent in Rampur and Saraimir were distinguished by lively interaction with ‘ulama. He spent most of his time discussing the Qur’an, the traditions of the Prophet (SAAS), commentaries on the Qur’an, *fiqh* (jurisprudence) and *usul al-fiqh* (principles of jurisprudence). He was influenced by the idea of combining modern and religious learning together to produce something that will lead towards the proper reform of society.

2. Muhammad Nejatullah Siddiqi: Higher Education and Teaching

After the completion of his religious study Nejatullah Siddiqi joined Aligarh Muslim University in 1956 for BA with subjects Arabic, Economics and English Literature. He topped the list of successful candidates both in the BA (1958) and MA (1960) examinations. After the completion of M.A., he was appointed as a lecturer in the Department of Economics, Aligarh Muslim University (1961-74). While lecturer, he also served as the warden of Aftab Hostel of Aligarh Muslim University between 1961-63. Meanwhile he also completed his Ph.D degree from the same university on the topic “A Critical Examination of the Recent Theories of Profit” in 1966. He was appointed as Associate Professor in Economics, Aligarh Muslim University (1975 -76). In 1976 Saudi Arabia organized the first International Conference on Islamic Economics. Nejatullah Siddiqi was a member of its various committees. The conference proved to be a turning point in rapid development and propagation of Islamic economics in various circles, academic expansions as well as practical experimentation. Siddiqi, after his return from this conference tried that Islamic economics be introduced as a subject at the Aligarh Muslim University and submitted a proposal of a paper on the history of Islamic economic thought but despite having the support of the Vice Chancellor Prof. A. M. Kusro the idea did not materialize.

In 1977, he was appointed as professor of Islamic Studies Department and Director of its institute due to his extraordinary works in the field. In 1978 he was offered professorship by the King Abdul Aziz University, Jeddah, while the probation period to his appointment in Islamic Studies was yet to be over. As soon as it was completed, he accepted the offer and in the same year joined King Abdul Aziz University, first the Department of Socio-Technical Studies, College of Engineering and then the newly established International Centre for Research in Islamic Economics where he worked till June 2000.

Nejatullah Siddiqi is among the first generation of leading professional economists who has joined hands to develop and propagate Islamic Economics. He raised a second generation of scholars who could carry it after him and proved successful in doing so. While working in the Centre for Research in Islamic Economics Jeddah, he coordinated researchers and writers on Islamic economics all over the globe. In recognition of his contribution to Islamic economics, he was awarded the prestigious King Faisal International Award in 1982. He is always open to dialogue and exchange of ideas with those who do not accede to his views. According to him there is no one whose every
Nejatullah Siddiqi has Tawhidi way of thinking. To him, Tawhid is the key concept in Islam. It sums up the Islamic way of life and presents, in a nutshell, the essence of the Islamic civilization. He stresses that Muslims must be brought into direct intellectual contact with the revealed word of Allah (the Qur’an) and personality of the Prophet (SAAS) as the leader of the Islamic movements, so that they are able to take a fresh and original commitment to Allah that is accompanied by a sense of Mission.

3. Muhammad Nejatullah Siddiqi: Works

Nejatullah Siddiqi is a prolific scholar. He has written a number of books and booklets many of which are voluminous works. These depict his depth of knowledge in Islam and modern developments. His works number about twenty-five excluding his articles published in various reputed journals and magazines. His works can be classified broadly into three categories viz. translations, general works, and works on economics.

3.1 Translations

Nejatullah Siddiqi translated two important works, one being the classical literature Kitab al-Kharaj of Abu Yusuf entitled, Islam ka Nizam-i Mahasil and the other Syed Qutb’s al Adalah al-Ijtima’iyah fi al-Islam under the title, Islam Mein Adl-i Ijtima’i.

1. Islam Mein Adl e Ijtima’i

This work is an Urdu translation of Syed Qutb’s al Adalah al-Ijtima’iyah fi al-Islam. This is perhaps the best-known work of Syed Qutb, a great Islamic thinker and leading figure in the Muslim Brotherhood of Egypt who was executed by the regime of ‘Abd al-Nasir in 1966. Nejatullah Siddiqi translated this book in the year 1963. The translated book consists of 455 pages with a lengthy introduction about the life and times of Syed Qutb. This work is a simple translation without any analysis or footnote commentary. Despite the years that have passed since Syed Qutb’s death, the imprint of his thought on the contemporary Islamic movements of the Arab world remains profound. The Arabic original of it was first published in 1949, but this book in particular retains its relevance in many respects: the persistence of gross socio-economic inequality in most Muslim societies; the need for viewing Islam as a totality, imperatively demanding comprehensive implementation; and the depiction of the West as a neo-Crusading force.

2. Islam ka Nizam-i Mahasil

This work is an Urdu translation of Qadi Abu Yusuf’s Kitab al-Kharaj. Nejatullah Siddiqi translated it in the year 1966. This translation work is pragmatic in its approach and is more juridical in nature. Dr. Siddiqi in his introduction has stressed the Islamic
origin of the taxes discussed by Abu Yusuf and other authors of works on taxation, and has underscored that these taxes were in most of the cases practical in nature. Dr. Siddiqi by adding notes has made an effort to establish a feasible fiscal system in the light of Islamic law in changing circumstances and in accordance with the requirements of the economy. With his high power of observation and analysis, Dr. Siddiqi has tried to analyze the fiscal issues and suggested policy measures to be adopted for the growth of the economy and prosperity of the Islamic state. The terminology of the book indicates that Dr. Siddiqi has not only relied upon simple translation but by adding hundreds of notes he set an example for researchers and editors which enhance the usefulness of this work. He has also reflected upon market and pricing and needs for the development of infrastructure in modern times.

3.2 General Works

1. *Islami Adab* (Islamic Literature)

This work comprises of various essays by different scholars of Islam put together in the form of the book. The book is an important work for those who seek to have an introduction and understanding of Islamic literature. Dr. Siddiqi has written the foreword of the book and in addition has contributed an essay entitled ‘the Temperament of Islamic Literature’. The book extensively deals with various ways in which Islamic literature emerges as a motivating force in changing the attitude of Muslims, providing a platform for the dissemination of Islamic values and practices. The other themes discussed in the book are; the position of Islamic literature, culture and literature, literature and society, concept of gender and Islamic literature, Islamic literature and constructive criticism, contribution of Islamic literature to Urdu literature, the philosophical foundations of Islamic literature, the reality of Islamic literature, superiority and uniqueness of Islamic literature and Islamic literature movement.

2. Muslim Personal Law

This work consists of proceedings of the seminar on Muslim Personal Law organized on 6th-7th September 1968 at Aligarh Muslim University. The papers on various aspects of Muslim personal law have been included in this book. The importance of this book can be assessed by the fact that some people consider Muslim personal law as a divisive set of laws. On this ground they oppose it even today. Since long the debate is going on, it is a living problem and the subject is still relevant. The broad themes of this work are a historical and cultural perspective on recent changes in Muslim personal law in Muslim countries. The other theories relating to the desirability and scope of changes in Muslim personal law in India and the mechanism of changes in Muslim personal law in India figure in it. This work being the first discussion of its kind has a tenor which makes it more suitable for the community’s internal consumption rather than convincing the outsiders.
3. **Nash’at Saniyah ki Rah (Towards an Islamic Renaissance)**

This work is a collection of various essays and lectures published in different magazines. The book has come out as a handbook for those who want to know about the movement driven by ideological basis. The book consists of eleven essays. The first essay discusses the wisdom in religion. The author has deliberated upon how a religiously guided life is more rational than a secular way of life. The second essay deals with the revolutionary approach of Islamic movements, its basic rules and responsibilities. The third essay deals with the foundations of *da’wah*. The author has elaborated upon proper planning of social reformation, moral turpitude and way of Islamic life. The fourth essay deals with philosophy and activity of *da’wah* towards Islam. In it the author has provided important explanations regarding striving in the path of Islam, spiritual upliftment, avoidance of vices, self-introspection and social work. The fifth essay discusses the path of an Islamic reformation. Here the author concludes that violence in the name of religion has to be avoided and the path of non-violence in proclaiming the message has to be taken. The seventh essay deals with the message of the Qur’an, its meaning and Islamic revivalist movements. The eighth essay deals with the Islamic movement, its strength and functioning. The ninth essay discusses the proper planning in Islamic movements pertaining to its working. The tenth essay deals with the differences that arise in different Islamic movements and their possible remedial measure. The last essay of this book discusses the final message of guidance. The author also highlights that only sincerity and strong determination can lead us to success.

4. **Tehreek Islami ‘Asr Hazir Mein (Islamic Movement in Contemporary Times)**

The book comprises of various lectures and articles published in different magazines. The papers deal with the propagation of Islam and the issues pertaining to the Islamic movement in India. There are some papers that discuss in detail the problems faced by Muslims in India. The book also includes two lectures one of which was addressed to a collective gathering of both Muslims and non-Muslims wherein they were made aware of the worsening state of affairs in the country and the remedies thereof and at the same time they were made conscious about taking important collective initiative for the betterment of the country. The other lecture is addressed to those Muslims who want to refashion their lives under Islamic spirit. The lecture extensively deals with various aspects without which it is not possible to live a rightly guided life. Overall, the book has discussed the issues, causes and possible remedies pertaining to Islamic movement in India.

5. **Ekiswein Sadi Mein Islam, Musalman aur Tehreek e Islami (Islam, Muslims and Islamic Movements in the 21st Century)**

This work deals with the affairs of Muslim and Islamic movements in the contemporary times. In this book the author has highlighted various issues faced by the Muslims in the 21st Century. The author has discussed at length the impact of various social, religious, ethical and political issues on Islamic movement with a desire to develop an understanding among the members of such movement to exhaust their mental capabilities in dealing with them. This work is a step towards understanding the issues that are commonly faced in Muslim nations suggesting the outcome and remedies
thereof. The book consists of five chapters. Chapter one deals with the basic elements of an Islamic movement. The chapter involves an invitation towards a movement, the understanding and wisdom involved and dedication towards the movement. Chapter two discusses the principal factors that led to the failure of a movement. The author has put forth the extravagant approach, peer pressure, love for wealth and inclination towards the luxuries of this world as the reasons. Chapter three discusses external factors causing the downfall of Muslim ummah in different spheres of life. These include the societal resistance towards such movements, the distance between the commoners and the movement in general, anti-Islamic forces and secular lifestyle. Chapter four discusses the internal factors of degradation which includes the dearth of exemplary character, the differences between leaders and workers, the absence of self-introspection and materialistic approach towards life. The last chapter discusses all important themes and remedial measures towards the Islamic renaissance both within and outside.


   This is the latest work of Dr. Siddiqi. In his opinion understanding and consideration of Shari‘ah objectives is inevitable and extremely important to cope with a number of issues faced by Muslims in the present age. The book is divided into eight chapters, in addition to a preface by the author and an introduction. Following are the titles of the chapters: Chapter one, ‘Shari‘ah Objectives – A Contemporary Study’. Chapter two, ‘Shari‘ah Objectives and the Contemporary Islamic Thought – Problems and Prospects’. Chapter three, ‘Role of Reasoning and Nature in Understanding and Application of Shari‘ah Objectives’. The fourth chapter, ‘How to Solve Differences arising in Understanding and Application of Shari‘ah Objectives’. The fifth chapter, ‘Recent Efforts in Exercising Ijtihad in the Light of Shari‘ah Objectives’. The sixth chapter, ‘An Investigation into Modern Islamic Finance in the light of Shari‘ah Objectives’. The seventh chapter, ‘Shari‘ah Objectives and Future of Mankind’ and the eighth chapter, ‘Shari‘ah Objectives – Understanding and Application’. According to the author, writings on the subject have considerably increased in recent years. But to him it is more important to benefit from these objectives in finding Shari‘ah ruling to solve the new issues of the society. While most of the authors confine their discussions to the known fiqh rules, the author believes that there is pressing need to extend the Shari‘ah objectives in other matters like, da‘wah, training and reforming the society.

3.3 Works on Economics

1. Some Aspects of Islamic Economy

   This book is actually a collection of some essays which deals with a preliminary study of basic economic issues in Islam. The essays included in this book were written by the author at different dates but all of them deal with some aspects of the Islamic economy. Being a short treatise, it neither covers all aspects of the economy nor discusses those covered in an exhaustive manner. Published first in the year 1970, the book consists of 137 pages and is divided into five chapters. Chapter one deals with the spirit of the Islamic economy. Chapter two deals with the Qur‘anic norm. Chapter three deals with the
Islam’s approach to the right of property. Chapter four sheds some light on the model of Interest-free banking and the last chapter discusses the economic system of Islam. Although this work is not that exhaustive in nature but nevertheless it provides some useful insights in understanding some fundamentals of Islamic economy.

2. Economic Enterprise in Islam

This book is a collection of papers which Nejatullah Siddiqi has written that appeared in the Islamic Thought (Aligarh) during 1956-57. This book was first published in the year 1972 and has 150 pages. In this book the author has deliberated on the economic activities and their place in an Islamic scheme of life. He has undertaken a study of the goals towards which productive efforts in the Islamic economy are directed which are different from the ends recognized in the conventional economic enterprises. The author has stressed upon the justice and benevolence and its implication on an Islamic economy. The book also provides valuable inputs about how the market will get influenced by the spirit of Islamic teachings. Lastly the author has discussed the Muslim entrepreneur and the economy stressing upon cooperation rather than cutthroat competition.

3. Muslim Economic Thinking

This book is a masterly survey of the Muslim economic thinking in the twentieth century in three major languages of Arabic, Urdu and English. In a precise but incisive and comprehensive statement, it captures both the spirit and substance of Muslim thought on modern economic issues. The book is thus an invaluable aid to research, measuring what has been accomplished as well as stimulating what needs to be done, setting an agenda for future research. Originally produced for the First International Conference on Islamic Economics held in Makkah in February, 1976, and subsequently revised, it is included in the Studies in Islamic Economics published by The Islamic Foundation Leicester.

4. Banking Without Interest

Dr. Siddiqi’s Banking Without Interest was first published in Urdu (Ghair Sudi Bankari) in the late 1960s. An English translation of it was published by The Islamic Foundation, Leicester in 1983. This book contains a full treatment of the subject for the first time. Building on what was written by Maulana Abul ‘Ala Mawdudi and others, the author has been successful in developing an elementary but thoroughly consistent and feasible model of interest-free banking. This work demonstrates that banking institutions can operate without difficulty on the principle of profit-sharing. It comprehensively deals with all such issues relevant to banking, bills of exchange and supply of short- and long-term interest-free loans. Nejatullah Siddiqi's model of an interest-free economy was the first and is one of the very few models that outline the micro and macroeconomic functioning of a financial system based on mudarabah (profit and loss sharing) and shirkah (partnership) instead of interest within the institutional framework of a market economy. The author has attempted to answer the question about how to reconstruct the economic system on the Islamic pattern and establish interest-free banking system. The
book consists of nine chapters. Chapter one deals with the establishment of the bank. Chapter two deals with the bank and the owners of capital. Chapter three deals with the bank loans. Chapter four deals with the process of credit creation. Chapter five deals with the central bank. Chapter six deals with the banking system and public finance. Chapter eight deals with the loans for consumers and chapter nine deals with some clarifications regarding the supply of money. The book has made its mark both in intellectual as well as practical circles. It was read and acclaimed as a pioneering work in its field. It also inspired many groups to start practicing interest-free banking, even though on a small scale. A number of credit societies were formed due to the impact of this book and a movement towards the elimination of riba was generated.

5. Issues in Islamic Banking

This book contains six papers. It begins with a survey article on money, banking and monetary policy in which the author has claimed that he has examined critical issues such as demand for money, credit creation, 100% reserves, discounting, indexation and so on. The author provides an exposition of the mudarabah financing and answers the question of why Islamic economists advocate a change from interest to profit-sharing which will contribute to allocative efficiency, justice and stability. On the economics of profit-sharing, the author argues that forces of demand and supply should determine the ratio of profit-sharing between users and suppliers of capital. The last chapter offers brief comments on the Report of the Pakistan Council of Islamic Ideology on the elimination of interest from the economy, submitted to the Government of Pakistan in 1980. On the rationale of Islamic banking the author's arguments against interest, based on justice, efficiency, stability and growth are refreshing. Dr. Siddiqi demonstrates with cogent arguments that an Islamic economy is capable of freeing modern man from the debt-ridden economy in which he lives and guiding him towards a society based on justice and equity.

6. Partnership and Profit-Sharing in an Islamic Law

This book was originally written in Urdu in the mid-sixties as a prelude to Banking Without Interest which appeared later. Its English translation was published by The Islamic Foundation, Leicester in 1985. It provides the necessary bases from Islamic jurisprudence for an alternative to interest-based banking. The book discusses the principles governing mudarabah and shirkah in Shari’ah. These principles provide the legal foundations on which banking and financial intermediation can be recognized in a modern Islamic economy. The rights and duties of a financial intermediary, the application of mudarabah to industrial enterprise and the feasibility of time-bound mudarabah contracts are some of the issues relevant to the contemporary practice of Islamic banking and finance dealt with in the light of fiqh in this book. The book consists of five chapters. Chapter one deals with an overview of shirkah and mudarabah. Chapter two deals with the distribution of profit and liability for loss in a joint enterprise. Chapter three deals with the limits of business operations in a joint enterprise. Chapter four deals with the financial liabilities of partners and the last chapter deals with the terms of the contract. This work is a valuable contribution to the literature on Islamic economics.
because it throws lucid light on the framework of economic institutions within which economic operations should take place in Islam.

7. Insurance in an Islamic Economy

Dr. Siddiqi’s Insurance in an Islamic Economy was first published in Urdu (Insurance Islami Ma’ishat Mein) in 1974. Its English translation was published by The Islamic Foundation, Leicester in 1985. This book consists of four chapters. Chapter one deals with the risk and uncertainty in human life. Chapter two deals with the insurance, gambling and other evils. Chapter three deals with the insurance in the capitalist and socialist systems. The last chapter deals with insurance under the Islamic system. The book discusses the nature of risks that are covered by insurance as distinguished from gambling. The author has identified the basic principles of insurance and debated whether they can or cannot fit into the Islamic system of life and assessed the possible advantages accruing from their adoption. This work has also reviewed the methods of application of these principles in modern times and showed how to safeguard against the ills associated with the present insurance system. Finally the author has suggested some guidelines regarding the organization of insurance under the Islamic system.

8. Role of the State in the Economy

This book affirms the importance of the state in Islamic society and underlines its place as an active agent in the economy. It was published in the year 1996 by the Islamic Foundation, Leicester. This book consists of five chapters. Chapter one, ‘Guarantee of a Minimum Level of Living in an Islamic State’, highlights the cooperative nature of Islamic living by making the bold statement that the constitution of an Islamic state must contain a clause guaranteeing the fulfillment of basic needs of every human being within its territorial jurisdiction. Chapter two, ‘Public Expenditure in an Islamic State’, follows up by focusing on other related functions. It examines the possibility of enlarging the area of state activity in the economy, when circumstances require it. Chapter Three, ‘Public Borrowing in Early Islamic History’, conveys the message that responsible borrowing has a place in the quest for need fulfillment and economic development. Chapter Four, ‘International Economic Relations in Islam’, introduces an essential but somewhat neglected dimension of state activity that relates to the rest of humanity, especially the world Islamic community. Chapter Five, ‘Role of the Voluntary Sector in Islam’, serves as a reminder that the state and the individual are not the only players. The voluntary sector also has a significant role.

9. Teaching Economics in an Islamic Perspective

This book provides a very useful descriptive explanation of the principles of Islamic economics. The book deals with a variety of themes in Islamic economics and is useful to a wide variety of readers, from those who are not familiar with the issues and the debates of Islamic economics to those who deal with these issues every day. Moreover, it brings out new ideas about the subject. The book consists of six chapters on economic issues and a reading list on Islamic economics and traditional non-Islamic economics. It starts with microeconomic issues like the need, rationality and satisfaction
in Islamic and non-Islamic worlds, production, distribution, markets as well as wages, profits and prices from both Islamic and non-Islamic perspectives. Chapter two covers issues in macroeconomics. The aggregate economic variables are discussed. Money and its functions as well as the role of fiscal and monetary policies from both Islamic and traditional non-Islamic aspects are discussed. Chapter 3 covers issues of public finance including goals and functions of an Islamic state. Functions, according to the Qur’an, Sunnah, ijtihad and people’s own choice are explained. Public expenditures and revenues, according to Islamic goals and functions, are fully and elegantly covered. Chapter 4 is devoted to international economics. In this chapter the author provides an Islamic view on transactions, in general, while introducing Islamic terminology on prohibited practices like usury, gambling, etc. A very descriptive and comprehensive explanation of theories of international trade and commercial policy is provided. Chapter 5 covers economic development. After providing a useful historical background, the author presents sections on Islamic strategies for development, factors mobilities (both human and physical resources), trade and development, and planning. The last chapter is devoted to money and banking. The monetary equilibrium from an Islamic point of view, Islamic financial intermediaries, central banking and conduct of monetary policy in an Islamic system are explained. This chapter also provides a section on government deficit financing and a critique of conventional banking and monetary reform proposals.

10. Economics: An Islamic Approach

In this book the author provides a rather thorough and detailed discussion of the conceptual aspects of Islamic economics. The book is divided into six chapters, two appendices and the list of figures. In chapter one, the author gives an overview of Islamic economics with the focus on the basic assumption, the concept of money in Islamic economy, interest and inflation, consumer behaviour and Islamic principles of taxation, consumer behaviour and deficit financing. Chapter two discusses the nature of Islamic economics, its definition, resources, cooperation and participation. Chapter three deals with the methodology of Islamic economics with special emphasis on the role of reason, the process of theorizing assumption of ideal Islamic economy. Chapter four is devoted to the practical aspect where the Islamic banks, zakah, insurance, waqf and al-hisbah are analyzed. In chapter five, the author explains the Islamic approach to contemporary problems like unemployment, inflation and economic development. Chapter six is on the direction of future researches and a search for interest-free international economic order.

11. Islamic Public Economics

This book is an English translation of author’s Urdu work Islam Ka Nazariya-i-Milkiyat. The book deals with Islamic perception on property rights. The author has discussed at length the various issues related to individual rights, rights of the landlord, public rights, the economic responsibility of Islamic state etc. The book consists of twelve chapters. Chapter one provides an ideological background of the Islamic system. Chapter two deals with distribution of land ownership between individual and society. Chapter three deals with different types of individual ownership. Chapter four deals with the rights of the owner. Chapter five provides an explanation of individual rights. Chapter six deals with the duties of the owner. Chapter seven provides a detailed discussion on
collective ownership of certain public goods. Chapter eight deals with different types of state property. Chapter nine deals with State’s exclusive ownership rights. Chapter ten provides an explanation for limits of state’s ownership rights. Chapter eleven deals exclusively with the Islamic State’s economic responsibilities and last chapter deals with rights of individual and the condition of an idealistic Islamic State. This book provides an in-depth analysis of the subject in a very scholarly manner. The author has examined and rejected the arguments in favor of socialization of all means of production and concludes that individual ownership is a necessary condition for democracy and the spiritual and moral growth of human beings. A balanced approach would accommodate individual ownership under social supervision as well as socialization whenever necessary, he opines.xx

12. The Dialogue in Islamic Economics

This book provides the basic elements of Islamic economics. In the book there are many aspects of the Islamic economic system that the author has dealt with the light of ethico-social teachings of the Qur’an and the Sunnah. The author has also selected some areas where the application of Islamic economics and its principles, as he thinks are likely to produce the greatest impact on the basic economic challenges of modern times. This book consists of two main parts, namely, ‘the ideology and philosophy’ and ‘the objectives of the Islamic economic system’. Part one covers the most important aspects of the book where the author provides a convincing explanation of the ideological perspective taking into account the philosophical foundation, mechanism and nature of the Islamic economic system. The second part of the book deals with some pertinent issues like the state and economic development, factors of production and the Islamic system of income and wealth distribution.

13. Riba, Bank Interest and the Rationale of its Prohibition

In the light of recent growing practices of Islamic finance, this book is an important contribution in dispelling the myth behind riba and bank interest. The book consists of six chapters. In the first chapter the author has discussed Islam’s worldview and the purpose of laws in Islam. How the quest for fairness in the ordinary business of life leads to a bunch of rules constraining individual freedom and guiding the state in its supervisory role is explained. The second chapter focuses on the meaning of riba in the light of the relevant texts. Muslims’ understanding of the concept and coverage of riba is traced through the ages till our own day. The effort by some to declare modern bank interest outside the scope of prohibited riba is put in historical perspective. After examining their arguments it is concluded that bank interest is riba.xx The third chapter examines what the prohibition of bank interest would do to a modern economy. It explores the alternatives to interest-based institutions in the light of the developments of interest-free Islamic banking theory and practice since the middle of the last century. It demonstrates that the economy can function smoothly without the institution of interest on the basis of Islamic finance. The fourth chapter focuses on some distinguishing features of interest-free Islamic finance at the macroeconomic level. It is argued that Islamic finance is conducive to greater stability and more efficiency than conventional finance. It is a fairer arrangement capable of leading human society to greater equity and higher growth. The fifth chapter shows how Islamic finance meets certain special needs like government finances, finance for the consumers, microfinance, especially for the
rural sector, and interest-free financial arrangements for Muslim minorities. The sixth chapter deals with monetary policy and the problems arising out of changes in the purchasing power of money in the context of loans made in money. The seventh chapter concludes the study by summarizing the findings.


In this small but very important booklet Dr. Siddiqi has made a survey with a view to enable the theorists and practitioners of Islamic banking and finance to take stock of the situation and plan for the future. Its focus is the current situation. It is not a historical account of the evolution of Islamic banking and finance in theory and practice. More attention is paid to discovering points of weakness than to projecting the points of strength. It indicates the distinctive features of Islamic banking and finance that make it different from the conventional theory of banking and finance. It is in this context that it evaluates the current practice of Islamic banking and finance. Both the original vision of the Islamic economic system and the growing awareness of what is needed for meeting the challenges facing human society today are kept in view.

4. Conclusion

The above survey of the works of Muhammad Nejatullah Siddiqi depicts him as a pioneer Islamic economist of modern times. His academic career in the field of economics began at Aligarh Muslim University, where he was appointed as a lecturer and subsequently promoted as reader in economics and later Professor and Head of the Department of Islamic Studies, at the same university. Later, he joined King Abdul Aziz University in Jeddah, where he made a special contribution to research in Islamic Economics. He demonstrates with cogent arguments that an Islamic economy is capable of freeing modern man from the debt-ridden economy in which he lives and of guiding him towards a society based on justice and equity. He has also demonstrated in his various works that such an economy would also ensure growth and stability. Dr. Siddiqi is also among the few economists who initiated research and dialogue on the subject of interest-free banking two decades before the issue came to the fore in the context of contemporary Islamic revivalism. He is one of the dozen or so economists who have on the one hand shown genuine flexibility and creativity necessary for the evolution of new discipline along with a strong sense of honesty, moral integrity and intellectual commitment to Islam. His distinction lies in discussing economic issues in the context of the current economic debate as well as from an Islamic perspective.
References


ii. Ibid, p. 144.

iii. Ibid., p. 146.

iv. Ibid, p. 150.


vi. Abu Yusuf (d.798 C.E.) wrote this book in response to the Abbasid caliph al-Mansur’s queries on the state of religious precepts dealing with taxation problems, revenue administration and public expenditure.


viii. Siddiqi, M. Nejatullah, Islami Adab, Markazi Maktaba Islami, New Delhi, 1960, p. 121.

ix. Siddiqi, M. Nejatullah, Nash’at Saniyah ki Rah, Markazi Maktaba Islami, New Delhi,1974, p. 139.


xv. Ibid, p. 145.


Can Shari’ah Governance Framework be the Way Forward for Islamic Finance?

By
Md Akther Uddin, PhD

Abstract
This paper attempts to give a brief overview of existing Shari’ah Governance framework in Malaysia, compare with AAOIFI and IFSB standards and guidelines, identify current issues, and recommend measures to improve existing practices. The study finds that a great number of researches have been carried out to study the Shari’ah governance framework in Malaysia, Indonesia, GCC, MENA, UK, and other OIC member countries. It can be concluded that the plurality in Shari’ah governance practice across regions and countries may ensure success and support innovation in the short run, but, in order to establish credibility and promote Islamic Finance as a comprehensive financial system in the long run, uniformity is desirable. A sustainable and viable Shari’ah governance framework, which will not only provide credibility to IFIs but also ensure transparency, trust, ethical behavior, underlying faith and belief and ethics and also help to protect the stakeholders right and fulfill the broader principle of Maqasid al-Shari’ah (foundational goals of the Shari’ah).

Keywords: Shari’ah Governance, Corporate Governance, Islamic Banks

1. Introduction
Good corporate governance has become a prime issue again among industry practitioners and academia since the 2008 financial crisis, when corporate fraud, poor governance and manipulation in earnings happen to widespread. In a recent award-winning Harvard Business Review article, William Lazonick criticizes existing Anglo-Saxon Corporate Governance (CG) model, which is based on the shareholder’s wealth maximization theory, as this instigates many top executives in the U.S. to manipulate
earnings, he highlights the issue of buying back of shares in order to artificially inflate the share price to gain lucrative incentives: bonus and right shares (Lazonick, 2014). Even though this model of corporate governance has been highly criticized, a Franco-German model of CG has so far failed to find valid logic to include stakeholders’ interest in decision making (Iqbal & Mirakhor, 2004).

Islamic finance has shown tremendous potential for the last two decades and it has become a formidable and sustainable counterpart of the conventional banking system in many Muslim dominated countries. At the same time, the importance of Shari’ah Governance (SG) has come up and over the past few years, many countries have developed a comprehensive governance framework for Shari’ah issues responding to the needs of Islamic Financial Institutions (IFIs). However, the absence of a well-conceptualized framework hinders the development of a unified, universal, and formalized system. If Islamic financial institutions are to be acceptable to their clients, IFIs need to have a formalized system to ensure all their activities are Shari’ah compliant (Wilson, 2009; Hassan, 2010; Grassa, 2013).

2.0 Shari’ah Governance

In order to define Shari’ah Governance, first, we need to define Corporate Governance as they exist side by side in Islamic Banks (IBs). The OECD has defined Corporate Governance as the “set of relationships between a company’s management, its board, its stakeholders and other stakeholders” (OECD, 1999). The dimension of Islamic perspectives of corporate governance has broader horizon and cannot compartmentalize the roles and responsibilities in which all actions and obligations fall under the jurisdiction of the divine law of Islam, whereas, the OECD principles implement a firm with six different issue and obligation (Abu Tapanjej, 2007; Hassan et al., 2014). Shari’ah governance is a unique characteristic of corporate governance in financial architecture and it is concerned with the religious aspects and the Islamicity of the activities and conducts of IFIs (Hasan, 2010).

According to IFSB standard 10, Shari’ah Governance System refers to the set of institutional and organizational arrangements through which an IFIs ensures that there is an effective independent oversight of Shari’ah compliance over the issuance of relevant Shari’ah pronouncements, dissemination of information, an internal and annual Shari’ah compliance review (IFSB, 2009: 2-3).

The definition above illustrates the extensive duties of Shari’ah Supervisory Board (SSB) to oversight and supervises the Shari’ah compliance of the Islamic financial institutions, as such, their competence is essential to form a robust Shari’ah board. It also implies that the institution of the Shari’ah board is crucial to the Shari’ah governance system as an authoritative body ensuring Shari’ah compliance (Haqqi, 2014).

2.1 A Conceptual framework of Shari’ah Governance framework

Principle 3.1 of the IFSB Guiding Principles on Corporate Governance states that an appropriate mechanism must be created to ensure compliance with the Shari’ah principles. The foundational dimension of Islamic corporate governance is rooted in the
fundamental principles of tawhid (the Oneness of Allah), the process of Shura (Consultation), property rights and contractual obligations (Travers, 2010).

While explaining the conceptual framework of corporate governance from Islamic perspective, Iqbal & Mirakhor (2004) argues that Shari’ah Governance covers overall governance issues, protection of stakeholders rights and compliance with the divine rules guided by Shari’ah, which actually broaden the area of governance issue from merely stakeholders model, where scholars have not yet found the logical foundation to include various interest groups in corporate governance model which are indirectly affected by corporations’ activities, while Shari’ah governance affirms the inclusion of not only human well-being but also surroundings and environment. Moreover, the foundation of stakeholder model is found in Islam’s principles of property rights, commitment to explicit and implicit contractual agreements and implementation of an effective incentive system (Iqbal and Mirakhor, 2004).

By analyzing stakeholder model of corporate governance from Islamic perspective proposed by Iqbal & Mirakhor (2004), Zulkifli Hasan concludes that little work has been done on corporate governance from Islamic economic perspective (Hasan, 2008). It seems logical as Islamic economics had been in hibernation for an unexpectedly long time and only four decades ago it woke up and has got some kind of momentum for the last few decades.

2.2 Existing Shari’ah Governance Practice

As the importance of Shari’ah Governance is recognized in a great number of researches that have been conducted to study the Shari’ah Governance framework, existing practice of SG in Islamic Banks and IFIs, contemporary issues and how to improve Shari’ah Governance system in leading Islamic Finance hub like in Malaysia, Indonesia, GCC, MENA, UK, and other OIC member countries.

Ginena (2014) states that (as cited in Alhabashi and Bakar, 2008) variations in Shari’ah governance practices between IFIs in 11 countries to be significantly different; thus, they recommended the establishment of a comprehensive Shari’ah Governance framework that would promote good governance. Corroborating Alhabashi and Bakar’s results, Hasan’s (2011) survey on Shari’ah Governance Practices found that operational aspects were significantly different between IFIs with only 39 percent in Malaysia, 3 percent in the UK (UK), and none in the Gulf Cooperative Council reporting having standard Shari’ah Governance operating procedures.

As confirmed earlier, different Shari’ah Governance structures exist in different jurisprudence depending on different legal frameworks governing Islamic banks and financial operations and can be divided into two broad categories: centralized and decentralized. The countries approaches on SG can either be strict, moderate or flexible; Malaysia and Pakistan belong to the first category, characterized by the provision of comprehensive guidelines on detailed implementations of SG. Countries like, Bahrain, Brunei and the UAE have adopted the moderate approach, providing the main provisions on the process but still leaving some aspects to the discretion of institutions or the authorities. On the other hand, Singapore and the U.K tend to adopt the flexible approach.
in this matter whereby most aspects of SG are left to the discretion of Islamic banks (Hassan et al., 2014). Wilson (2009) discusses the merits of centralized versus devolved Shari’ah governance and considers what competencies and experience Shari’ah Board members should have. He mentions the four key attributes identified by the IFSB for sound and effective Shari’ah Governance are competence, independence, confidentiality and consistency (Wilson, 2009).

The OECD has issued Guidelines on Corporate Governance, the IOSCO on capital market and the BCBS on Basel Committee I, II and III. Nevertheless these standards and guidelines failed to address specific issues of Islamic finance (Dusuki, 2011). However, Hassan et al. (2009) argue that Shari’ah Governance structure must be in line with internationally recognized corporate governance standards such as those issued by the OECD in order to ensure effective implementation, in addition to that, conserve the fulfillment of fiduciary duties that include good faith, care, skill and diligence towards all their stakeholders. Moreover, it is necessary to appreciate the comprehensive nature that Shari’ah Governance provides to supervise the services of IFIs, the policy makers of a country have to focus on its key elements.

In the following section, a brief description of Bank Negara Malaysia Shari’ah Governance Framework (BNM SGF) 2010 is going to be discussed.

2.3 A Brief Overview BNM SGF 2010

The Bank Negara Malaysia Shari’ah Governance Framework (SGF 2010) for IFIs was introduced by BNM in October 2010, which is expected to solve the basic problems and can be a Shari’ah corporate governance model for the rest of the world (Muneeza & Hassan, 2011). The framework works in accordance with Malaysia’s two-tier Shari’ah Governance infrastructure which consists of BNM’s central Shari’ah advisory body along with the individual boards, committees or advisories of each institution. Hassan et al. (2014) argue that this framework has been introduced at a critical juncture where concerns are being voiced across the industry regarding the role and function of Shari’ah advisories and debating whether, and to what extent, Shari’ah advisory should be regulated.

The objective of the SGF 2010 is to provide comprehensive guidelines to the board and the Shari’ah committee of the IFIs in discharging their responsibilities in relation to Shari’ah matters. It also sets out the expectations of BNM on the IFI’s Shari’ah Governance process, structure and arrangement in order to ensure that all business activities and operations are Shari’ah compliant. The new scope of this framework is the formation of functioning outlines for Shari’ah review, Shari’ah audit, Shari’ah risk management and Shari’ah research, which are the four significant functions that provide a system of checks and balances within the organization.

Omar et al. (2014) conducted a survey on 25 Islamic Banks and 12 Takaful Institutions to identify the problems and constraints in implementing BNM SGF 2010 in Malaysia and find that Shari’ah Governance Framework 2010 is well received by IFIs. They further argue that the introduction of Shari’ah audit and review function in BNM SGF 2010 has enhanced the institution's product development. Under BNM SGF 2010 any product has to undergo several steps before it is finally approved which helps to improve the professional monitoring of Islamic financial products. It is also found in their study that the Shari’ah non-compliance issue has been reduced after SGF 2010.
Interestingly, a common perception regarding difficulties of the Board of Directors in making decisions due to Shari’ah Committee resolution has been found not correct. However, difficulty in getting qualified Shari’ah officer is acknowledged by the industry practitioners and they further explain that this may be due to difficulty in finding a person who is well versed both in Shari’ah and modern financial transaction.

2.4 Comparative Analysis of Shari’ah Governance Framework

In order to have a clear idea about differences in Shari’ah Governance practice across the region and countries, a comparative analysis is used in this section. Kasim et al. (2013) compare AAOIFI, IFSB and BNM Shari’ah Governance guidelines and argue that all the guidelines discuss and emphasize on independence, competence, responsibility, accountability, confidentiality of Shari’ah board members, also, the importance of Shari’ah review and audit functions are highlighted in all the guidelines although AAOIFI discuss in more detail, Shari’ah risk management and research function have been discussed only in BNM Shari’ah Governance framework (Kasim et al., 2013). The difference between the IFSB Prudential Standards and the AAOIFI Governance Standards is that the IFSB approach is more concerned towards regulators while the AAOIFI, to individual IFIs (Dusuki, 2011). Shari’ah Governance framework provided by AAOIFI has seven sections, the framework of IFSB includes scope and approach of SG system and the qualitative characteristics of the Shari’ah Supervisory Committee, at the same time, BNM provides the general requirements of the framework, qualitative characteristics and provide the guidelines on Shari’ah review and Shari’ah audit, in addition to that, BNM provides the guideline on the functions of Shari’ah risk management and Shari’ah research in Islamic Finance (Kasim et al., 2013). As Shari’ah Governance is new, they propose that respective regulators should implement the prescriptive approach like the first approach taken by the U.K while implementing the corporate governance code. They conclude by suggesting standardized and comprehensive guideline or framework for easy reference for industry practitioners, regulators, Shari’ah advisors and investors.

Table 1

Comparative analysis among Shari’ah Governance guidelines

<table>
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<tr>
<th>No</th>
<th>Discussion</th>
<th>AAOIFI*</th>
<th>IFSB†</th>
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<td>Research function</td>
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*Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)
† Islamic Financial Services Board and ¥ Bank Negara Malaysia Shari’ah Governance Framework 2010

2.5 Current issues in Shari’ah Governance

In a recent working paper, Shamsher et al. (2015) state that in addition to shareholders right protection, IFIs must also protect interests of all stakeholders and ensure justice. They further argue that to do so IFIs would face challenges in the real markets that could adversely affect its effectiveness in mitigating Shari’ah risk and identify such issues as the degree of independence of Shari’ah committee, confidentiality, competence, consistency, and information disclosure (Shamsher et al., 2015; Wilson, 2012; ).

Hasan (2014) finds that there are gaps and shortcomings in the existing Shari’ah Governance practices of IFIs, particularly the aspects of the general approach to SG, the internal SG framework, the attributes of the Shari’ah board in terms of mechanisms of competence, independence and transparency and confidentiality, operational procedures and Shari’ah board’s assessment. He also finds that regulatory framework has a positive influence on Shari’ah scholars’ views towards Shari’ah governance. It was also found that lack of responsibility, accountability and independence in decision making, as corporate governance principles, is contributing to the ineffectiveness of current practices in the investigated IFIs (Magalhaes & Al-Saad, 2013).

Investment account holders right in Islamic banks has been widely discussed and debated. Wilson (2012:213) argues that investment account holders have a much greater stake in an Islamic bank than depositors with a conventional bank as they share in its profits rather than being paid interest. It is appropriate therefore that there should be a more direct corporate responsibility to investment-account holders in an Islamic bank which will be reflected in the corporate governance structure. Magalhaes & Al-Saad (2013) confirm that the current practices implemented by IFIs in protecting the rights of Unrestricted Investment Account Holders are not effective enough, in the light of standard corporate governance principles. Wilson (2012) further argues that as the mudaraba account holders are not the owners of the Islamic banks, as a result, they cannot benefit from ownership rights. By comparing the responsibility of Islamic banks to the unrestricted and restricted investment-account holder, he concludes that restricted-investment depositors cannot be regarded as stakeholders in the Islamic bank.

3.0 Recommendation to Improve Shari’ah Governance Practice

Grassa (2013) argue that even if the Southeast Asian model of Shari’ah supervision seems to be most efficient and effective in achieving the Shari’ah compliant purpose than the GCC model, it cannot be considered as a perfect model. A lot of works are required to improve it (Grassa, 2013). Hassan et al. (2014) recommend the following mechanisms in order to ensure a sound Shari’ah Governance system: a) a Shari’ah board with qualified members; b) a well-defined and adequately qualified and staffed organizational structure; c) clear lines of authority and accountability; d) policies and procedures pertaining to the approval of products and activities that require adherence to Shari’ah rules and principles; and e) an independent and regular review of Shari’ah compliance (Hassan et al., 2014).
Muneeza & Hassan (2014) argue that IFIs need sound “Shari’ah Governance Code” based on the principle of Islamic Law in addition to good governance rules like their conventional counterpart.

While analyzing four key attributes identified by IFSB: competence, independence, confidentiality and consistency Wilson (2009) recommends followings to improve Shari’ah Governance practice: professional development with modern finance and contemporary legal contract (Ghayad, 2008), renewable contract with Shari’ah board members, compensation of Shari’ah board members by the government but not idealistic for all countries, consistency between IFIs within a single jurisdiction, and coordination between AAOIFI, OIC Fiqh Academy, IFSB. Moreover, clear organizational charts, showing the remit and accountability of different stakeholder groups would help explaining the role and workings of Shari’ah boards. In addition, scholars from economics, finance, law and political science should be included in Shari’ah board as practiced in Sudan in order for making well-informed decisions, while there exist arguments for and against this as well.

A framework including structures and processes internal and external to the IIFS can be expected to enhance public understanding of the requirements of Shari’ah. It would be conducive to the development of market discipline as it would permit an effective utilization of exit and participatory actions (Grais & Pellegrini, 2006).

4. Conclusion

In the recent past, Shari’ah Governance has got a considerable attention not only from academia, but also from Islamic Financial Institutions (IFIs). Consequently, a great number of researches have been carried out in countries where Islamic Finance (IF) has been playing a significant role in the economy or where it has just started to emerge. The study indicates that the plurality in Shari’ah governance practice across regions and countries may promote innovation but in order to establish credibility and promote Islamic Finance as a comprehensive financial system, uniformity is desirable. Against a backdrop of global financial crisis in 2007-2008, the issue has even become more vital for IFIs to uphold its uniqueness, sustainability, credibility and transparency in doing business for its Muslim as well as non-Muslim stakeholders. In order to develop a comprehensive governance system, it is necessary to ensure the active involvement of Shari’ah scholars with industry practitioners and regulators. A sustainable and viable Shari’ah governance framework, which will not only provide credibility to IFIs, but also ensure transparency, trust, ethical behavior, credibility, underlying faith and belief and ethics (Thomas et al., 2005 cited in Nathan & Ribieri, 2007) and also help protecting the stakeholders rights and fulfill the broader principle of Maqasid al-Shari’ah (foundational goals of the Shari’ah).
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The Ends of Development in Islam: Seven Overlapping Concepts

By

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Abstract:

The purpose of the article is to articulate Islamic developmental ideals and to outline the various ends of Islamic development. We provide a list of seven overlapping concepts that together define the Islamic ideal of human development. In contrast to the purely materialistic conceptions of human development in modern economics, Islamic human development ideals entail the seven overlapping concepts of (1) Purification (Tazkiyah); (2) Freedom (‘Uboodiyah); (3) God-consciousness (Taqwa); (4) Excellence and Beauty (Iḥsān); (5) Felicity or Happiness (Ṣā‘ādah); (6) High Morals (Akhlaq); and (7) Civilization (‘Umrān).

Keywords: Human Development; Islamic Worldview; Maqasid Al Shar‘īah

1. Introduction

“Principles of ethics or values are basically derived from worldviews. Therefore, every economic system, i.e., capitalism, socialism, and Islam, has a particular set of values which are unique to the system derived from its particular worldview. These ethical principles are implicitly incorporated in the notions, concepts, assumptions, ideals and even theories of economics.”—Seyyed Hossein Nasr.

The concept of development and progress ultimately depends on the belief and value systems of the human population at large. Development and progress can only be measured with reference to these set of values and objectives. Islamic life is purposeful and has some end goals. The purpose of human life according to the Islamic tradition is clarified by God to be “nothing except for worship God” (Qūrān 51:56) and the end of

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human pursuit can be ascertained in the light of the Qur’anic verse, “And that to your Lord is thefinality” (Qur’an 53:42).

In contrast to the modern worldview, Islamic conception of development are spiritual in nature. Broadly speaking, the purpose of Islamic Law (Maqasid Al Shar’īah) has been defined as ensuring human good (Maslaha) and righteousness (sala’h) and avoiding harm (Dar’i al-mafāsid). In traditional formulation (e.g., in the works of Imam Al-Ghazāli d. 1111 CE), the objective of Islamic law is defined to be five-fold: (1) Religion (Dīn); (2) Life (Nafs); (3) Intellect (`Aql); (4) Progeny or Family (Nasl); and (5) Property or Wealth (Māl). Thus, Islam considers the development of people and their welfare in the safeguarding of their faith, their life, their intellect, their posterity and their wealth. Whatever ensures the safeguard of these five Maqāṣid serves the public interest (Maṣlahah) and leads to development and progress. Whatever impedes these objectives is undesirable.

2. The Ends of Development in Islam: Seven Overlapping Concepts

In the Islamic tradition, there exist many synonyms for the concept of human development. For example, human development can refer to the purification of the soul (Tazkiyah); freeing oneself of base desires and recognizing one’s slavehood (’Uboodiyah); attaining God-consciousness (Taqwa) and sublime moral and ethical qualities ( Akhlaq); reaching a state of spiritual excellence and beauty (Ihsān); attaining felicity in this world and the hereafter (Sa`ādah); and sustaining civilization (`Umran). The Arabic terminology Sa‘adat, Fālah, Fauz is also used in Islamic literature to refer to happiness, felicity, prosperity, and success. All these notions are, more or less, connected to each other. In this section, we will discuss seven important overlapping terms that relate to human development and progress.

I. Development as Purification (Tazkiyah)

``The value-system which the Holy Qur’an has given establishes spirituality as the root, morality as the trunk, and all other aspects of life: economic, political, etc., as offshoots of morality; whereby it ensures the emergence of the integrated and progressive individual and the integrated and progressive social order.”—Fazlur Rehman Ansari.

According to the Islamic tradition, Prophet Muhammad has introduced to the world the most refined system of spirituality known to humanity that leads to a thorough purification of the soul (Tazkiyat al-nafs, or simply Tazkiyah). The Qurān says, “As also We have sent in your midst a messenger from among you, who recites to you Our verses, and purifies you, and teaches you the Book and the wisdom, and teaches you what you did not know.”(Qurān 2:151). Tazkiyah is an expression that is derived and emphasized in the Qurān (91:7–9) and describes the effort through which (1) blameworthy character traits (akhlāq dhamīmah) are eliminated; and (2) praiseworthy character traits (akhlāq ḥamīdah) are accumulated. It is through the efforts of Tazkiyah only can a human attain the pleasure of God, leading to falāh—prosperity in this world and the hereafter (Qurān 87:14; 91:9). The Qurān says (87:14), “He has certainly succeeded who purifies himself”.

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Tazkiyah is the subject studied and elaborated in the Islamic sciences of Tasawwuf (Sufism) through which the state of Ihsān or spiritual excellence is cultivated and the hearts of human beings are connected to the Transcendent God. Tazkiyah ultimately relates to the soundness of the heart (in which lies the human intention—and when the heart is sound, the actions (‘amāl) that come forth from the body are ipso facto sound). The focus of Tazkiyah is not just the individual but it also seeks societal transformation.

Tazkiyah can be achieved through the following instruments (Khurshid Ahmad)
1. dhikr—the remembrance of God; 2. ‘ibādah—servitude to God; 3. tawbah—repentance to God; 4. ṣabr—the spirit of perseverance and tolerance; 5. ḥasābah—criticism (including self-criticism); and 6. ḍu‘ā—supplication.

II. Development as Freedom (‘Uboodiyah)

In the Islamic worldview, freedom is understood differently from its usual liberal interpretation. In Islamic conception, freedom is in escaping the slavehood of the creation (Makhlūq) to arrive at the slavehood (‘Ubūdiyah) of the creator (Khāliq). The free man is the one who’s the master of his desires (Nafs) while the slave is the one who’s a slave to his desires.

One can understand the nuanced meaning of freedom in Islam by recalling the story of the Rabia Ibn ‘Amir (a companion of the Prophet ﷺ) and the Persian army commander Rustom. In a famous historical duel, Rabia addressed Rustom in the following way, "Allah the Exalted has sent us to free and deliver you from worshipping the creation to worshipping the sustainer and creator (Rabb) of the creation. And to deliver you from the constriction of this world to the vastness of this world and the afterlife. And from the oppression of religions to the justice of Islam." (At-Tabari). This famous narration is important for two reasons. (1) It clearly articulates how different the Islamic conception of freedom is from modern notions of liberty and freedom as espoused by Rousseau et al. (i.e., Islamic conception of freedom is not in doing things that one desires to; freedom is in following divine injunctions and subjugating desires). (2) It also highlights the importance of the afterlife for Muslims, who believe that this world is transient and the afterlife is everlasting. The Islamic viewpoint of development must therefore necessarily reject any development conception that does not take into account the afterlife.

Furthermore, Islamic models of development must also be based fundamentally on Tawhīd (Divine unity) and ‘Ubūdiyah (servanthood) to God. Development is adherence to God’s way and to follow the path of Divine Guidance (Al-huda) that God has revealed through His Prophet ﷺ—in this way, Islamic economics can be defined in essence to be the "economics that is guided by the Prophet rather than by the Profit".

According to Al-Attas the Islamic concept of freedom is reflected in Ikhtiyār (i.e., choosing the better of all available actions). Muhammad Iqbal describes freedom as the “surrender to the moral ideals” and the ability of man to be free of lowly
egocentric desires and to choose God. For Iqbal, liberty is not negative or positive liberty as argued by Isaiah Berlin⁶. Liberty or freedom is attained by discovering the laws of God in one’s self. This signifies the fusion of the will of God and that of man.

III. Development as the development of God-consciousness (Taqwa)

Taqwa literally means to guard oneself against Allah’s displeasure. God defines Taqwa as the measure of honor in Islam; the Qurān says (49:13), “Indeed the most noble of you in the Sight of Allah is the most righteous of you (Atqākum, which means the person with most Taqwa)”.

Taqwa does not only bring about God’s pleasure in the hereafter. To the contrary, even worldly blessings come with Taqwa. God indicates how the blessings of the Earth and the Sky would have been opened to the people of the town if they had Taqwa, “And if the people of the towns had believed and had Taqwa (piety), certainly We would have opened for them blessings from the Heaven and the Earth; but they belied (the Messengers) so We took them (with punishment) for what they used to earn (unbelief and crimes)” (Qurān 7:96).

One of the important manifestations of Taqwa is to avoid the actions prohibited by God. Any society that flouts the Islamic boundaries of lawful and unlawful cannot be considered developed according to the Islamic viewpoint. In financial matters, this would mean prohibition of engaging in unethical business and avoiding interest. The prohibition of interest-based transactions in the Qurān comes in a uniquely stern manner in which God announces in a reprimanding way a war from Himself and His Messenger to those who don’t desist from this corrupting practice.

IV. Development as acquiring Excellence and Beauty (Ihsān)

“And seek, through which Allah has given you, the home of the Hereafter; and [yet], do not forget your share of the world. And do Ihsān (be good) as Allah has done Ihsān towards you (has gone good to you).” (Quran 28:77)

Ihsān is a comprehensive concept often translated by commentators and interpreters as excellence. Al-Ihsān, as Imam Raghib al-Isfahani (the famous Arabic linguist) explains, stands for “the creation of beauty in one’s conduct, which is achieved through beauty in knowledge and beauty in action”. The Prophet clarified in a Ḥadīth, “God is beautiful and He loves beauty”. God is infinitely beautiful and the source of all beauty in the world and within us. Prophet Muhammad also said: “Verily, Allah the Exalted loves that the doer of an action perfects his action.” In performing actions, once can attain Ihsān through the following: 1) Sincerity (Ikhlās); 2) Completeness; 3) Tastefulness (doing things in a nice manner); and 4) Correctness (doing things in the right way).

According to the Islamic philosopher Rafi-ud-din⁷, the overriding ideal behind all the higher desires of man is the search for beauty. For example, moral action is the expression of beauty in one’s deeds. It is the man's desire for an ideal that dominates all his desires on the purely psychological level. The ideal is also the basis and source of the moral code of do’s and don’ts that a person follows. Broadly speaking, one can
distinguish human desires into: (1) the lower desires, which can be referred to as animal instincts—such as feeding, sex, etc.—since these desires are common to man and the animals below him in the scale of evolution; (2) the higher desires, which refers to the desire of an ideal; the desire for moral action; the desire for knowledge; and the desire for artistic creation or art. These higher desires are specific to a man and define a fundamental difference between human beings and other animals. These higher desires may be called the ‘free desires’ since there is no biological compulsion attached to them and they belong exclusively to the psychological realm.

*Ihsān* can be thought of as the development of higher consciousness through which human beings can transcend animal instincts and become conscious of a higher Self, a transcendental reality, or God. In Islamic belief, human development is achieved through the development of self-consciousness and more than that by God-consciousness, which is the pinnacle of human development.

V. Development as Attaining Felicity or Happiness (Sa‘ādat)

While happiness is a universal ideal that all humans across the various cultures aim for, the notions of happiness are culturally informed. Modern society has wrongly assumed that happiness is a byproduct of hedonism and consumerism. In conventional economics, human development is based on the ability of the economic man to fulfill material goals. The underlying assumption is that the more income a person achieves per capita, the more welfare (and consequently development) that is achieved. Spiritual achievement, ethical progress and conduct, God-consciousness is difficult to measure and is thus excluded from this calculation.

Islam stresses the attainment of everlasting and enduring happiness in the hereafter rather than the pursuit of the transient happiness of this world that is pursued by modern secularized cultures. It is the hereafter that will differentiate the happy from the wretched as the Qurān enunciates, "On the day it comes, no soul shall speak save by His Leave. Among them shall be the wretched and the felicitous (sa‘īdat)." (11:105). The word *Sa‘ādat* can loosely be defined as happiness and/or felicity. This world holds special significance in Islamic thought and has featured in the book titles of many leading scholars, such as *Kimya Sa‘ādat* by Imam Al-Ghāzali and *Tahsilas Sa‘ādat* of Al-Farabi. Instead of the commonly used phrase “Pursuit of Happiness”, the Islamic comparable word means “Attainment of Happiness”, which is how Al-Farābī’s book’s title will be translated.

Paradoxically, it has been shown by researchers in the areas of positive psychology that increased wealth does not necessarily make a person happier and an agent has to aim at things other than one’s own happiness to become happy. Islam is clear in its stance that happiness does not lie in the hedonistic pursuit of wealth or pleasures; instead, it is the remembrance of God through which human beings find solace and happiness, as stated in the Qurān (13:28), "Verily, It is in the remembrance of Allah that Hearts Find Solace". The desire of only this world (*Duniyah*) is disparaged by God in the Qurān in the following way, “So turn away from whoever turns his back on Our message and
desires not except the worldly life. That is their sum of knowledge. Indeed, your Lord is most knowing of who strays from His way, and He is most knowing of who is guided” (Qurān53:29–30).

This is not to imply that Muslims have to make a choice between a good life in this world and the hereafter. To the contrary, those who act righteously and are believers will see eternal happiness in the hereafter and concomitantly a pure worldly life (Hayātān Tayyibah). The Qurān says (16:97), “Whoever does righteousness, whether male or female, while he is a believer - We will surely cause him to live a good life, and We will surely give them their reward [in the Hereafter] according to the best of what they used to do.”

VI. Development as maintaining Akhlaq (High Morals):

“Religiosity without regard for the moral refinement and development emerges in the Qurānic view as nothing less than an opiate, because the very concept of ‘godliness’ loses all meaning without the active pursuit of the highest Morality.”—Fazl-Ur-Rahman Ansari.

In the Ḥadīth, “I have only been sent to the perfect noble character”, the Prophet described the mission of his Prophethood as Makārim ul Akhlaq, or perfection of practical morals. Laying the foundation for the perpetuation of this ethics-moral system was at the heart of the Prophet’s mission. It is a fundamental ideal of an Islamic society that its members must have highly developed ethical disposition (Akhlāq). Akhlāq is the plural of Khuluq, which means the inner disposition of a human being. The Islamic ideal of Akhlāq—plural for khuluq, which refers to inner dispassion of a human being—is the character traits of the Prophet Muhammad, whose exalted character was praised by God himself in the Qurān (68:4), “And You (Muhammad) are on an exalted standard of character”. According to Isutzu (the Japanese Qurānic scholar), ethics subsumes three kinds of moral discourse: (1) divine ethics—which relates to the divine attributes that relates to the ethical nature of God (e.g., ‘Merciful’, ‘Forgiving’, ‘Just’); (2) ethical human relationship with God, and (3) human social ethics towards fellow-humans that coexist in a society. These three ethical categories are not aloof or separate but integrate into multiple ways. It is by adhering to this Islamic ethical code of life can a person return to the condition of genuine Fitrah (primordial ethical disposition) of man and it is only on the basis of this ethical system that any progress is possible in Islam.

The character in Islamic tradition is not confined only to external actions (such as cheerfulness, leadership, optimism, thankfulness, trustworthiness)—but more than that refers to the inner state of the heart or the soul that drives human actions. Imam Al-Ghazālī stated that man consists of two forms: 1) the Khalq—which refers to the physical forms of human actions; and 2) Khuluq (singular form of Akhlāq), which refers to the
spiritual forms driving human actions. Thus true exalted character means elevated spiritual states based on the right intention and God-consciousness due to which outwardly ethical actions are driven. Broadly speaking, Islamic social ethics is guided by five general principles (The Study Qurān project\textsuperscript{13}, chapter by Dakake): (1) the significance of the Umrah (religious community); (2) the concern for justice; (3) the maintenance of social harmony; (4) human equality before God; and (5) the balancing of rights & responsibilities.

The Islam science of ethics (`Ilm ul Akhlāq) is concerned with ways to develop virtuous praiseworthy qualities in human beings so that human beings become worthy of being the vicegerents of God on Earth. The two primary sources of Akhlāq are the Qurān and the Sunnah of the Prophet ﷺ. The moral life of a Muslim when applied correctly and honestly it results in a smoothly functioning of harmonious society, and at the same time it removes all barriers in the path of virtue. Along with this, it endeavors to eradicate evils from social life by eliminating the causes of ills appearance and growth, by closing the inlets through which harms creeps into a society. All of the major societal functionalities—such as politics, economics, science, and law—can only function well if it incorporates ethics and is not detached from it.

A term fundamentally related to Akhlāq is Adab—which refers roughly speaking to comportment and wisdom. The idea of Adab is intrinsic to Islam and was philosophically developed comprehensively by Naquib Al-Attas.\textsuperscript{14} According to Al-Attas, a man of Adab is an individual who is fully conscious of his individual responsibility and has developed a proper relationship with himself, his Creator, his family members, his society—in effect with everyone who has a right on him. It is the loss of Adab that is causing human beings to transgress by excessive exploiting, hoarding, monopolizing the use of natural resources gifted by God; and by being egotistically driven to be insensitive to the needs of others—actions that belie the high position entrusted to humans by God on the account of being His vicegerents.

VII. Development as maintaining `Umrān (Civilization):

Islam is not only concerned with matters related to the hereafter. In contrast, Qurān clearly instructs the Muslims that even though the striving is for the hereafter (Al-Ākhira), one must not forget their share in this world. The concept of development is reflected in the Qurānic concept of Imar-Al-Ardh or building the earth (Qurān, 11:61), which is a duty of human beings as the vicegerent (Khālifa) of God. The Qurān refers to isti’mār (civilizational construct) indicating that humanity is responsible for maintaining and building a civilization on Earth (i’mār al-ard).

The idea of building `Umrān was taken up in rigorous manner by Ibn Khaldun (d. 1406 CE) who can lay a rightful claim to be the father of sociology as he developed a new insightful field of knowledge called `ilm al-`Umrān or the science of `being together”—or sociology as it is called today. `Umrān does entail constructing the building (`imara is a building or a construction) as well as establishing urban civilized societies. Ibn Khaldun’s idea of civilization (`Umrān)—a word related etymologically to Imar-Al-
Ardh—refers to the building of humane civilization on earth, which entails transiting from a nomadic lifestyle to the building of cities and attending to aesthetics and knowledge of both arts and sciences. ‘Umran is a polysemous concept that can mean ‘filling of a vacuum/void’; culture; civilization; prosperity; and even development.

3. Conclusions

The Islamic conception of development is spiritual and is built through slavehood of God (’Ubūdiyyah), the development of God-consciousness (Taqwa), and the purification of the soul (Tazkiyyah). Through purification, and the inculcation of the desirable spiritual virtues and the elimination of undesirable spiritual vices, human beings can attain an excellent disposition in all matters (Ihsān)—especially in terms of the ethical and moral characteristics of a person (Akhlāq). In the Islamic tradition, a lofty civilization (Umran) is built by producing human beings who have these qualities—and these are the qualities through which human beings can live a goodly life (Ḥayāt Tāyyībah) and also ultimate felicity and happiness (Sa’ādah) in the hereafter.

References


Shari’a Governance Framework in Islamic Banking in Oman: Issues and Challenges

By

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Abstract

The most crucial challenge facing Islamic Banking Entities (IBEs) in the Sultanate of Oman, as the new comer in Islamic banking especially in the GCC Market, is to ensure the full compliance of the IBEs in planning, development, and implementation of the products, services, conducts of business and activities with Shari’a rules and principles. The main objective of this paper is to summarize the current practice of Shari’a governance framework of the IBEs in Oman in the face of the challenges faced by such institutions. In the meantime, Central Bank of Oman (CBO) has issued a proper Shari’a Governance Framework -the Islamic Banking Regulatory Framework (IBRF) of CBO. The framework designed by an expert and experienced team adopts best practices of Shari’a governance in GCC in particular and worldwide in general. The key elements of Shari’a governance framework shall contain Shari’a Supervisory Board, Internal Shari’a Reviewer (Head of Shari’a), Shari’a Compliance unit, Shari’a Risk unit, and Shari’a Audit unit. Not only that, to strengthen the role of Shari’a, the CBO also issued a regulation for the establishment of High Shari’a Supervisory Authority (HSSA) in the CBO to harmonize the opinion related to Shari’a matters among the IBEs. These elements are expected to perform an oversight role on Shari’a matters relating to Islamic banking business activities. This paper also discusses the issues and challenges faced by IBEs in Oman and proposes some improvement for the CBO in order to strengthen Shari’a governance framework in the Sultanate.

Keywords: Shari’a governance, Islamic banking entities, central bank of Oman

Paper Type- Research paper

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1. Introduction

Islamic Banking and Finance has been experiencing an impressive development and remarkable growth triggered by increasing Islamic awareness in recent years (Chong & Liu, 2009). It is one of the fastest growing industries and has spread to all corners of the globe and at the same time is receiving wide acceptance by both Muslims and non-Muslims alike (Iqbal & Molyneux, 2005). Islamic Banking Entities have a duty to ensure full compliance of the IBEs with Shari’a rules and principles in all aspects of their products, instruments, business, operations, and practices by establishment of a proper Shari’a governance framework. On top of that, regulatory authorities (such as Central Bank and Financial Services Authority) are to ensure the establishment of proper regulations that cover good Shari’a governance framework.

The Central Bank of Oman has been covered the important areas of Shari’a Governance in its regulatory framework namely Islamic Banking Regulatory Framework (IBRF). The Shari’a Governance is discussed in detail in the second heading on General Obligation and Governance page 7 including the roles and responsibility of its units such as the role of Shari’a Supervisory Board, Internal Shari’a Reviewer, Shari’a Compliance Unit, Shari’a Audit Unit and Shari’a Risk Control function. Their functions have a pivotal role to play in ensuring and maintaining Shari’a compliance matters.

Shari’a governance is a very crucial area in Islamic banking entities (IBEs). It is as important as corporate governance to any institution. It is the mechanism which determines the compliance of business activities, transactions, products and instruments with the principles of Shari’a. The significance of Shari’a governance transpires via its role of ensuring and maintaining the confidence of Islamic banking and finance industry from viewpoint of its stakeholders. Historical data in the impressive growth of the Islamic finance industry (Onagun & Mikail, 2013). It can be considered as the hallmark and the differentiating factor for Islamic banks that makes them divergent from their conventional counterparts (IBRF, Title 2, p. 7). Therefore, the paper highlights the implementation of Shari’a governance framework within the IBEs in the Sultanate of Oman including the issues and challenges that are faced by them.

2. Islamic Banking in Oman

Islamic banks in the Sultanate of Oman have begun in early 2013 after the issuance of Royal Decree 69/2012 of December 6, 2012. The main purpose of the Royal Decree issuance was to amend six additional articles that are article 120-126 in the former Banking Law of Oman under new section titled ‘Islamic Banking’. These articles cover the general provisions of the legal framework, supervision and advisory of Islamic banking, the jurisdiction of the Board of Governor of CBO to set regulations and guidelines as well as its authority to license Islamic banks and Islamic windows. Other than that, these articles also mentioned that Islamic banking transactions should not contradict with Shari’a principles including the basis of the Shari’a supervision for each Islamic Banking Entity. The point plus that is covered in the articles is that, IBEs are exempted from any kind of fees imposed on dealing in real estate and movable asset because the nature of Islamic bank is to own the asset before it is being sold to the customers (Muscat Supreme Council for Planning, 2016). The Royal Decree has amended some provisions of the Banking Law officially in the Royal Decree 114/2000. In order to strengthen the position of Islamic Banking after the issuance of Royal Decree,
Central Bank of Oman released Circular IB 1 of December 18, 2012, which adopted the relevant Islamic banking framework to regulate the Islamic banking business activities and its operations. The minimum capital requirement was also regulated in the article which is OMR 100 million for full-fledged Islamic Bank, while OMR 10 million for Islamic windows and OMR 20 million for foreign bank (IBRF, Title 1 – Licensing Requirement, p. 12).

Although Oman is the last country in the six-nation Gulf Cooperation Council to introduce Islamic finance, the establishment of Islamic banking in the last five years is supported by a strong regulatory framework that is designed by experts and experienced Islamic banking and finance players in the global market that covers all aspects of Islamic banking. This framework namely Islamic Banking Regulatory Framework of Central Bank of Oman applies to full-fledged Islamic banks and to the Islamic windows of the conventional banks that are licensed to operate in the Sultanate. Currently, Oman has two full-fledge Islamic banks which are Bank Nizwa and Al-Izz Islamic Bank, and six Islamic Windows that are, Al Yusr Islamic Banking (Oman Arab Bank), Meethaq Islamic Banking (Bank Muscat), Muzn Islamic Banking (National Bank of Oman), Sohar Islamic (Bank Sohar), Maysarah Islamic Bank (Bank Dhofar), and Al Hilal Islamic Bank (Bank Al Ahli).

In addition to that, the future for Islamic banks in Oman is also promising. As of end 2015, the total market share of the Islamic banks in Oman reached to 7.75% of the total banking assets in the Sultanate (IFN Oman Report, 2016). In June 2016, the market share of Islamic banks in Oman reach to 8.42% which is equivalent to OMR 2.65 billion with 71 branches throughout Oman (Muscat Supreme Council for Planning, 2016) (please see table 1). While by end of January 2017, CBO reported that the market share of Islamic banks in Oman increase to 10.6% which is equivalent to OMR 3.2 billion (CBO, 2017). This number is achieved because Oman had learning from the experience of other jurisdictions. Learning from the mistakes made elsewhere has helped avoid same to Islamic banking market in Oman. Up till now, the Central Bank of Oman (CBO) still has not allowed the contract of bay’ al-‘inah and tawarruq to be used by Islamic banking entities as such contracts are still being debated among ‘some’ of the global Shari’a scholars.

Table 1.
Financial Ratios for Islamic Banks and Windows in Oman

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total of Assets</td>
<td>819</td>
<td>1,270</td>
<td>2,253</td>
<td>2,650</td>
</tr>
<tr>
<td>Total of Deposits</td>
<td>170</td>
<td>688</td>
<td>1,539</td>
<td>1,836</td>
</tr>
<tr>
<td>Total of Financing</td>
<td>436</td>
<td>1,048</td>
<td>1,781</td>
<td>2,103</td>
</tr>
<tr>
<td>Market Share of Banking Activity</td>
<td>3.64%</td>
<td>5.27%</td>
<td>7.45%</td>
<td>8.42%</td>
</tr>
<tr>
<td>Number of Branches</td>
<td>34</td>
<td>51</td>
<td>68</td>
<td>71</td>
</tr>
</tbody>
</table>

Other than that, the remarkable achievements of the Islamic banking sector will continue with a positive trajectory over the next five years. As the new comer, there are some challenges still faced by Islamic Banking Entities (IBEs) in the Sultanate, such as, the lack of awareness about Islamic banking transaction and activities, limited qualified human capital in Islamic finance, insufficiency of liquidity instruments in Islamic money market, and lack of Sukuk issuance and its availability in the secondary market. These challenges need to be collectively addressed by the Islamic banking stakeholders in order for the industry to grow. Especially in the area of Shari’a matters, the major players in the IBEs have to be aware about the importance of Shari’a governance in their good corporate governance. This is because Shari’a plays a major player in supervising the bank to comply with Shari’a acceptable rules and principles.

3. The Importance of Shari’a Governance for Islamic Banking Entities in Oman

The importance of Shari’a governance has been pointed out by the IFSB in principle 3.1 of the “IFSB Guiding Principles on Corporate Governance”. IFSB states that; “an appropriate mechanism must be created to ensure the compliance with the Shari’a principles”. Similarly, Principle 7.1 of the “IFSB Guiding Principles on Risk Management” states that; “IFIs shall have in place adequate systems and controls, including Shari’a Board/Advisor to ensure compliance with Shari’a principles”. In addition to that, IFIs shall provide the structure and system to govern all the business activities in order to ensure Shari’a compliance at all times and at all levels. There are key elements of Shari’a governance framework in Oman including, High Shari’a Supervisory Authority (in CBO), Shari’a Supervisory Board, Internal Shari’a Reviewer (Head of Shari’a), Shari’a Compliance unit, Shari’a Risk Control unit and Shari’a Audit unit.

Central Bank of Oman has defined Shari’a governance as “a system whereby an Islamic Financial Institution attempts to comply with Shari’a in all its activities”. According to IFSB-10 No. 3, Shari’a Governance System is “a set of institutional and organizational arrangements through which Islamic Financial Institutions (IFIs) ensure that there is effective independent oversight of Shari’a compliance over the issuance of relevant Shari’a pronouncements, dissemination of information, an internal Shari’a compliance review/audit and annual Shari’a compliance review/audit (IFSB, December 2009). While according to IBRF of CBO in the Title 2 on General Obligations and Governance on page 7 Shari’a Governance is defined as a system whereby an Islamic financial institution attempts to comply with Shari’a in all its activities. The existance of Shari’a governance framework and guidelines becomes a tool to meet the unique needs of the Islamic banking entities in the Sultanate.

However, implementing Shari’a governance system in Islamic banking entities is too challenging. There are unique risks embedded in IBEs which isdo not exist in conventional counterparts such as Shari’a non-compliance risk. The risk arises when IBEs fails to comply with Shari’a principle that have been imposed by Shari’a authority (either HSSA or SSB) (IFSB, 2006, p.26). Therefore, sound and proper Shari’a governance system can manage to avoid Shari’a non-compliance risk in IBEs that may cause loss and negative reputation of the IBEs.
Since the Shari’a compliance is the backbone of IBEs, it gives legitimacy to the practices of IBEs. It also boosts the confidence of the shareholders and the public, that all the practices and activities comply with the Shari’a at all times. Therefore, Shari’a governance is crucial to IBEs to protect the interest of the stakeholders. In addition to that, the implementation of Shari’a governance is encouraged by international regulatory institutions like Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and Islamic Financial Services Board (IFSB) (Hamza, 2013). It is essential to IBEs to comply with Shari’a to enhance the confidence of the stakeholders of IBEs (Miskam and Nasrul, 2013).

Moreover, the existence of non-Shari’a compliant element in the business and operation of IBEs does not only affect the confidence of the public in IBEs, but also exposes IBEs to reputational risks. The full compliance of IBEs with the Shari’a rules and principles will be achieved by having a proper Shari’a Governance framework.

Since CBO has the full authority to oversee, regulate and supervise the Shari’a compliance of all IBEs, it is very important for CBO to ensure that IBEs have implemented proper Shari’a governance in each Islamic bank. It should be noted that Oman is a new player of Islamic banking in the GCC market. The probability of an Islamic bank not implementing proper Shari’a governance is higher due to lack of awareness by it of the importance of Shari’a governance to be apply in the Islamic banking structure. On the other hand, the CBO is better placed to identify what are the potential issues in implementing Shari’a governance and what are the issues faced by Shari’a Supervisory Board and internal Shari’a Department in that particular Islamic bank.

4. Shari’a Governance Framework in Islamic Banking in Oman

Islamic banks as Shari’a compliant companies operate under a different structure of corporate governance from conventional banks. Because in Islamic banking, the existence of Shari’a Supervisory Board has to be in place to supervise Shari’a matters in any particular Islamic bank which comprises of Shari’a scholars who specialized in fiqhmuamalah. The Islamic bank shall establish Shari’a department which comprises Internal Shari’a Reviewer, Shari’a Risk Control, Shari’a Audit unit and Shari’a Compliance unit who control and manage the business activities of the bank in order to ensure it complies with Shari’a on a day to day basis. This structure is called Shari’a Governance, implementing of which will help Islamic banks to differentiate themselves from normal banking institutions.

Kasim et al, (2013) compare the Shari’a governance guidelines of AAOIFI, IFSB and Bank Negara Malaysia (BNM). The paper found that Shari’a governance framework provided by AAOIFI has seven sections. While in IFSB, the framework includes scope and approach of Shari’a governance system and the qualitative characteristics of Shari’a Supervisory Committee. In the case of BNM, the framework provides general requirements on qualitative characteristics and guidelines on Shari’a review, Shari’a audit, Shari’a risk management and Shari’a research.
The importance of Shari’a governance for IBEs is also stressed in the IBRF of CBO. There are two main objectives of a Shari’a Governance framework that play a very important role to ensure the business activities are in accordance with Shari’a; first, to provide a structure and a system to govern all the business activities of the Islamic Banking Entities in order to ensure Shari’a compliance at all times and at all levels. Second; to enable the Islamic Banking Entities to be perceived as Shari’a compliant by the stakeholders including the general public.

In general, the structure of Shari’a governance in Oman as stated in the IBRF is following AAOIFI Shari’a governance standards for Islamic financial institutions (IFIs). There are seven standards under AAOIFI governance for IFIs which are as follow:

1. Shari’a Supervisory Board: Appointment, Composition and Report, which is also stated in the IBRF,
2. Shari’a Review: As per IBRF, IBEs shall have Internal Shari’a Reviewer (ISR) as Head of Shari’a,
3. Internal Shari’a Review: As per IBRF, IBEs shall have Shari’a Compliance unit who which reviews the business activities of the Islamic bank,
4. Audit and Governance Committee for Islamic Financial Institutions: As per IBRF, IBEs shall have Shari’a Audit unit under Shari’a Department whose reporting will be to ISR,
5. Independence of Shari’a Supervisory Boards: This too is as per IBRF,
6. Statement of Governance Principles for Islamic Financial Institutions, is also mention in the IBRF,

In the IFSB-10 on Shari’a Governance, the structure is illustrated in details on how Shari’a governance system complements the existing governance, control, compliance function within the IBEs, as the hallmark and differentiating factor for Islamic banks in comparison to conventional banks, as described below:

<table>
<thead>
<tr>
<th>Functions</th>
<th>Common Corporate Governance</th>
<th>Additional for IBEs in Oman</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governance</td>
<td>• Board of Directors</td>
<td>• Shari’a Supervisory Board (SSB)</td>
</tr>
<tr>
<td>Control</td>
<td>• Internal Audit Division</td>
<td>• Internal Shari’a Reviewer as Head of Shari’a Department</td>
</tr>
<tr>
<td></td>
<td>• External Auditor</td>
<td>• Audit unit under Head of Shari’a and Shari’a</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• External Shari’a Auditor</td>
</tr>
<tr>
<td>Compliance</td>
<td>• Regulatory and Financial Compliance Division</td>
<td>• Shari’a Compliance unit under Head of Shari’a</td>
</tr>
<tr>
<td>Risk Management</td>
<td>• Risk Management Division (Credit, Market and Operational Risk)</td>
<td>• Shari’a Risk Control unit under Risk Management Division or Shari’a Division</td>
</tr>
</tbody>
</table>

Source: IFSB – 10 on Shari’a Governance and Author.
It is the duty of all the stakeholders particularly the shareholders and the management of the Licensees to strengthen Shari’a Governance framework of their respective institutions. This objective can be achieved by delivering proper training to the management and proper understanding pertaining to the importance of Shari’a governance in IBEs.

In practice, the detailed scope of the Shari’a governance system in Islamic banks may vary from one country to another, depending on the types of structures adopted by the IBE as permitted by the authorities. The Shari’a governance also depends on the size and the stage of development of that particular Islamic bank. All countries in the GCC such as Oman, Qatar, Saudi Arabia, Kuwait, Bahrain and UAE are following the same structure in the implementation of the Shari’a governance structure in their Islamic banks. While only Oman, Bahrain and UAE have the High Shari’a Authority in their Central Bank which has the final say on Shari’a matters in that particular jurisdiction.

There are six key elements in Islamic banking in Oman that should be in place in their Shari’a governance structure (see diagram 1), whereby five elements should exist in the Islamic bank and one element in the Central Bank. These key elements are as follow:

1. High Shari’a Supervisory Authority in Central Bank of Oman
2. Shari’a Supervisory Board in Islamic Bank
3. Internal Shari’a Reviewer (ISR) in Islamic Bank
4. Shari’a Compliance Unit under ISR
5. Shari’a Audit Unit under ISR
6. Shari’a Risk Control under Risk Management Division and dotted line to ISR or vice versa.

**Diagram 1**

Shari’a governance Framework as per the IBRF of CBO
5. Current Issues and Challenges in Implementing Good Shari’a Governance in IBEs in Oman

5.1 Issues

5.1.1 Independency

The independence of Shari’a Supervisory Board and Internal Shari’a Department is paramount to enhance the public confidence in the IBE and ensure the IBE achieves the fundamental objective which is compliance with Shari’a rules and principles. Independence for the SSB for example in this case is in the sense of any Fatwa issued by the SSB shall not get any pressure of conflicting interest from the management of the IBE. No individual or group of individuals shall be allowed to dominate the SSB’s decision-making. In many cases in Oman, the customer asks the IBE to show the Fatwa that is issued by the SSB of the Islamic bank showing the product is in compliance with Shari’a. This is important in order to give a sense of confidence and comfort to the customer that the practice of Islamic bank is based on the Shari’a rules and principles. Therefore, to maintain this confidence, the SSB should not be the employees of the same IBE and should not be involved in managerial decisions and operational responsibilities of the IBE.

Therefore, the performance assessment of the SSB members has to be evaluated by the board of directors of the IBEs and not by the management in order to avoid conflict of interest. The BOD shall identify any situations that may impair the independence of the SSB in issuance of decisions. It is the duty of the shareholders and the management of the IBE to strengthen Shari’a governance framework. In some cases, where the management of the IBE has conflict of interest with the SSB and intends to disqualify the SSB member, the management has to get a recommendation from board of directors and subject to the approval of the shareholders in a general meeting. Any resignation or termination of Contract in Shari’a Board should be provided with a valid reason to CBO to avoid conflict of interest.

Similarly, the Internal Shari’a Reviewer acts as an eye of the SSB members in the IBE, where its role is to ensure day-to-day transaction of the IBE are in accordance with Shari’a principles. In order to maintain its independency, the removal of the ISR requires approval from the board of director in consultation with the SSB and notification to the Central Bank of Oman when it occurs with cause of action. However, the CBO does not mention the specific minimum seniority requirement of the ISR in an IBE as it does for the position of Head of Islamic Banking in the Islamic windows which in its Shari’a governance guidelines gives as at least General Manager, Deputy General Manager or Assistant General Manager. This seniority requirement should be in place, for example, the ISR should be at least Assistant General Manager in a full-fledged Islamic bank while in Islamic windows an Executive Manager. Therefore, in many cases the ISR is not able to enforce the Shari’a decision to the related department in case there is non-compliance found in the IBE’s transaction.

5.1.2 Competence

There are various measures given in the IBRF to ensure reasonable expertise and skill-sets in SSB. An SSB member has to have a Shari’a background, holder of minimum
bachelor degree in the field of Shari’a including Usul al Fiqh and Fiqh Muamalat from a recognized university. The SSB member has to be able to demonstrate an adequate understanding of finance/banking, legal and regulatory framework, and Islamic finance/banking. The IBE shall facilitate the SSB to continue professional development by providing member training in finance and banking related matters.

Although with all the requirements stated in the IBRF, some SSB members who have less experience in banking and finance still have difficulty in understanding the nature of the product. Moreover, majority of product development managers in the IBEs is non-Arab speakers resulting in products being designed is in English version, while some SSB members are only able to speak Arabic.

5.1.3 Limitation of Local Shari’a Scholars

Central Bank of Oman is encouraging the IBEs to develop Omani expertise in the Shari’a scholarship as well as Shari’a expertise in the Shari’a department. However, since its establishment, it is not an easy job to find qualified Shari’a scholars who have qualification in Usul al Fiqh and Fiqh Muamalat to sit as SSB member in the IBEs. In order to have Omani Scholarship in the future, CBO has to enforce the IBEs have to have at least one Omani in their SSB members as exceptional case.

In addition to that, CBO also needs to require the IBE to submit the IBE’s plan in developing Omani scholarship and expertise as well as in the Internal Shari’a department within the Islamic bank. Furthermore, CBO has to lower the requirement for Omani who sits as an SSB member as well as in the internal Shari’a department.

5.1.4 Training on Banking Practices

Training for the SSB members and internal Shari’a department is an important issue in order to develop the skills for the Shari’a resources within the Islamic bank. CBO obliges the IBEs to provide all the needed support to facilitate appropriate training of its internal Shari’a resources in order to enable them to carry out their duties with competence. This training plan shall be submitted to the CBO on annual basis (please see IBRF Title 1, Clause 3.13.3).

However pertaining to the training for the Shari’a resources, currently it is difficult to find suitable and appropriate training for the Shari’a resources in Oman. Because the training providers in Oman mostly provide conventional banking system. training. Only limited Shari’a related courses are provided by the College of Banking and Financial Studies (CBFS). Most of Shari’a related trainings are available outside Oman, for example, in Dubai which results in more costs to the Omani IBEs. In many cases, the CBFS cancels the courses due to limitation of applicants for Shari’a courses.

5.2 Challenges

One of the most significant challenge is the additional costs borne by Islamic banking entities in the Sultanate of Oman resulting from additional Shari’a governance elements in their Good Corporate Governance Framework that consist of at least six elements. The additional cost for the IBEs to place dedicated human resources with a
specific requirements set out by the Central Bank of Oman in the IBRF is another challenge for the IBEs in Oman. This obliges the IBEs to hire expatriate from outside Oman to sit in those positions in order to meet the requirements of CBO. Besides, at the same time the IBEs have to manage the Omanisation in their bank by increasing number of Omani staff.

Let us see the position of Shari’a Supervisory Board in the IBEs. CBO requires the IBE to have SSB members who has qualification as Shari’a scholars specialized in Fiqh Muamalah (Islamic commercial jurisprudence). While the availability of Omani Shari’a scholars specialized in Fiqh Muamalah is very limited, therefore, it is very difficult for the IBE to find qualified Shari’a scholars as specified in the IBRF to sit in six Islamic windows and two full-fledged Islamic banks.

Moreover, Fiqh muamalat is still in developing phase and a complicated part of Islamic law as it requires depth actual business and banking experience. Sometimes, local Shari’a scholars may not be appropriately familiar with the concept of Islamic financial transactions. There are different Mazhabs (school of thoughts in Islamic law) in Oman, while the majority of Omanis are Ibadhi, there is Sunni and Shi’a school of thought. Each Mazhab has different interpretations of Shari’a laws. However, Central Bank of Oman has established High Shari’a Supervisory Authority to harmonize the Shari’a opinion among the SSB in the IBEs in the Sultanate. Therefore, Rahman (2006) argues that the limitation of product knowledge and practical banking exposure would create difficulties for Shari’a scholars to understand the objective of the approval of products and services. Even Malaysia, one the pioneer country in Islamic banking, still faces the challenges of shortage of knowledge of Shari’a scholars (Chowdhury, 2015).

In addition to that, CBO suggests that every Islamic bank has to have their Internal Shari’a Department to support Shari’a control of the SSB members on day-to-day basis as the extended hand and eyes of the SSB. The head of Shari’a Department or as they are called “Internal Shari’a Reviewer” has to fulfil the same criteria as of SSB members which is to be a Shari’a Scholar, except that the minimum experience requirement is five years. Since the establishment of Islamic banking in Oman in 2013, to meet the requirement of CBO as given in the IBRF is very challenging. In order to meet with the requirements of CBO for the Shari’a Department which not just for Internal Shari’a Reviewer, but also other key elements such as Shari’a compliance unit, Shari’a audit unit and Shari’a risk control, each IBE has to have their future five or ten years business plan for Omani citizens to sit in this department.

Similarly for SSB position, Islamic bank has to arrange the training plan for local Shari’a scholars to train them in term of practical Islamic banking systems, operations and contemporary fiqh muamalat. This initiative should come from an authority like a central bank in order to force the IBEs to submit future successor plan for the Omani candidate.

6. Conclusion

The primary objective of the paper is to summarize the current practice of Shari’a governance framework of the IBEs in Oman comprises the challenges faced by such
institutions. The current regulation of Central Bank of Oman (CBO) has provided a proper Shari’a governance framework in order to ensure the IBEs compliance with Shari’a rules and principles. Although the establishment of the Islamic banking was a bit late in Oman compared to other GCC countries. A proper Shari’a governance framework is in place that is designed by the expert and the experienced team that adopts best practices of Shari’a governance in GCC and the worldwide in general.

Compared to the pioneer in Islamic banking such as Malaysia which had began Islamic banking since 1991, Oman has forced the IBEs to place the six key elements in their Shari’a governance framework that contains Shari’a Supervisory Board, Internal Shari’a Reviewer (Head of Shari’a), Shari’a Compliance unit, Shari’a Risk unit, and Shari’a Audit unit. Not only that, to strengthen the role of Shari’a, the CBO also issued a regulation for the establishment of Higher Shari’a Supervisory Authority (HSSA) in the CBO to harmonize the opinions related to Shari’a matters among the IBEs. These elements are expected to perform an oversight role on Shari’a matters relating to Islamic banking business activities. However, there are issues and challenges still faced by IBEs in Oman. The paper proposes some improvement for the CBO in order to strengthen Shari’a governance framework in the Sultanate. This proposal requires some modification of the IBRF by the CBO in order to avoid conflict of interest in implementing proper Shari’a governance in the IBEs.

In addition to that, CBO auditor has to be able to identify the currents issues and challenges that are faced by the Internal Shari’a department. CBO also should be able to dig up the potential issues that might affect the internal Shari’a department in performing the Shari’a function within the Islamic bank.
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Managing Displaced Commercial Risk in Dual Banking System: A Challenge Ahead

By
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Mat Noor Mat Zain
Nik Abdul Rahim Nik Abdul Ghani

Abstract
The encouraging growth momentum in Islamic banking in Malaysia has made it the first country to adopt dual banking system wherein Islamic banking exists side by side with the conventional counterparts. The positive developments, via several stages started with a stand-alone Islamic bank in 1983 to the emergence of Islamic banking windows within the conventional banking system, through to the presence of foreign Islamic banks and up to the full-blown appearance of Islamic subsidiaries both for domestic and foreign entities, has led to not only expanded opportunities within the system but also contributed to increasing risk profile of the institutions. Several studies suggested that Islamic banks that operate in dual banking system are exposed to interest rate risk despite operating on interest free basis. The crux of the problem is attributed to the practice of replicating the products to be offered by Islamic banks as used in the existing conventional banking products. The objective of this paper is to discuss the management of displaced commercial risk, a type of risk that arises as an implication from operating in parallel with conventional banks that inevitably exposes the Islamic banks to the rate of return risk. In discussing the challenge in managing displaced commercial risk, the impact of enactment of the new Islamic Financial Services Act 2013 (IFSA) is considered as the profit equalisation reserve (PER) that is commonly practiced in the industry as a mechanism to manage and mitigate such risk and which are no longer allowed under the new regulatory regime.

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empirical studies showed changes in the Islamic financial landscape subsequent to the enactment of the new act whereby the Islamic banks’ deposit products offering is skewed towards commodity based murabahah/tawarruq and has migrated from their investment-based shariah contract products. This among others, is meant to manage displaced commercial risk.

**Keywords:** Risk in dual banking system; Islamic Financial Services Act 2013; displaced commercial risk; profit equalisation reserve

1. **Introduction**

After four decades of subsistence, it is envisaged that the Islamic banks will operate in full-compliance to shariah principles. On this note, the new Islamic Financial Services Act 2013 (IFSA) has been gazetted which marked another milestone for a more stable and comprehensive regulatory framework. In a nutshell, the direct impact of IFSA on the Islamic banking operations is to distinguish between deposits made for saving vis-à-vis those made for investment purposes. The enactment of IFSA is further manifested by issuance of policies and shariah standards to govern the operations of Islamic banks by Bank Negara Malaysia (BNM), being the regulatory authority looking after the stability of financial system in Malaysia.

Islamic banks are established as an alternative for the provision of banking services to Muslim who believe in the prohibition of interest. Notwithstanding that, the positive growth in Islamic banking system could bring efficiency, opportunities and flexibility to the market. The alarming trade-off is that it will contribute to increasing risk profile of an institution if the new business exposures are not properly managed. Consequently, this development has led to a greater need to strengthen the risk management capabilities of an Islamic banking institution. Clear understanding of the risk profile and awareness of risk inherent in the Islamic banking activities is not an option but a must. In this regard, to ensure a continuous stable presence and long-term success of an Islamic banking institution, it is critical to have an effective risk management which is the key principal in managing the financial goal of maximising profitability within the acceptable risk level.

In Malaysia, the implementation and practice of dual banking system is well accepted thus far. Both conventional and Islamic banking institutions are operated in parallel in offering banking services to the public at large. As the first country to adopt such a banking system, it has gained popularity and proven to be a viable system with more sophisticated and competitive products been introduced into the system (Embaya 2013). The operational approach of these dual banking activities is that the products and/or services offered by conventional banks are replicated to be offered under the Islamic banks’ umbrella. Besides, other than sharing banking products equivalent to conventional banks, Islamic banking institutions in Malaysia also share a common customer base within the same overall economic landscape.

Given the conjoining of banking practices in Malaysia, displaced commercial risk is one of the prominent risks that is peculiar to Islamic banking institutions, on top of
generic risk exposures facing the banks. This dual banking practice has rendered challenges to Islamic banks to acquire a fair market share and maintain its customers’ base particularly in relation to its funding requirements as well as assets spread given the competition from the conventional banking institutions. While Islamic banks are prohibited from guaranteeing fixed return and encouraged to operate in a profit and loss sharing basis, conventional banks are steadily standing with complete package of guaranteeing return to depositors or investors.

In view of this pressing needs, BNM via the Framework of Rate of Return (the framework) introduced in 2004, outlined a standard calculation table for managing the allocation of return rates by Islamic banks. At this juncture, the framework has permitted up to 15% of the bank’s gross income to be allocated monthly into the reserve account to stabilise returns to depositors and investors. The maximum accumulated return in this reserve account is capped at 30% of the bank’s shareholders fund. Subsequent to that, BNM has in May 2011, introduced a revised guideline called Profit Equalisation Reserve (PER) to guide in managing the risk of displacement of funds in Islamic banks and maintain a competitive rate of return to customer, with the objective to stabilise the banking system as a whole (Sheila & Syed Ahmed 2013).

BNM also envisions that Islamic banking will continue to garner interest. As a continuous effort to develop Islamic banking industry in line with the aspiration to make Malaysia the Islamic financial hub, the new Islamic Financial Service Act (IFSA) was gazetted on 22nd March and came into effect on 1st July 2013. This new act provides greater regulatory and supervisory powers to BNM to counter future risks to financial stability, increase consumer protection and promote competition in the financial services sector.

2. Risk Management in Islamic Banking

Risks are undesirable events and uncertainty in regard to conditions occurred that influence and affect the achievement of the bank’s objectives. A risk which is left unattended may expose the bank to huge losses and may potentially lead to the downfall of the bank. Risk in Islamic banks are unique and complex due to the underlying transactions in financing activities, the intermingling of more than one risk in a financing arrangement, change in nature of risk from one form to another at different stages of contracts/transactions and the scarceness in infrastructure that resulted in the risks exposure being difficult to manage and mitigate (Habib & Tariqullah 2007). However, in general, Islamic banks are exposed to several types of risk namely systemic risk, liquidity risk, credit risk, solvency (capital) risk and currency risk similar to conventional banking institutions. Systemic risks include market risk, mark-up risk and exchange rate risk that arise from unfavourable price movements of benchmark rates, foreign exchange rates and commodity prices.

As taking risks is part of banking business activities, managing these risks is of paramount importance. Moreover, from shariah perspective, the legitimacy of income or profit generated must be substantiated with real economic activities that is associated with risks and liability, in line with a saying of the Prophet on the concept of *al-kharaj bi al-dhaman* whereby entitlement for return on assets shall be accompanied with the risk of
ownership. Any business transactions that are risk-free might give rise to interest-based activities which are forbidden in Islam. Ownership according to the shariah, as cited by Nik Abdul Rahim (2018), refers to the exclusive relationship that affords rights to the owner to benefits from the property in a shariah compliant manner. The main attributes of ownership, namely, liability (daman) and entitlement to proceed when the asset is sold (al-ahaqqiyatbial-thamanindabayal-asl) must be fairly observed.

Although in principle Islamic banks shall be different from the conventional banks due to prohibition of interest/riba and requirement to comply with Shariah principles, findings show that both banking systems are exposed to similar source of risks that lead to credit, market and operational risks (Fauziah, Rashidah & Zarina 2012). However, managing risk in Islamic banks has become very challenging particularly due to its peculiar risk characteristic and sophistication in nature of risk profiles. The underlying shariah principles which form the base for Islamic modes of financing attract risks which are different from conventional products. The intensity of the financial impact of these risks are also slightly different from the conventional banks, particularly in relation to the requirements to operate on profit and loss sharing (PLS) basis as well as liquidity risk (Dadang 2008). Financing products based on PLS contracts such as mudharabah and musharakah expose the bank to risks normally borne by equity holders instead of holders of debts.

It is also critical to note the specific risk associated with non-PLS based products such as financing under ijarah or salam contracts. Financing based on ijarah contracts refrain Islamic banks from transferring substantial risk to customers as ownership of the leased assets remains with the bank throughout the lease period, which then exposes Islamic banks to both market risk and credit risk (Seyed Nezamuddin t.th). While salam based financing transactions expose the bank to credit and commodity risks at the same time.

The risk profile of an Islamic bank can be outlined as below:

Source: Bank Islam Malaysia Berhad.
As banking activities are directed by the risk appetite statement of the bank, all risks identified arising from such activities need proper management and control in order to contain them within the banking institutions’ risk tolerance level. Managing risk is a process to control possibility of losses arising from pure and speculative risks. According to Irawan and Rahmatina (2007), Islamic risk management is about risk and uncertainties of business outcomes. The financial risks arising from credit, liquidity and settlement for instance, are manageable and within control, while market risks involving among others price, regulatory, legal or product risks are systematic risk which are beyond control. The presence of risk in contractual obligations or ghorm which derives from the legal maxim al-ghormbilghnom (no pain no gain) is acknowledged in Islam (Rosly 2005).

Risk management is acceptable in Islam, in line with the objectives of maqasid as-shariah that includes among others the aim to preserve wealth (hifzulmaal). The need for effective risk management is critical to protect transacting parties from any risk that may harm and endanger their lives. Under the shariah principle of mudharabah for instance, it is allowable for the transacting parties to specify investment project to reduce the risk of loss (Nurhafiza 2015). This allowance is in line with the concept of risk management as outlined in the Quran, Surah Yusof verse 67:

وَقَالَ ﷺ ﻟَا تَدْخُلُوا ﺷَرْكًا وَلَبَدَأْ خَالِدًا ﻣِنَ ﺍﻟْمُؤْذِنِينَ ﻓَإِنَّ اللَّهَ ﻟَا يُؤْمِنُ ﺑِهِمُ ﻣَنْ أُمِرْتُ ﻋَنْهُ ﻋِنْدَكُمْ ﻳُؤْمِنُ

The verse says:

And he said, "O my sons, do not enter from one gate but enter from different gates; and I cannot avail you against [the decree of] Allah at all. The decision is only for Allah; upon Him I have relied, and upon Him let those who would rely (indeed) rely."

The techniques used to manage risk in Islamic banking are not significantly different from conventional banks as both banking system face the same generic risks, despite the fact that the nature of risks in Islamic banking is different. Notwithstanding, there are some additional risks specific to Islamic banking institutions that require different types of risk treatment and management to ensure compliance with the objectives of shariah (Syed Ehsan & Ruslan 2015). Salman and Amanat (2009) shared the views of Luca Errico and Mitra Farahbaksh that although supervision of Islamic banks by the respective regulatory authorities tends to follow conventional standard, there is a divergence between Islamic banks and conventional counterparts in several ways. The underlying shariah contracts applied in Islamic product structures attract different risk characters and exposures to the Islamic banking institutions.

The basic concept of mudharabah contract, for example, outlines that both mobilization and utilization of funds shall be on the basis of profit sharing among the bank, customer and the entrepreneur. However, there is differed practice as the funds are mainly applied by means of commodities and assets financing instruments that avoid interest but it is not a kind of profit sharing (Irawan & Rahmatina 2007). Managing credit risk in a mudharabah based product is also challenging due to the nature of such product whereby no penalty can be imposed in the event of customers defaulted or negligence
unless the case has been proven. **Mudharabah** contract also prohibits the bank’s involvement in the management of the project which created further difficulties in assessing risk associated with such financing. In addition, the lack of mechanism to determine losses resulting from **mudharib**’s negligence as well as asymmetrical information and low transparency heighten risk in Islamic banking institutions (Aisyah & Shahida 2010). Hence, in view of this unique products’ nature, Faridah and M. Ishaq (t.th) urged that different risk identification and management process, methods and techniques as well as supervision approaches shall be adopted.

Rahisam et al. (2016) stated that the specific risk associated with Islamic product structures which shall be in compliance with shariah principles, require Islamic banks to have in place innovative ways to manage and mitigate these risks. Unfortunately, as there was no clearly defined risk management framework for Islamic banks, Islamic banks mimic those practices used by conventional counterparts (AIF 2013) to manage their risks. Irawan (2011) also concluded that in managing risk such as credit, market, rate of return risk as well as operational risk, Islamic banking institutions should be involved in the process of identifying, measuring and monitoring as well as reporting and control of such risks. Adequate capital should be held in addition to setting and defining clear strategy and objective for such a business or investment decision that exposed the bank to commercial risks. Monitoring and assessment of transformation risks, periodical review of policies, procedures and management structure, appropriate framework for pricing, valuation and portfolio management as well as funding and capital plan shall be in place to manage these risks.

### 3. Displaced Commercial Risk in A Dual Banking System

The growth and development of Islamic banking in Malaysia undoubtedly is manifested by strong involvement and contributions by conventional banks that have promoted Islamic banking products and services to the public via extensive market outreach. However, the strategy to make Islamic banks operating side by side with the conventional banks has created commercial pressure and led to competition among the two sectors. Islamic banks are exposed to interest rate risk despite the interest-free principles that is the backbone of the Islamic banking operations. Mohamed Ariff (2014) suggested that there is less interest in risk sharing that forms the substance of Islamic banking due to, among others, the risky nature of such arrangements. The focus of Islamic banks has skewed towards substituting the conventional products with one of shariah compliant and resembling such features and pricing so that the returns are competitive and compatible with the conventional banks. Exposures to withdrawal risk is one of the reasons that pushed the Islamic banks to pay higher returns surpassing the actual performance or return earned on the assets financed by the customers or investors’ funds.

The risk of withdrawal arises from the product structures based on **murabahah**, **ijarah**, **salam** and **istisna** that charge fixed payment. The mark-up rates are beyond the Islamic banks’ control as they compete with interest bearing conventional products that coexist within the system. Any changes in the market rates may result in Islamic banks facing withdrawal runs. Although Islamic banks can employ return smoothing tool by
transferring shareholders’ return on investments to the investors, such practices have only been affected within a certain range of market fluctuation. In addition, mismatch of assets and liability is also pressing in Islamic banks, whereby depositors/investors are always looking at higher returns in shorter tenure vis-à-vis the credit utilizing customers who are expecting lower cost to serve their obligation within a longer period. In this respect, it has been the usual practice of Islamic banks to pool deposits into several maturity segments and utilise accordingly in the credit granting process. As Islamic banks earn their living from profit sharing with customers, returns to each pool may be adjusted by changing the sharing ratio to meet the objective of the bank and it is up to the Islamic banks to change the ratio in favor of the depositors as long as shareholders have consented to such exercise for the sake of their business. The issue may however, arise if such reduction is done among different deposit pools with different degrees, then rights of deposit holders are violated (Hassan & Dicle 2005).

Given the banking alternatives available to the customers, movement in the interest rate in conventional banking sector will have implication on the activities of Islamic banks as customers can easily switch between the two systems to arbitrage on the rate eccentricity. In this regard, the deposit rates have to be risen to match the high expectation of Islamic banking clientele on the returns from their deposits and investments in order to mitigate withdrawal risk as well as part of liquidity management strategy in the event of raising interest rates in the conventional market. The lower returns on deposits or investments may lead to the outflow of these funds from the Islamic banking system, hence triggers liquidity call among others. As such, the deposit rates in Islamic banking system must change when there is change to such benchmark rates in conventional banking since rate differentials shall prevail leading to arbitrage opportunity (Obiyathulla 2004).

A research by Noraziah, Roza and Ahmad (2015) revealed that, empirical analysis by Archer et. al (2010) and Toumi et. al (2011) had evidenced a significant amount of return smoothing and absorption of risk by the bank capital following the need to induce confidence among investors. The paper also highlighted a study by Khan and Ahmed (2001) which concluded that the most critical risk faced by Islamic banks which is hard to manage is rate of return risk as it stems from other banks’ business decision. Further, the discussion also pointed that Islamic banks are strongly exposed to massive withdrawal risk due to lower returns on investment deposits and this explains the increased contribution to the reserve account for payment to investors or funders.

Similar to conventional banks, Islamic banking institutions’ source of funds are also derived mainly from depositors or investors’ money. Baldwin and Sukmana (2016) shared that returns paid to profit sharing investment account holders are benchmarked against the return paid on deposit rates in the conventional market. Consequentially, the dual banking system in practice has triggered the need to ensure stable return to the funds’ holders or to even exceed the bank’s contractual return obligation on investment accounts based on mudharabah assets in order to prevent risk of withdrawal. Their study on hedging of displaced commercial risk in Islamic banks in Indonesia also indicated high positive correlation between conventional deposit rates and Indonesia Islamic interbank rates.
Accordingly, Zairy and Salina (2010) raised the point that rate of return in Islamic banks are cointegrated and respond significantly to changes in the conventional interest rates. Rising interest rate have caused Islamic banks to go with the market trend by raising the deposit rate in order to overcome implication from potential withdrawal that may lead to liquidity issues. The discussion also revealed that customers are driven by profit motives which influence their decision whereby higher deposits in Islamic banks are evident when the rate of return increases. The negative relationship between interest rate and Islamic deposits have led to the displaced commercial risk as a consequence of rate of return risk. Chong and Liu (2007) also shared that the returns on Islamic deposit accounts are effectively pegged to the returns on conventional deposit products to remain competitive. However, contradictory to the way the Islamic banks reacted, changes in Islamic products rate do not implicate the rate offered in conventional banking.

Khairul, Shamsher and Mohamed (2016) also found that profit rates of Islamic banks are significantly linked with the movement in the interest rates in conventional banking system which is probably due to competitive pressure. Their finding highlighted triggers to displaced commercial risk as large proportion of customer of Islamic banks are non-muslim who seek to earn higher returns irrespective of the type of banking system. In a study by Sudin and Norafifah (2000) on the effect of interest rates of conventional deposit accounts and dividend rates of Islamic deposit funds of Malaysian banks, the writers concluded that customers placed deposits in saving and investment accounts guided by a profit motive. This study had evidenced the concern on displaced commercial risk wherein the interest rate offered in conventional banks will have negative relationship with the level of deposits or investment in Islamic banks. Sudin and Norafifah also shared a study conducted in Malaysia and Singapore that revealed religion and profit as the reason for people to maintain their relationship with banking institutions. Hence, to mitigate the risk of commercial pressure, it is vital for the management of Islamic banks to know the objective and mentality of fund providers that influence their decision to deposit and invest money.

In reality, it is a common commercial decision for Islamic banks to waive their profit portion into the reserve accounts as a mean to smooth returns payable to the investors and shield the Islamic banks against withdrawal risk. The banks forgo part or all of their share of profits on the customers’ funds and/or make transfer from shareholders’ fund investment profit to customers in order to retain and deter withdrawal of funds and hence to a certain extent manage the displaced commercial risk. Islamic Financial Services Board (IFSB) also stated that the withdrawal risk is managed through the transfer or practice of foregoing part or all of its mudharib share of profit on such fund to fund providers or investors.

In addition to commercial pressure, Islamic banks in some countries like Qatar and Malaysia are also required by the supervisory authority to adopt return smoothing mechanism as a mean to manage variability in returns. Mohammad Omar and Sowmya (2012) revealed that the recognition of displaced commercial risk has triggered the need for Islamic banks to set capital buffer to absorb such risk. In relation to this, IFSB has outlined the calculation methods for capital to be set aside to account for the displaced
commercial risk. The first standard model advocated by IFSB is based on the assumption that investors assume all risk for their investment account, hence assets funded by investors’ funds are excluded from capital calculation. While the second method involved uses supervisory discretion formula that considers a proportion of $\alpha\%$ (value between 0 and 1) of the assets funded by investors not being absorbed by investors. This study concluded the need to have the necessary data to facilitate management of displaced commercial risk.

In contrast, the study by Kaouther, Viviani and Belkacem (2011) has proposed an alternative method to determine the additional capital required to cover the displaced commercial risk which involved modelling the displaced commercial risk to the value at risk rather than applying the same proportion of risk-weighted assets funded by investors as suggested under the IFSB calculation techniques.

4. The Challenges Facing Management of DCR

Return to depositors are determined upfront and guaranteed in conventional banking practice, while for Islamic banking that operate in full compliance with shariah principles, return is indicative and prohibited to be pre-agreed. During periods of under-performance whereby Islamic banks generate slim profits to be shared with depositors and investors, the risk of funds outflow to competitors is undeniably high as what is payable shall be of actual profit. In this regard, it seems like return on assets is more volatile in Islamic banking operations. This situation is further pestering in dual banking system practices in Malaysia as customers have alternative to switch between the two systems for solutions to their banking needs. If the rate of return on investment has shown a contradicting trend to the investors’ return expectation, the investors will withdraw their funds and place it elsewhere, including in conventional banks, which thereby may subject an Islamic bank to funding and liquidity risk and to the extreme end lead to potential failure.

In response to this, it has been in practice for Islamic banks to allocate certain percentage of profit generated from investment accounts’ activities or portion of shareholders’ funds as reserve by the bank (Noor Fadhzana 2016). The creation of reserve accounts, either PER or investment risk reserve, is meant to protect Islamic banks from the systemic risk embedded in a dual banking system and prevail over displaced commercial risk, to entice investors and fund providers to Islamic banks. Specific is the application of PER as a mechanism to smoothen returns to customers. Several studies highlighted this common practice by majority Islamic banks that place reliance on this reserve account to mitigate withdrawal risk and manage the uncertainty in returns to customers.

Raudha, Shahida and Abdul Ghafar (2012) found that based on sample study on fifteen commercial banks that offer Islamic banking services, PER has been used to stabilise returns to depositors and that capital management is an important determinant for PER. The negative link between PER and total capital suggests that banks with lower capital tend to increase the PER in order to increase the capital requirement. However, this study did not cover the practice for provisioning of PER by other financial institutions namely developmental financial institutions and cooperative banks that offer Islamic banking services.
Despite the wide usage of this smoothing method by Islamic banks, there are discussions on the lapses and issues surrounding the practice. Tariq and Aroua (2017) opined that although the application of PER is critical to manage displaced commercial risk, any lag in managing, monitoring or clear guidance on implementation of PER may lead to possibility of unmannerly abuse or manipulation on the part of Islamic banks for their own benefits as they have absolute control over the funds. The practice of PER is not practical and defeats the shariah principle due to transparency issue whereby in some cases investors were not informed of the maintenance of such reserve or the manner the amount apportioned from their profit sharing was managed. This ambiguity may tantamount to non-conformance to IFSA wherein Ruzian (2013) in her reviews of the act stated the need to ensure an ethical and professional business conduct in dealing with customers. Ruzian quoted the requirements to ensure transparency and disclosure of adequate and accurate information as well as fair treatment and contract terms with the customers as emphasised via BNM’s standard on market conduct. Aroua (2017) further added that PER has defeated the principle of mudharabah that provides for profit to be returned to the mudharib in full, while loss is to be shared accordingly. In this case, PER takes portion of customer’s profit with no permission and to a certain extend guaranteeing minimum return to customers.

There is also deviation in term of treatment of PER or investment risk reserve by standard setting bodies such as Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and IFSB. AAOIFI recognises the said reserves as Tier II capital as against the IFSB’s capital adequacy standards which provides for the reserve as deduction from the risk weighted assets funded by customers (Sundararajan 2008). Besides, in addition to the existing critics on the application of PER to manage rate of return risk, the Islamic financial institutions act legislated in 2013 had triggers further concern and attracted special attention of the industry players. The new act clearly defines that funds receive for investment purposes, including for provision of financing services shall be free from any implicit or explicit obligatory requirements in terms of return on investments. To the worse end, investors or fund providers may lose all the money placed for investment as stipulated pursuant to Section 2(b) of the act.

Although the imposition of the new act is timely in order to enhance shariah-compliance in banking practice, it has resulted in causing difficulties in managing displaced commercial risk as the bank can no longer apply income smoother to retain customers and remain competitive in the market. As evidenced in many studies, Islamic deposits or investments are negatively correlated with the interest rate offered in conventional banking system. This situation is alarming and hence finding an alternative to retain customers and to manage withdrawal risk is vital. Additionally, as the funds for investments are no longer guarantee by PIDM and PER is no longer available pursuant to the new act, the risk of fund outflows to other financial institutions, including to conventional banks is high. The situation is further compounded given profit motives are also the main driver as deposits determinants.
Abdul Ghafar, Nik Abdul Rahim and Mat Noor (2013) suggested that the introduction of IFSA causes changes to Islamic banks’ contractual features wherein it draws distinctive forms between deposits and investment activities depending on the shariah contract applied. The *mudharabah* or *wakalah* based-products shall not be capital or principal guaranteed as it is deemed contrary to the ‘investment nature’ of such shariah contracts. Hence, for deposit-taking activities based on *mudharabah* or *wakalah*, Islamic banks are forced to initiate new products as replacement. Likewise, PER which is commonly applied to smoothen returns is not allowed as IFSA has explicitly forbidden such practice. In relation to this, the establishment of effective risk management processes or procedures to manage displaced commercial risk is imperative, while guidance and parameters to effectively measure, mitigate and control such risk shall be in place.

Besides, the Islamic banks shall also consider the worst case scenario, should liquidity run occur following massive withdrawal in the event of adverse movement of interest rate in the conventional banking system. In relation to this, formulation of the bank’s capital and funding plan shall include reasonable assumptions and stress testing scenarios for withdrawal and displaced commercial risks based on the risk profiles and business portfolio of the particular banks. A well-defined and prudent investment strategy incorporating diversification and tactical assets allocation shall also be established with the aim to maximise profit and stabilise returns on investment to the investors. This extent of exercise however requires skill, competencies and capabilities to position the management of displaced commercial risks within the appropriate continuum of the bank risk appetite and risk management system.

Knowledge on Islamic banking products, customers and employees’ attitude as well as the practice of Islamic banks are also areas that post challenges in managing displaced commercial risk. Post implementation of IFSA, Islamic banks’ strategy is noted to be slanted towards commodity *murabahah* based products that can offer upfront profit and guarantee by PIDM. Research revealed that Hong Leong Islamic Bank Berhad and Alliance Islamic Bank Berhad had experienced increase in commodity *murabahah* accounts and marginalised their investment portfolio (Azharul & Mohammad 2017). In this respect, it is noted that instead of managing market risk, Islamic banking institutions had rather resolved the situation via deployment of new products based on *murabahah* and dodged the investment-based products. This market reaction may reflect the ‘avoidance’ of unnecessary risk which is hard to manage as a result of the enactment of the new act. According to Irawan and Rahmatina (2007), the banks’ low risk appetite, additional cost of monitoring the investment instruments and lack of transparency within the operating environment for Islamic banks are among the several reasons for Islamic banks to avoid offering investment products.

**5. Conclusion**

Managing displaced commercial risk has become more challenging subsequent to the enforcement of the new act. With a clear distinction between money placed for saving and investment purposes, Islamic banking institutions have formulated a mechanism to ensure stable returns to the investors or to face consequential risk of losing their
Managing Displaced Commercial Risk in Dual Banking…….

customers. Several previous studies on the application of both conventional and Islamic banking system in Malaysia revealed that the Islamic banking products tend to mimic the products offered by their conventional counterparts. Following this, due to commercial pressure, Islamic banks offer returns at a rate comparable to the conventional banking system that may exceed the actual rate earned on the assets financed by the investors’ funds. This competitive pressure from the conventional banking institutions constrains the actual profit and loss sharing principle that forms the backbone of Islamic banking operations.

With the disbanding of PER or other income smoothing tools post IFSA, coupled with absence of guarantee by PIDM on the investment-like deposits, the expectation is on risk management of the bank to have in place an effective risk control system to manage displaced commercial risk. Islamic banks should be more prudent and stringent in their assessment and policy direction related to investment portfolio and to also have in place a policy framework to manage stakeholders’ return expectations. In this regard, clear parameters on the utilisation of customers’ fund, close monitoring on fund performance, benchmarking and trend analysis on returns on investment as well as transparency and disclosure are the areas which are to be given due attention. Relevant training and Islamic banking technical exposures should be emphasised on development of human capital to man certain critical roles within the Islamic banks. Additionally, market survey should be conducted to study customers understanding on Islamic banking operations, its products and services as well as to understand the return expectation and factors that influence customers’ behaviour. Clear understanding of Islamic banking operations shall be the bridge between religious and customers’ commercial transactions, driven by the belief in the repercussions in life in the hereafter.

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Country Model

Lebanon *

Lebanon’s economy follows a laissez-faire model. Most of the economy is dollarized, and the country has no restrictions on the movement of capital across its borders. The Lebanese government’s intervention in foreign trade is minimal. The country has been a victim of regional conflicts and a domestic political stalemate, which deeply impacted the republic’s financial and economic well-being. While the country has seen brief respite in 2015, its Islamic banking sector is still struggling to find its footing.

Islamic Banking & Finance

A prominent feature of the Lebanese banking system is the strong presence of foreign banks in the country, particularly Arab banks. While figures vary in the range of 60-90 institutions, the complete list of banks provided by the Central Bank of Lebanon (Banque du Liban) names 141 banks (including the now-defunct Bank Al-Madina). Out of the figure, five of them are full-fledged Islamic banks: (i) Iraq’s Al-Bilad Islamic Bank for Investment & Finance; (ii) Bahrain’s Al Baraka Bank Lebanon; (iii) Arab Finance House; (iv) BLOM Development Bank; and (v) Lebanese Islamic Bank. Lebanese Islamic was the country’s first Shariah compliant bank that got established in 2005, following the official gazette of Law No. 575 on 11th February 2004 which allowed the creation of Islamic banks.

The banking sector is still highly liquid and profitable: as at the end of August 2017, the country’s commercial banks’ total assets stood at US$213.56 billion compared with US$197.62 billion a year before. Banking deposits continued to increase at an annual average rate of 4.5% and reached US$192 billion by mid-2017. However, the country’s Islamic banking industry is still below 0.2% (US$ 300 million) of the total deposits of the overall banking sector in 2017.

Regulatory Environment

Overall banking activities are also subject to both the Code of Commerce (1942) and the Code of Money and Credit (1963). However, Shariah banking regulations were effective through official gazette of Law No. 575 since 2004. Regulations dictate that half of Islamic banks’ assets are to be invested in Lebanon, and a three-member Shariah consultative body is required to approve and monitor Shariah compliance. However, after 14 years, the industry is still struggling to grow due to, among others, the legal status regarding foreign ownership and value-added tax rules.

Industry participants have long called for more comprehensive and enabling Islamic finance regulations including the removal of double taxation and stamp duty and the implementation of laws that are conducive for equity-type financing as current regulations are restrictive and do not accommodate a variety of transactions. However, Islamic banking products can only be offered through stand-alone entities as window operations are not allowed.

* Source: State Bank of Pakistan, Quarterly Islamic Banking Bulletin Jan-Mar 2018
Takaful

Lebanon’s Takaful sector dates back to 2001 when Al Aman Takaful Insurance (previously known as Main Insurance Company) was established. Part of Al Baraka Group, it is the country’s only full-fledged Takaful player. The insurance market is dominated by conventional insurance providers. However, there are several Lebanese insurance companies involved in the Islamic insurance business abroad including:

Libano-Suisse (through Libano-Suisse Takaful Egypt) and Lebanese Delta Insurance Holding Company, which acquired Solidarity Family Takaful’s unit in Egypt in 2012.

Conclusion

The outlook for Islamic banking is optimistic and Islamic banks operating in Lebanon will likely take the lead in financing service sectors and investment projects. Government support for Islamic banking is vital and will give more assurance to potential investors in this important emerging sector. Developing Shariah-compliant asset and wealth management services is considered as one among potential areas of overall industry’s growth of the country.

Sources of Information

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Book Review

**Title:** The Price of Inequality  
**Author:** Prof. Dr. Joseph Stiglitz  
**Publisher:** W. W. Norton and Company  
**Reviewed by:** Dr. Salman Ahmed Shaikh

Prof. Dr. Joseph Stiglitz is a Nobel Prize-winning economist who teaches at Columbia University. In his book “The Price of Inequality”, Stiglitz argues that inequality is self-perpetuating, that it is produced by the vast amount of political power the wealthy hold to control legislative and regulatory activity. Thus, he affirms that political power translates into economic power and thus explains lack of political will and inaction to reduce perpetuating inequalities in the market economy.

Stiglitz blames rent-seeking for causing the inequality, with the wealthy using their power to shape monopolies, incur favorable treatment by the government, and pay low taxes. The end result is not only morally wrong, but also hurts the productivity in the economy.

The noted Professor and 2001 Nobel Laureate promotes the idea that a free market is good for society if it is competitive. Stiglitz states that the government needs to regulate it to be beneficial. If that does not happen, the powerful corporations will use leverage to profit at the expense of the majority. According to Stiglitz, concentrating market power in too few hands is just as bad as excessive regulation.

If we contrast these viewpoints with Islamic economics, there is no fixed compensation to capital in the Islamic economics framework. Hence, the capital has to be used in some production process to earn its reward out of actual net payoffs arising from a production process. This will have positive effects on the distribution of income as well as wealth. With no fixed compensation to capital and together with a tax on idle capital, the capital would be directed towards production activities enabling the households to get more employment opportunities rather than to rely on subsidies and poverty reduction grants.

Unlike in a capitalistic system, capital will not add a burden factor, i.e. interest cost in the production process. It will get compensation from the actual profits earned rather than adding to the cost of productive activities. Through the above features, efficiency as
well as equity can both be adequately addressed and obtained without having to rely on force, exorbitant taxes, and unnecessary government intervention.

Furthermore, at the institutional level, Islamic institution of Zakat redistributes wealth and income in the society from the rich to the poor. Zakat on wealth checks both income as well as wealth inequality. The institution of Zakat levies a special tax on cash, cash equivalents and capital in excess of need that makes sure that the money circulates and is used in the productive activities. Tax on cash and capital will force the people to invest their money in productive uses. With the prohibition of interest, this money will only go into business, either with the start of one’s own business or equity participation through Mudarabah, Musharakah and joint stock companies. Islamic modes of financing like Mudarabah and Musharakah allow pooling of capital on the basis of competence rather than repayment capacity as in debt financing. Hence, by reducing the scarcity of capital as a barrier to entry, these modes of financing can help in increasing the extent of competition in the market to reduce efficiency loss, prices and concentration of profits.

The institution of Waqf encourages perpetual charity so that it becomes a sustainable and long-term source of benefit for the society. On the other hand, Islamic inheritance laws ensure that wealth circulates from generations to generations widely among the various relatives of the deceased. In this way, wealth concentration is checked in each household unit in each generation.

Interest-based monetary system filters capital availability by providing it mainly to the capitalists who already possess the capital. Hence, it benefits the capitalists rather than enterprising people who have skills and determination to work and engage in productive enterprise. Increased income inequality, poverty and below full employment use of real resources results from artificially making capital scarce. Islam disregards privilege to money capital in the form of interest. It links the payoff paid to the factors of production with the outcome of the productive enterprise or productive use of real assets in a real economic activity. Resultantly, the capital circulates in the economy and gets invested rather than remaining idle since idle money capital deserves no compensation in the Islamic economic framework. Thus, Islamic teachings and institutions have substantial potential to solve the problem of poverty and income inequality within the market by influencing market dynamics as well as through the vibrant social sector institutions.
### Income Inequality in OIC Countries Measured by GINI Index (2017)

<table>
<thead>
<tr>
<th>Country</th>
<th>2017</th>
<th>Country</th>
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<td>26.90</td>
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