# ISLAMIC ECONOMIC STUDIES

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**Articles**

# Islamic Research & Training Institute (IRTI)

## Establishment

The Islamic Research and Training Institute (IRTI) was established by the Board of Executive Directors (BED) of the Islamic Development Bank (IDB) in conformity with paragraph (a) of the Resolution No. BG/14-99 of the Board of Governors adopted at its Third Annual Meeting held on 10th Rabi-ul-Thani, 1399H corresponding to 14th March, 1979. The Institute became operational in 1403H corresponding to 1983. The Statute of the IRTI was modified in accordance with the resolutions of the IDB BED No.247 held on 27/08/1428H.

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B. Develop and coordinate basic and applied research for the application of Sharīʿah in economics, banking and finance.
C. Conduct policy dialogue with member countries.
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F. Provide learning and training opportunities for personnel engaged in socio-economic development activities in member countries.
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H. Collaborate to provide policy advice and advisory services on the development and stability of Islamic Finance and on the role of Islamic institutions in economic development to member government, private sector and the NGO sector.
I. Develop partnership with research and academic institutions at OIC and international levels.

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# ISLAMIC ECONOMIC STUDIES

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# ARTICLES

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# Fiscal and Monetary Policies in Islamic Economics: Contours of an Institutional Framework

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**Abstract**

*This paper summarizes salient features of the existing thinking on fiscal and monetary policies in the Islamic economics literature. It outlines institutional framework for these policies from the Islamic economics perspective. The nature and role of government, in the light of the Sharīʿah principles, are revisited. The general goals for macroeconomic policies are discussed along with separate goals for each of the two policies. The argument is capped with a look at practical considerations in the actual working of both the policies. The following are the main points in the paper. (1) Roles of both the policies shall be complementary in the context of the overall objectives at the state level. (2) Thrust of both policies would be different from that presently recognized. These conclusions are drawn in the context of the government's role being limited to prudent governance and the society's economic and distributional concerns being addressed as much as possible without adopting the budgetary channel.*

Keywords: Fiscal Policy, Monetary Policy, the Sharīʿah, Government
JEL classifications: E62, E52, H11.

## 1. Introduction

Islamic economics project was launched by Muslim economists in 1976 with the holding of the first international conference on the subject in Makkah. The main constituency of this initiative was the Muslims. Speedy development and

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quick recognition required focus on issues of practical significance for Muslim countries at that time. Accordingly, economic development, income distribution, poverty and macroeconomic policies were part of the initial research agenda. Fiscal and monetary policies were thus among the subjects that attracted attention of Islamic economists quite early. This happened when contour of the subject of Islamic economics were yet to be defined. Two international seminars on monetary and fiscal economics of Islam were held at Jeddah and Islamabad in 1978 and 1980, respectively. Since then the discourse on these themes coincides with the development of Islamic economics in general.

Fiscal policy works through the government budget in a country. “Government” includes national, provincial/state, county/district and other local governments. However, the literature on fiscal policy generally focuses on fiscal action by the central government. Fiscal policy works through expenditures, taxes and subsidies at the government level. Sometimes public debt also becomes a guiding consideration. Monetary policy is concerned with monetary management by the monetary authority in a country. It revolves around volume of liquidity—purchasing power—in an economy. It works through the volume of money supply (high-powered money) and variations in the rates at which resource-surplus and resource-short units in the economy carry out their exchanges, whether directly with one another or through financial intermediaries.

Traditionally executing authorities for both the policies are different: the treasury, *alias* government, for fiscal policy and the central bank for monetary policy. Linkage between both the policies is recognized in the mainstream economics literature. But that is limited mostly to the case of deficit financing when government expenditure is not tax-financed. In such an instance, the monetary scene is affected by either injection of fresh money supply into the economy or shift of resources from the private sector to the public sector through public borrowing.

Where do the things stand in this regard from the Islamic economics perspective? And, what is the likely line for further research? This study looks into these matters. Organization of the argument is as follows. State of the existing thinking is briefly reviewed in section 2. Survey of the literature reveals gaps in the area of institutional framework for these policies. Accordingly, the issue of institutional framework is dilated upon in section 3. Among other things, this includes nature and role of government in the light of the Sharīʿah principles. In section 4 the goals of macroeconomic policy, in general, and those of fiscal and monetary policies, in particular, are separately discussed. The argument is capped in section 5 by addressing some practical considerations in the actual working of the two policies. This is followed by some concluding observations in section 6.

## 2. A Selected Literature Survey

International conferences and seminars have played defining role in the development of literature on Islamic economics. This is more so in the case of the subject of this study. The process of these symposia involves issuance of a call of papers along with identification of topics for research, writing of papers on the approved themes and presentation of the approved papers by the respective authors. The entire exercise is completed in a set time-frame. It is also pertinent to mention that during the formative years of Islamic economics a select group of Islamic economists was involved, either directly or indirectly, in the organization of the said conferences and seminars. All these factors have had great impact on both the direction and the nature of the research effort. Three broad features characterize the work done on the subject of monetary and fiscal policies:

1. Fiscal and monetary policies have been subjects of separate inquiries. The respective Islamic economics literature has, therefore, developed separately for each policy. This, in turn, has had the following result. The argument and the conclusions for both the policies do not rest on common institutional set-up and policy goals.
2. The audience of Islamic economists has generally been the Muslim countries. Therefore, the ground realities and the needs in these countries played a role in their articulation of Islamic economics. They highlighted importance of *zakāh*, prohibition of *ribā* and role of the voluntary sector in the economy (*see below*). However, they did not fully spell out the macroeconomic framework from the Sharīʿah point of view for these policies. That is, institutional framework of the economy, nature and role of government, the policy framework and the goals of macroeconomic policies.
3. Distinction between state and government is not maintained in the discourse.[1]

In fact, the positions actually taken are close to those already held in conventional economics. An interesting feature of the existing literature is that in the early stage of development of Islamic economics, fiscal and monetary policies

[1] See, for example, Faridi (1983) and Siddiqi (1996).

were subjects of separate studies. In the late 1980s and early 1990s that some analytical papers were published with the focus on calculating policy multipliers for either one or both the policies.[2] Likewise, there have been some studies focusing on implications of *zakāh* for an economy.[3] The focus of this short survey is on conceptual matters related to fiscal and monetary policies. Accordingly, the said works are excluded from this survey. With the growing interest in Islamic banking and finance, trend of most of the works again turned to analysis of monetary policy alone. In what follows, we separately look at the state of thinking on fiscal and monetary policies.

### 2.1. *Fiscal Policy*

Faridi (1983, p.28) attributes the following socioeconomic goals at the state level for fiscal policy:

1. Justice and equity
2. Provision of socioeconomic needs of the community or socioeconomic welfare
3. Enhancement of the community's economic resources or economic growth
4. Improvement in the cultural milieu of the society

He contends that Islamic economy would be a three-sector economy consisting of traditional private and public sectors as well as a voluntary sector. He goes on to note that the state (by which he means government) shall perform traditional allocation, stabilization and distribution roles. In his view, *zakāh* and voluntary charity would provide anchors for distributive purposes.

Salama (1983) also assigns stabilization, distribution and regulation goals to fiscal policy. To this extent he is no different from recommendations in the mainstream economics literature. But he also adds a fourth goal: economic growth. He also touches upon revenue and expenditure sides of the Islamic state, and what one might expect for the case of the existing Muslims countries.

Metwally (1983) makes no major addition to the above points. He mainly discusses mechanism for fiscal policy in an Islamic economy and effects of *zakāh* levy on selected macroeconomic aggregates.

[2] See, for example, Tahir (1989), Mahdi and al-Asaly (1991), Sattar (1991) and M.F. Khan (1996).
[3] See, for example, Salama (1982).

Kahf (1983) discusses genesis of an Islamic state, goals of fiscal policy and principles for taxation policy in an Islamic economy.

Siddiqi (1986) focused on public expenditure in Islam. According to his argument, heads of public expenditure from the Islamic point of view will be more or less the same as in any economy in the current age. In a later study, Siddiqi (1993) also presented evidence on public borrowing during the time of the Prophet SAAWS, falling in the period of the first Islamic state, and later Muslim rulers.

Ahmad (1989, 1992) presented a detailed analysis of public finance in Islam. His 1992 paper is a survey of the existing thinking in the area.[4] The 1989 paper, the more important of the two, contains reviews of (i) basic teachings of Islam with a bearing for the discipline of public finance and (ii) fiscal system in the first Islamic state of Madinah. His conclusion is that many of the issues of public finance had precedence during the time of the Prophet SAAWS and his able successors. The main paper gives an outline for public finances in Islam in the modern age. The most striking proposal in his paper is that the distribution or welfare budget is to be based on *zakāh* and to be maintained separately from the rest of the government budget. He also argues that transfers could be made from the main budget to the *zakāh*-based budget, but not vice versa.

Hasan and Siddiqui (1994) examine the stability implications of equity-based financing of government expenditure in an interest-free economy. They replicate similar exercises for bond-financed government expenditure in an interest-based economy. Their study offers no breakthrough at the conceptual level.

This above review captures most, if not all, of the points in the existing literature related to fiscal policy. It is pertinent to mention that when the above writings were penned, advances in the area of Islamic banking and finance were yet to be made.

### 2.2. *Monetary Policy*

In the 1978 seminar in Jeddah, Ariff (1982) and Uzair (1982) made some preliminary observations on the working of monetary policy in an interest-based

[4] While the publication year is 1992, the paper itself was presented in 1987 at the First International Seminar on Islamic Economics for University Teachers organized at the International Institute of Islamic Economics, Islamabad.

economy, and the possibilities in an interest-free economy. During the same seminar, Ahmad (1982) floated the idea of achieving distributive justice through monetary policy.[5]

Chapra led the discussion on the subject in a series of papers and books published between 1983 and 1996. He initially listed in his 1983 paper the following three goals for monetary policy from the Islamic point of view:

1. Economic well-being with full employment and optimum rate of economic growth,
2. Socioeconomic justice and equitable distribution of income and wealth, and
3. Stability in the value of money

He also discussed sources of monetary expansion and monetary policy instruments. One novel proposal in his paper is earmarking 25% of demand deposits with the banks for advancing interest-free loan to government. This may serve as a sort of proxy for reserve requirements for the respective banks as well as a means for financing government needs in the face of shortage of revenue through taxes or interest-based borrowing. Chapra's 1985 book *Towards a Just Monetary System* greatly expands on these themes.

Chapra (1996) also revisited the subject in his paper on monetary management in an Islamic economy published in *Islamic Economic Studies*. This paper presents the case for monetary management in a comparative perspective. Need fulfillment, optimum growth and full employment and equitable distribution and economic stability are some of the recurring themes in this paper. And, the monetary instruments include, among others, statutory reserve requirements, credit ceilings (in particular, goal-oriented allocation of credit), equity-based instruments, changes in profit-and-loss sharing ratio and moral suasion.

Al-Jarhi (1983) made an early attempt to spell out monetary and financial structure of an interest-free economy, and work out monetary policy details. The players are deemed to be central bank, commercial banks and the treasury, of course, with the private sector in the background. Vital details remain obscured due to the use of broad brush. Quite interestingly, loan-based zero-interest debt

[5] During this seminar, Siddiqi (1982) discussed the challenges that Islamic economists face on the financial side and the likely form of Islamic banking. He made only a passing reference to monetary policy.

instruments also find a place in his schema. In his view, "neither the required reserve ratio nor the discount rate exist in such an (i.e., interest-free) economy as policy tools" (p.86). In the end, he upholds the monetarists rule for management of money supply.

M.S. Khan (1986, 1992) focused on the financial side of an interest-free economy, and developed a macroeconomic model in order to study the working of monetary policy in such an economy. He observed that non-guarantee of bank deposits will add to the speed of adjustment in an interest-free economy. Apart from this, he found no difference in the working of monetary policy in an interest-free economy as compared with an interest-based economy.

Khan and Mirakhor (1987) gave a flow-of-funds matrix for an Islamic economy in which the central bank provided equity-based support to banks. However, their analytical model rested on conventional interest rate variable relabeled as an *a priori* variable rate of return. It is, therefore, not surprising that they did not find any difference in the role of monetary policy in an Islamic versus a traditional one economy.

The papers by Khan and Mirakhor (1994) and Choudhry and Mirakhor (1997) have reflection of the advances made in Islamic banking and finance in the 1990s. Khan and Mirakhor highlight the *muḍārabah* mode deposit mobilization, and list financing instruments that might be available in the Islamic financial system. They point out that apart from the Islamic banking system there would also be primary, secondary and money markets. There is great semblance between their thinking and what is available in conventional economics. Of course, the instruments like *muḍārabah* and *mushārakah* certificates are expected to have Sharīʿah legitimacy. They regard macroeconomic stability, characterized by price stability and viable balance of payments position as the chief goals for monetary policy. As for monetary policy, their conclusion is as follows:

> Monetary policy of an Islamic state takes place in a framework in which all conventional tools normally available in a modern economy are at the disposal of the monetary authorities with the exception of the discount rate and other policy tools that involve interest rate. All other tools, namely open market operations (where equity shares rather than bonds are traded) and credit policies, can be as effective in an Islamic system as they are in the conventional Western system. Additionally, the authorities in an Islamic system can utilize reserve requirements and profit-sharing ratios to achieve changes in the stocks of money and credit. (Khan and Mirakhor, 1994, p.19).

Choudhry and Mirakhor (1997) focus on the tools for monetary policy. Their main proposal is use of equity-based government securities with rates of returns based on budgetary surplus for the purpose of monetary management. This study, like the others noted above, does not spell out blueprint of Islamic economy and, therefore, remains silent on the role of monetary policy in Islamization of an economy.

A largely unnoted work in the Islamic economics and finance literature has been *IIIE's Blueprint of Islamic Financial System* (1999). This study explores, among other things, the issue of monetary management of an Islamic economy. It outlines institutional framework for monetary management (including nature and role function of the central bank), instruments available for this purpose and policy choices available to the central bank, in an Islamic economy.

This completes our short survey of the state of thinking on monetary policy. Some other studies also touch on the points relevant for the subject of this inquiry. For example, econometric study of Elhiraika (2004) about monetary policy in Sudan that opted for full elimination of *ribā* from the economy in 1984. Likewise, Iqbal and Khan (2004)'s work on instruments for financing government's budgetary deficit. The points raised in such are only indirectly relevant for the purpose of this study, and are, therefore, not noted here.

In conclusion, the following points sum up the present positions in the field of fiscal and monetary policies in the discipline of Islamic economics. The various positions are not based on proper Islamic institutional framework in order to satisfy the criteria of logic. The objectives of the Sharīʿah, in one way or another, do carry weight in the various positions taken so far. However, the Sharīʿah side of macroeconomic policy is entirely ignored. The Sharīʿah becomes directly relevant when one talks of actually doing something. Here, matters of what can be done, and how become unavoidable. With these remarks, we now proceed to the main aims of this study: the relevant institutional framework for fiscal and monetary policies and the policies themselves.

## 3. Institutional Framework For Fiscal and Monetary Policies

Islamic economics is about solutions to economic issues of real life on the basis of the Sharīʿah principles. The Sharīʿah perspective implies that the Islamic economic solutions will give the best results in a Sharīʿah-compliant institutional framework. As explained hereunder, this does not limit the applicability of the

Islamic economic solutions. These solutions remain applicable in Islamic as well as other settings, whether in Muslim or in other societies. The Sharīʿah-perspective helps to draw attention to institutional arrangements that are not often appreciated in the academic discourse.

According to the Islamic worldview, this life is a test for man. For the purpose of test, Allah SWT gave man free will and allowed private ownership. This, in turn, implies that people can own property and exchange property rights. How can millions and millions of economic agents do so with their free will? The answer is "through the institution of market". It is, therefore, safe to conclude that the Sharīʿah prescribes a market-based economy. This conclusion is also confirmed by scores of *Aḥādīth* on forms of transactions and the evidence available for the first Islamic economy during the days of the Prophet SAAWS and his rightly-guided successors.

One may add the following point to the above point about market-based character of Islamic economy. Allah SWT is the Original, the Absolute and the Ultimate Owner of everything that is in the heavens and the earth. This, in turn, implies that when two people enter into exchanges with one another, Allah SWT is always the Third-Party. Thus, His Will also matters in how transactions are to take place. The Divine Will is available to us in the form of general principles governing permissible exchanges as well as detailed rules for the various transactions norms. The former include, among others, free willing consent of all stakeholders, no transaction of a thing on which one does not have a Sharīʿah-recognized claim, no vague elements in contracts, no *qimār* and no *ribā*.—The principle of no *qimār* implies that all exchanges inspired by economic considerations must involve some quid pro quo. And, the principle of no *ribā* requires that all loans, debts and other similar exchanges must be carried out on an equal basis in terms of the relevant units of exchange. With these main restrictions, people may do trading, leasing, partnership-based exchanges, loaning and a host of other exchanges. The list also extends to more complex cases involving many exchanges among several parties, both at a point in time and across time. The possibilities are virtually unlimited. It is easy to imagine the existence of an economy comparable to a modern economy where individuals, businesses and companies exist, and work in a gainful manner for themselves and the others. Market forms would depend on the existence of substitutes for different products and the number of players on the demand and the supply sides.

On the financial plane, the Islamic principles for exchanges will have the following implications. Institutions like banks may exist for economic reasons, but with the following differences from the contemporary scene. Banks would no more be pure financial intermediaries that borrow short and lend long. They would be economic agents. They would interact with resource-surplus units in two ways. First, they may provide interest-free demand deposits for those seeking security of their money and flexibility in the use of the funds. Second, they would enter into partnership contracts with owners of funds conscious about seeking a return on their money. On the financing side, the restriction of "no interest" will rule out the banks providing credit to their clients who can use it at their discretion. This will force the banks to actually enter into the transaction process at the grassroots level as traders, lessor and partners. To this, one may add that Sharīʿah-based divisible and tradable financial instruments will add depth to the Islamic money market. This will remove the dichotomy between financing by the banks and its use at the beneficiaries' end, and, hence that between financial flows and real flows in the economy.[6]

The above recapitulation of Islamic economy would be complete with an addition of its distribution dimension. Islam addresses the problem of distribution at the opportunity, production and inter-temporal stages. Salient features of this scheme are as follows:

1. Everyone has equal right of access to primary means of production like rivers, forests, natural meadows, etc.
2. Contributors to production process are entitled to reward for their respective role. The Sharīʿah a step further, and grants the poor and destitute a right in the outcome of the process despite their being unable to make a direct contribution.
3. The Sharīʿah also provides a comprehensive social security system in terms of rights of parents, family and neighbors along with institutional framework and comprehensive legal system all provide an effective enforcement mechanism.
4. Annual *zakāh* on wealth and the Islamic law of inheritance provides additional checks on concentration of wealth.

*Zakāh* is the main pillar of the Islamic scheme for distribution. The Sharīʿah prescribes detailed guidelines for its management on a self-financing basis. *Zakāh* plus other social safety nets noted at point 3 form an elaborate Islamic social security system. In the Islamic scheme relies on the individual for both the

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[6] See *IIE's Blueprint of Islamic Financial System* (1999), chapter 4 for further details.

initiative and necessary action in order to solving the problems of poverty and economic inequalities. This is a significant departure from the Western model where the welfare issues are addressed by the government, i.e. at the macro level, with the people contributing through taxes. The fiscal implications of the Islamic approach are enormous. They shift the welfare matters off the government budget.

The last piece of our description of the institutional framework is government, the key element and dominant player in any organized society. In order to keep the argument brief, we list the main points on nature and role of government from the Sharīʿah point of view.

First of all, in principle one must distinguish between "government" and "state". The latter is a geo-legal construct, and is a legal person in the international community. The government, on the other hand, is operational arm of the Sharīʿah and the state as well as representative of the people. In democratic dispensations, government is elected representative of the people. In other settings, the ruler(s) draw their mandate from acceptance of their position from the masses in one form or another.

In its capacity as operational arm of the Sharīʿah and the state, the government is supposed to fulfill all claims of the Sharīʿah on the people (such as collection and distribution of *zakāh*) and to discharge the obligations of the Sharīʿah in favor of the people (like, for example, fulfillment of critical minimum needs of the people should a problem arise due to systemic failure). In its capacity as representative of the people, the matter becomes quite complex. The following points throw further light on this matter.

All *Aḥkām* of the Sharīʿah given in the Qur'an and the Sunnah at the micro level, also apply to government—representative of the individuals. In particular, all prohibitions of the Sharīʿah apply to the government without further ado. For example, the government cannot enter into interest-based transactions. However, in the case of the permissible of the Sharīʿah, the matter is somewhat different. Government's status as representative of the people implies that it observes neutrality in interpersonal economic matters. This is not just logical but is unambiguously established by refusal of the Prophet SAAWS to impose controls (Al-Tirmidhī, 2007, *Kitāb al-Buyū', Bāb Mā Jā'a fī al-Tas'eer*; Abu Dawūd, 2008, *Kitāb al-Ijārah, Bāb al-Tas'eer*). A logical extension of this principle of neutrality is that government may not act as an economic agent in an Islamic milieu. For example, while the government may buy furniture for its needs, it may not be either a manufacturer or seller of furniture because in that event it would be competing with its own subjects. This point also implies that public sector enterprises, an important source of pressures on government budget, have little place in the Islamic set-up. In addition to not being an economic agent, the government may not automatically tax one group of people against their will and transfer the benefits to another. The Qur'ānic decree requiring free willing consent of people before taking their property (*an-Nisā' 4:29*) necessitates that the taxpayers be provided some economic or Sharīʿah justification for their obligations. Good versus bad considerations alone do not suffice. This limits economic role of government to only the provision of Sharīʿah-justified pure public goods. In all other cases, the teachings of the Sharīʿah require that the cost of government action to be charged to the respective beneficiaries. Any discussion of macroeconomic policy from the Islamic perspective has to reflect on these points.

## 4. Goals of Macroeconomic Policy from Islamic Economics Perspective

This section is concerned with the goals of macroeconomic policy, in general, and those of fiscal and monetary policies, in particular. The approach here is to spell out what one may regard as general policy objectives from the Islamic economic perspective. The argument is then narrowed to discuss the roles that might be assigned to fiscal and monetary action in an economy.

The general policy objectives are identified hereunder in the context of an Islamic economy. The reference of Islamic economy helps us to provide the Sharīʿah support for these goals. Nevertheless, many of these goals can be policy objectives for any economy in this age.

It is also pertinent to mention that an Islamic state has an ideological context, namely, spreading the message of the God Almighty to everyone, both inside and outside the state. On the practical plane, this ideological perspective also means (1) keeping working of the economy in line with the Sharīʿah dictates for economic activity and (2) Islamization of the economy where it is found to be off the Sharīʿah-prescribed course. Elimination of *ribā* from the financial system through conscious policy action is an example of the latter. In what follows, we do not emphasize this dimension of macroeconomic policy, and limit our argument to the pure economic side of public policy.

### 4.1. *General Policy Objectives at the State Level*

The general policy objectives may be divided into primary goals and secondary goals for economic policy at the state level. Both kinds of goals are listed hereunder:

Primary Goals/Objectives at the State Level:

1. Development and preservation of institutional framework for supporting economic and distributional activity[7]
2. Fulfillment of critical minimum needs (fundamental economic rights) of the citizens
3. Maintenance of credible deterrence against external threats
4. Education

Secondary Goals/Objectives at the State Level:

1. Reduction in interregional disparities
2. Integration of economy into the world economy
3. Development of economic infrastructure such as means for communication and transportation
4. Poverty alleviation

Before explaining the rationale for the above goals and their specific meanings, it is pertinent to mention that the above list represents slight departure from the existing views in Islamic economics (*sections 2.1* and *2.2*). All scholars indeed rest their case on the Qur'an, the Sunnah, the practice during the time of the four rightly-guided Caliphs of the Prophet SAAWS and opinions of reputed *fuqahā'* and Islamic scholars.[8] But the most important source of inspiration has been the practices during the time of the second Rightly-guided Caliph, Sayyidena Omar, may Allah SWT be pleased with him. A point often missed is that during his time the economy was a resource-surplus economy. Sayyidena Omar took all the

[7] This includes maintenance of law and order and dispensation of justice in order to ensure security of life and property.
[8] Siddiqi (1983) is a recent example.

initiatives without introducing taxes on the citizenry.[9] In other words, while forming opinion in the modern age, greater emphasis is to be placed on ground realities, of course, without in any way sacrificing the dictates of the Qur'an and the Sunnah.

The first two goals are absolutely sacrosanct. Development and preservation of the institutional framework and fulfillment of critical minimum needs of the people fall under the natural role of government. Without security of life and property, law and order and justice the state loses its *raison d'être*. These two goals are, therefore, independent of pre-existence of means for doing the needful. In order words, the state's claim on its subjects for arranging the necessary means holds true by default. The provision of necessary means remains the obligation of the citizenry through, of course, taxation.

As for meeting critical minimum needs of the people, the idea springs from the Islamic concept of life as a test for man (*Al-Mulk 67: 1-2*). A meaningful test requires some means for survival and completing the routine of the said test during one's life. Allah SWT has addressed this point in various ways. Some of these are resource endowments of parents at the time of one's birth, one's personal faculties and freedom for owning and exchanging property rights. The Sharīʿah also supplements the exchange process with *zakāh* and other social safety-nets. Primary obligation of the state and its operational arm, namely the government, is that the system is in place for doing the needful. However, if systemic failures lead to some lacking critical means for survival, responsibility at the level of Islamic state arises. Of course, in such an event the society has to bear the costs through the government.[10]

Maintenance of credible deterrence is mandated by Allah SWT for the Muslims (*al-Anfāl* 8: 60). It is also the need of every society. The only debatable issue may be the extent of such a deterrent. Given that the goal is to keep the hostile external forces at a distance, over-sized armed forces and lavish cantonments and armaments quickly becoming obsolete do not come on the list.

Basic Sharīʿah knowledge is right of an individual and obligation of the state. The scope of "education", however, extends to all aspects of practical life. That includes knowledge of humanities, arts, culture, law, science and technology. After

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[9] Sayyidena Omar introduced kharaj (land-tax) and ʿushoor. Kharaj was a levy on state lands made available to the cultivators who stayed outside the fold of Islam after the conquest of their territories. And, ʻushoor were levies on foreign traders seeking to sell their merchandise in the Muslim lands.

[10] Siddiqui (1988) has also discussed this point. The reasoning provided here is different.

the experience of the Muslim societies in the field of education during last 14 centuries, there is hardly any room for further argument. Skilled and polished individuals are not only good for themselves but also for the others. Given the wide gap between needs of the society and the private concerns, it is only natural that the issue of mass education may be addressed at the state level. Effective consultation process between the people, businesses and industry and the government, can help set the priorities and the criteria for meeting financing needs. But, if one is willing to draw lessons from the past, the government ought to spearhead the education agenda.

Among the four secondary goals noted above, several things are noteworthy. Take the case of reduction in inter-regional disparities first. In the present age, most of the countries are like “joint home” of different population groups differing in language, culture and history. Shared interests bring them into one fold but their long-term association is sustained by common concerns. Reduction in inter-regional economic disparities is vital for preserving federal structures and unity of state.

As for integration of economy into the world economy, the case may be argued on economic grounds. But, we rest the matter on the Sharīʿah grounds. The economy during the time of the Prophet SAAWS was an open economy. The same has been true for Muslim states during the past 14 centuries. International trade and mobility of resources provides a natural avenue for getting into contact with the foreigners and spreading the word of Allah SWT to them. Government can work toward opening of the economy through developing economic protocols and agreements, not necessarily through activist fiscal or monetary policies.

Importance of the goal of development of economic infrastructure, hardly needs a comment. As for poverty, the Prophet SAAWS has strongly advised all the believers to seek the refuge of Allah SWT from it. Common concern of all citizens automatically makes as a policy target. In both these cases, however, being policy goals means monitoring and directing or coordinating necessary action in these respects at the government level. It does not necessarily mean action through government budget. Monetary policy instruments may have a role here (*see below*).

In passing, it is notable that the four primary and four secondary goals noted in this section may not be “the” goals of economic policy in the light of the Sharīʿah principles. Some researchers may have other views about logical basis given in this paper. Some may even add to the said list. The argument needs to be dispassionate and conservative interpretation of the Sharīʿah because of the resource commitments that any goals will ultimately call for.

4.2. *Goals of Fiscal and Monetary Policies*

As noted at the outset, traditionally fiscal policy is seen as the policy that works through the government budget. Thus, it is associated with the role that the government is called upon to perform in its own name in the economy. Monetary policy, on the other hand, is about monetary management—in particular, the volume of liquidity—in the economy by the central bank. Both policies aim at macroeconomic stabilization mainly through demand management. Fiscal policy is routed through public expenditures and taxes, and monetary through private investment in the economy. Fiscal policy also acts as channel for distribution agenda assigned to the government. Government carries a welfare agenda whereby economic support is provided to the have-nots through a tax- transfer mechanism. Islamic economists have not challenged this conventional wisdom.

The discussion in the section 2 of this paper, reveals that the goals of both the policies have separately discussed in the Islamic economics literature. Full employment with price stability is deemed as the chief macroeconomic objective. But the argument is open-ended on other pursuits. In what follows, we review some of the goals for both the policies. The basis for our argument is that from the Islamic economics perspective monetary and fiscal authorities may not necessarily work as independent policies. Where necessary, action on both the fronts may be coordinated in the larger interest of the economy and the society.

To the extent that government is not expected to directly take part in economic activity for the Sharīʿah reasons, fiscal policy will have minimal proactive role. Two arguments supporting this stance are as follows:

1. Government cannot compromise on its neutrality on the economic plane.
2. Government cannot tax one group, whether the existing taxpayers or future generations, and transfer the benefits to another.

The same principle largely applies to monetary policy with reading “central bank” in place of government in the above points.

The traditional goals assigned to these policies are not defensible for the following reasons:

1. Full employment without inflation. First of all, employment is a means to an end, not the end by itself. Secondly, with constraints emerging from the principles of no *ribā* and no *qimār* will have two implications. First, real and financial sectors in the economy will be integrated. And, financial bubbles will not be created that are important cause of inflation and business cycles. Second, economic exchanges beneficial to only one party will be pushed into the background. Both these factors will encourage production and employment, and lessen chances of inflation.
2. Economy is unlikely to carry unmanageable weight of pensions and welfare payments that are an important cause of fiscal deficits and, hence, inflation.

Government can play defining role in determining the economic course of a county. But, given the Sharīʿah constraints, the modus operandi will be short of direct intervention on either the fiscal or the monetary plane.

## 5. Some Practical Considerations in the Working of the two Policies

At present in the case of government, the ruling elite makes fiscal decisions, the establishment (or, bureaucracy) implements them and the public (whether present or future generations) pick up the price tag. Social contract (constitution), laws, rules and regulations and binding consultative process (in the form of elected bodies in a democratic set-up) seek to ensure orderly working of the system. However, lack of common concerns at the three tiers of fiscal activity, makes the system a recipe for disaster. This problem is partially remedied by the Sharīʿah through the introduction of constraints on the nature and the role of government. These factors have been explained in the preceding sections. In what follows, we take note of some practical matters in the working of fiscal and monetary policies.

One thing should be clear at the outset. The welfare or distribution agenda of society needs to be off the normal government budget. The government's role may be limited to look after *zakāh*-related matters through separate budgetary setup in this regard (Ahmad, 1989). Of course, the government may encourage private initiative for welfare matters through, for example, *waqf* and other institutions.

Taxation warrants specific Sharīʿah justification on a case by case basis. One implication of this principle is that taxation will be mostly earmarked. Closure of the option of interest-Based borrowings will bring forth additional constraints on fiscal action. This would result in, for example, curtailment of inessential expenditures under the various heads, such as law and order and national defense. A lot of fat from fiscal side of economy is likely to be shed away.

Economic subsidies for promoting economic activity by producers and exporters are difficult to justify on the Sharīʿah grounds. Therefore, they are unlikely to have a place in the Islamic milieu. This ought to remove a big cause of fiscal deficits in a country.

As explained at length in the preceding sections, government's active role will be brought into line with the natural role for a government. Government may make its economic contribution to the society through off-budget measures.

The following point will merit consideration in the Islamic fiscal set-up. Where government expenditure can be carried out in mutually exclusive ways and all the options do not have identical distributive implications, preference may be given to the way with the implications for reduction income inequality.

As for the monetary side, one expects some radical changes. With the "no interest" restriction, banks will have access to demand deposits raised as interest-free loans to the banks and partnership-based deposits. In the former case, banks may use the available deposits in providing financing in their own names because ownership of the said deposits shall be with them. However, joint ownership of deposits generated through partnership-based modes will have far reaching implications. In principle, with the ownership of the funds belonging to both the depositors and the banks, the latter shall not be in position to do financing transactions (with the available funds) in the banks' own names. This would place a cap on credit creation as known in the interest-based banking industry. The notion of high-powered money is expected to change.

Notwithstanding the above, monetary authorities may call upon the banks to maintain reserves to back up demand deposits. However, no such requirement may be introduced in lieu of on deposits raised for investment purposes with the prior permission of the monetary authorities. Of course, the goal of limiting (increasing) the banks' capacity to generate partnership-based deposits may be achieved by increasing (lowering) the contribution by the banks raising the said deposits. Exogenously introduced restrictions on the ratio of profits shared by the banks with their depositors would violate the Sharīʿah principle of no government intervention in bilateral matters.

The foregoing points should not raise alarms. The chief source of increase (decrease) in money supply will be Sharīʿah-justified budgetary deficits (surpluses) and foreign trade surpluses (deficits). If capital markets are perfect, the velocity of circulation of available money supply, along with adjustments generated through international channels, should help meet liquidity needs of the economy. This was partly the case in the early Islamic state. The Prophet SAAWS and his four Rightly-guided successors took no steps on the monetary side of the economy. Money was injected into the system through foreign trade surpluses. An additional source of money was the interested people directly bearing the cost of having their gold and silver minted into dinars and dirhams, respectively, by those who had special dyes for this purpose.

## 6. Concluding Observations

The existing Islamic economics literature on fiscal and monetary literature came up before development of the thinking on the contours of the Islamic financial system and nature and role of state and government. This paper builds upon the existing thinking in the light of developments on the said matters during the last two decades.

Main messages of this study are two. First, fresh thinking is called for at the systemic level. Many a beneficial changes are possible in the way an economy works and the goals assigned to the policies under reference. Second, there is room for reviewing active role by the government on both economic and distributive planes. The government's responsibilities should be reduced to only governance. This is what naturally fits with the occupation of "government". The economic goals of a country may be met through developments on the monetary side — financial engineering — in the light of the Sharīʿah. Even on the monetary side, major role of the respective authority may be largely regulatory.

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# Are Islamic Banks Sufficiently Diversified? An Empirical Analysis of Eight Islamic Banks in Malaysia

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**Abstract**

*The aim of this study is to analyze the diversification among financial activities of Islamic banks and how it affects banks performance. We used the Herfindahl-Hirschman Index (HHI) to measure the degree of asset/liability diversification and risk-adjusted performance as criteria of assets allocation and management compensation. We found that retail and commercial activity are the most profitable activity, which lead to an overinvestment in those activities. Some banks show high average correlation between commercial and retail activities, and corporate and investment activities. The analysis of the efficiency shows that none of these banks falls on the frontier which means that they should change the structure of their portfolio in order to become less concentrated. They should also allocate more assets to treasury activity.*

Keywords: Diversification, performance, Islamic banks, HHI, MPT.
JEL classifications: C01, G11, G21.

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## 1. Introduction

It is commonly known that the portfolio risk can be reduced when assets with different price movements are combined. Accordingly, diversification among products, activities and sectors should increase return. The intuition is that a diversified portfolio is less volatile than the average of the volatilities of its assets. The Modern Portfolio Theory (MPT) of Markowitz (1952) enables investors to estimate expected risks or returns of their portfolios. They can either maximize the overall portfolio return for a given level of overall risk or minimize overall portfolio risk for a given level of overall portfolio return.

Many papers analyzed how diversification affects performance. Most of these studies highlight the positive effect of diversification on performance and on risk reduction. For instance, Saunders and Walter (1994) conducted a simulation analysis of large mergers among the largest financial intermediaries in the US. Their results show that when companies provide varied financial services, their level of risk will be lower than the specialized banks. Templeton and Severiens (1992) provided evidence on the impact of increasing the level of diversification on decreasing risk when the nonbanking activities are uncorrelated with the banking activities.

In conventional banks, results about the effects of diversification on performance are contrasting. For instance, Cubo-Ottone and Nurgia (2000) found a significant and positive relation between abnormal returns and diversification products as a result to mergers and acquisitions of banks. Focarelli et al. (2002) used Italian balance-sheet data on mergers and acquisitions of banks and highlighted the increase of ROE after a merger, and a long-run increase of profitability. However, some papers found a low or negative impact of diversification on bank performance. Mercieca et al. (2007) provided evidence that there is no direct benefit of diversification within and across business lines and a negative relation between non-interest income and bank performance. Goddard et al. (2008) noticed that revenues from non-interest activities have increased in US credit unions. They examined the impact of revenue diversification on their financial performance between 1993 and 2004. Their main conclusion was that diversification strategies should vary according to the credit union size. For instance, small-sized unions should avoid diversification and concentrate on loans and savings activities while large-sized ones should look for new product opportunities related to their main expertise.

We have to notice that the issue of diversification is not extensively discussed in Islamic banks unlike the issue of performance and efficiency which are well discussed, particularly in the last ten years. For instance, Yudistira (2004) analyzed the impact of financial crises on the efficiency of 18 Islamic banks over the period of 1997-2000. He found that Islamic banks performed badly after the global crisis 1998-1999 but they improved their performance subsequently. In addition, small and medium-size banks faced diseconomies of scale and publicly listed banks are less efficient. Sufian (2007) adopted the same approach as Yudistira (2004) to examine efficiency in domestic and foreign Islamic banks in Malaysia between 2001 and 2004. He provided evidence that these banks slightly improved their efficiency in 2003 and 2004. Moreover, domestic Islamic banks are found marginally more efficient than foreign Islamic banks. More recently, many papers focus on the efficiency of Islamic banks in large-size samples because of the availability of banks datasets. Srairi (2010) used a sample of conventional and Islamic banks over the period 1999-2007. He showed that Islamic banks set up in the Gulf region are relatively more efficient to increase profits and decrease costs. However, they are still less efficient than conventional banks.

In contrast, Abdul-Majid et al. (2010-a) used an output distance function approach to study the efficiency of Islamic banks. They provided evidence that some countries notably Sudan and Yemen displayed higher inefficiency in comparison with other countries namely Bahrain and Bangladesh. In addition, the majority of their banks had higher returns to scale than conventional banks. They focused also on the efficiency of Malaysian banks through different approaches (Mokhtar et al., 2006 and Abdul-Majid et al. 2010 b and 2011) and provided evidence that fully Islamic banks and conventional banks operating Islamic banking windows have lower efficiency than other banks. But these banks still have low potential to get around their inefficiency.

Kablan and Yousfi (2011) examined efficiency of Islamic banks operating in both Muslim and non-Muslim regions. They argued that Malaysian and Pakistani banks display the highest scores. One explanation is that government in these countries undertook many reforms to make these banks better involved in their financial markets. Moreover, Islamic banks operating in the United Kingdom have the lowest average efficiency score.

On the contrary, some studies, such as in Beck et al. (2010) showed little significant differences between conventional and Islamic banks in business orientation. They conclude that conventional banks are more cost effective and less stable when they have lower market shares than their Islamic counterparts while Islamic banks display higher capital-asset ratios.

Despite the booming development of Islamic banking, to the best of our knowledge, there are no papers on the effect of diversification on performance. In the current paper we raise the following question: *are Islamic banks sufficiently diversified?*

To answer this question, we focus on diversification among financial activities and analyze how it affects banks performance. We used the Herfindahl-Hirschman Index (HHI) to measure the degree of asset/liability diversification and risk-adjusted performance as criteria of assets allocation and management compensation. We used Sharpe, Treynor and Jensen indices to analyze risk-adjusted performance. Data are collected from the annual financial statements of eight Malaysian banks over the period 2004-2008.[1] We choose a sample of Malaysian banks because Malaysia is being established as an important centre of Islamic finance through cooperation with the centres of Islamic finance in Bahrain and in Dubai to jointly develop the global Islamic finance market (Haque, 2010). Bin-Bahari (2009) conducted a comparative study between Malaysian and GCC (Gulf Cooperation Council) Islamic banks. He found that the number of Islamic banking principles applied in Malaysian banks is higher than in their counterparts. Moreover, some transactions are completely rejected in Malaysia because they are source of conflicts between scholars which could explain how Malaysia becomes the first financial choice of many Muslims. Such restrictions may be considered as signal of the strict application of Sharīʿah.

In the absence of unified accounting and disclosure codes in Islamic banking system, we considered a small sample size[2]. S&P argues that financial disclosure of Islamic banks does not very often meet the standards of global best practices, which hinders their growth. This may also explain why there are not yet studies dealing with the issues of diversification among products, financial activities and sectors in Islamic banking.

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[1] Some databases, like for example *Datastream* and *Bankscope*, provide more data over longer period than us. But, they do not provide information we need in our study in contrast with annual reports.

[2] The Malaysian Islamic Banking Act of 1983 enables to better control and unifies practices in these banks. There was also the creation of centralized and separate Sharīʿah boards in the Bank Negara Malaysia (the Central Bank) and the Securities Commission. The Malaysian government tries now to reform the banking sector to meet Basel II capital requirements and international accounting standards.

In 2008, the Islamic Financial Services Board (IFSB)[3] had spearheaded global initiatives to standardize Islamic financial transactions. Standardization remains a significant challenge for practitioners, regulators and depositors, particularly at the macroeconomic level since countries display different characteristics in terms of regulation.

There are many types of diversification. Bank's diversification activities can be captured according to different criteria: interest and non-interest income activities. Banks can also diversify into non-interest income products and services that are directly linked to an existing interest income generating activity. However, in the sake of Islamic banks, there are no interest income activities (Mercieca et al., 2007). Accordingly, we focus only on non-interest income activities. Then, we distinguish four activities like in conventional banking:

First, banks can have activities related to sales and trading of various financial instruments, equity research and asset management. This is the corporate banking activity.

Second, investment banking activity aims at advising and helping different institutions raising capital to undertake, mergers and acquisitions, LBO and IPO.

Thirdly, commercial banking encompasses the bank's activities that are related to commercial enterprises or corporations. Unlike commercial banking, retail or consumer banking consists in range of products and services provided to consumers and small businesses.

Finally, treasury is considered a core function in conventional banking. However, it is the heart of Islamic banking. It aims at providing necessary funds at a cost efficient manner that diminishes financial risks. There must be enough liquidity to meet all the current and future obligations of the bank for all the line activities.

However, they must be Sharīʿah compliant: they cannot charge interests since it is *ribā* and cannot invest in prohibited sectors. Consequently, they have narrower investment market than their conventional counterparts. As diversification is not always possible, Islamic banks are easily affected by shocks and crisis. Even if the effects of the subprime crisis were limited, they incurred real losses. It would be more appealing to analyze diversification among sectors and to compare with

[3] IFSB is the global standard-setting body for Islamic finance, capital markets and insurance.

conventional banks but because of the lack of data availability; we were not able to perform the analysis. However, this study is a first step to understand how these banks diversify their activities. First, we estimated risk-adjusted performance of Islamic Malaysian banks. Then we studied the effects of diversification across activities on banks' performance, in particular on risks. Finally, we deduced the efficient frontier and the optimal portfolio according to the MPT.

Our study aims at assessing some features of Malaysian Islamic banks diversification. Our paper is therefore structured as follows. Section 2 presents our measures of diversification and performance, and data. Estimation and results are discussed in Section 3. Section 4 concludes the paper.

## 2. Methodology

### 2.1. *Risks in Islamic Banking*

In banking activity, there are three main types of risks: market risk, credit risk and operational risk. As their conventional counterparts, Islamic banks are subject to these risks.

First, both kinds of banks are exposed to significant and negative fluctuations of prices and therefore to the market risk, they have different techniques to overcome it, however. In conventional banks, the use of future contracts decreases this risk. However, these contracts very often lead to speculation which is prohibited in Islamic transactions. According to the Sharīʿah, there is no wealth creation in such transactions. Speculation is based on wealth transfer not on added value: it increases the gains of one party by taking advantages of the second party. Again, the equivalent financial product of option and speculation aim at protecting both parties by sharing profits and losses between them. For instance, option is replaced by the contract of *Bayʿ al-urbūn*[4]. As explained before these banks have limited investment opportunities. Because they cannot invest in prohibited sectors, they may face higher risks than their conventional counterparts.

Second, when the borrower cannot meet his payments, the bank is then exposed to credit risk. One explanation is that the quality borrower was overvalued. Moreover the higher the credit risk, the higher the interest rate fixed by the bank. If payments must be scheduled after a first default, the bank sets high interest rate.

[4] In this contract, the buyer has to pay in advance a partial amount of the good price as a security deposit. This amount may be lost if he decided not to buy. It is a way to force him to meet his obligation.

There are some similarities between conventional and Islamic banks concerning credit risk: they are facing default risk and also a selection problem of customers like for example adverse selection problems. They also ask for collateral as a security deposit to get financed.

However, there are some differences in the process of credit distribution:

- Unlike conventional banking, Islamic banking is interest-free banking.
- Islamic banks offer funds on the basis of *Murābaḥah*[5] (sale with profit) or *Mushārakah*[6].
- The client is exposed to lower risks than in interest based financing: if the asset is damaged, losses are borne partially or totally by the bank as it is legally an owner.
- Islamic banks are more selective than conventional ones because they have limited investment opportunities and they must select high quality client to which they will grant loans.
- Islamic banks are also exposed to a different structure of risks that are not borne by conventional banks: risks related to the asset/investment opportunity. This explains to some extent why the average financing cost in Islamic banks is higher than in conventional ones.
- Instead of receiving fixed interest rates, they are paid share on the profits or losses generated by their assets/businesses.

Third, operational risk is more complicated in Islamic banks than in conventional banks. One explanation is the high number of contracts that should be written in each stage of the transaction. This takes time and needs the involvement of many parties (the bank, the Sharīʿah board, and the bank's client, the vendor) to ensure transparency. In addition, regulation varies significantly from one country to another. For instance, there is neither unified disclosure code nor common contract clauses. This poses new legal risk particularly for Islamic banks operating in

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[5] The client would like to purchase a particular asset at a fixed date but he is wealthy constrained. Under specific conditions, the bank will buy the asset for him at a certain price (cost plus profit). He has then to identify the best offer/seller in the market. Accordingly, the Islamic bank will appoint the client as its "*wakīl*" (bank's agent) to acquire the asset on the bank's behalf. The bank acquires the asset and sells it to the client. The vendor will deliver the asset to the bank's client as it is the bank's agent.

[6] The bank and the client must contribute jointly to the funding of the project and all of them are involved actively in the project while the client brings Know-how. Profits and losses are shared between them according to their financial contribution or on agreed ratios.

conventional banking system or conventional banks operating Islamic windows competing with Islamic banks. Moreover, uncertainties associated with Sharīʿah compliance lead to fiduciary and reputational risk. Besides, Basel II provides principles of effective banks' control that cope with Islamic banking. However, risk measurement and risk management practices are not completely suited for Islamic banks' operational characteristics and still need further adaptations (Abdullah et al., 2009). Islamic banking activities are based on partnership. They share the fruit of their investments with their depositors and the fruit of financed economic activities with their borrowers. Projects losses are therefore supported by Islamic banks unlike their conventional counterparts. This means that they are subject to more operational risks than conventional banks.

### 2.2. *Measures of Risk adjusted Performance*

In this subsection, we present the measures used to estimate these risks. The banking literature provides three measures of risk-adjusted return that are extensions of financial index: return on risk-adjusted capital (RORAC), risk-adjusted return on capital (RAROC) and risk-adjusted return on risk-adjusted capital (RARORAC). They enable us to analyze risk management from different areas even in Islamic banking (Bandyopadhyay and Saha, 2008, Guill, 2007, Robert and Bishop, 2007, Shimko, 1997 Uyemura et al. 1996).

These measures are:

- RORAC presented in Bankers Trust in the late 1970s to compare investments that have different levels and profiles of risk (Guill, 2007). It is based on capital at risk and is given by:

$$RORAC = \frac{\text{Net Income}}{\text{Allocated Economic Capital}}$$

  where *Allocated Economic Capital* is the firm's capital, adjusted for the maximum potential loss based on the probability of future returns or volatility of earnings. The economic capital is adjusted for the maximum potential loss after calculating probable returns and/or their volatility. It is a very useful method of quantifying and managing acceptable levels of exposure to risk.

- RAROC measures risk-based profitability and compares returns of a range of projects. It is given by:

$$RAROC = \frac{\text{Revenue - Expenses - Expected loss} + \text{income from capital}}{\text{Economic Capital}}$$

- RARORAC is an extension of RAROC and RORAC ratios and encompasses both the risk-adjusted economic capital and the risk-adjusted return of an investment. It is calculated by dividing risk-weighted return by the economic capital after including the diversification benefits. The risk-weighted return is given by the sum of the net profit before results on divestments, provisions for credit risks after replacing by estimated values, cycle-neutral expected losses on loans and investment securities (KPMG, 2007). The RARORAC is given by:

$$RARORAC = \frac{\text{Risk Ajusted Return}}{\text{Capital at Risk}}$$

  It is straightforward to see that there is a double risk adjustment made, in both numerator and denominator. RARORAC cannot cover systemic risk but measures market risk, credit risk and operational risk. This ratio is very useful to analyze the link between the three types of risks in different scenarios where there might be too-high concentration of risks.

### 2.3. *Risk Measures*

In financial literature, RAROC is commonly used in the same meaning of the three ratios presented in the previous subsection, even though we are estimating one of them RORAC, RAROC or RARORAC (Landskroner et al., 2005). In *Internal Systematic Risk* approach, systematic risk of a unit is measured inherent to the bank’s portfolio (covariance between the bank’s activity and the portfolio of all activities) and not to the market portfolio. The difference stems from the fact that, unlike the common assumption of perfect capital markets in which all assets are tradable, in banking a large proportion of the bank’s assets and liabilities are not tradable, especially in the banking book. For instance, the bank’s business (activity) units are of limited marketability.

Froot and Stein (1998) develop a two-factor pricing model for banks in which the first factor is the market factor, as in the CAPM, and the second is the bank’s (non-tradable) portfolio factor. They have defined an internal systematic risk (and price of risk) based on the covariance with the bank's portfolio. We used two approaches to estimate the performance: the stand-alone approach where assets are considered asset by asset and the portfolio approach in which correlations between business units in banking activities are taken into account. We adopted a variance-covariance approach to compute the value at risk (VAR)[7] of the line activities and the bank as a whole.

Three indices were used in banking finance to measure RAROC (see among others Bandyopadhyay and Saha, 2008, Guill, 2007, Robert and Bishop, 2007, Shimko, 1997 Uyemura et al. 1996)

- The first index RAROCS is an extension of the Sharpe index (Shimko, 1997) and is written:

$$RAROCS_i = \frac{\Pi_i - \Pi_{fi}}{\sigma_{\Pi_i}}$$

  where $\Pi_i$ is the average profits (net operating profit or net profit from ordinary items) in activity *i*, $\Pi_{fi}$ is the average of earnings in the risk free share of the activity i and

  $\sigma_{\Pi_i}$ is the standard deviation of the profit of activity *i* during the whole period T (5 years).

- The second index $RAROCT$ is an extension of the Treynor index. It is given by:

$$RAROCT_i = \frac{\Pi_i - \Pi_{fi}}{B_{\Pi_i}}$$

  where $B_{\Pi_i}$ is the risk index or the CoVaR in the activity *i*.

- The third index RAROCJ is an extension of Jensen index and measures the earnings of the activity $i$. It is written:

$$RAROCJ_i = \frac{A_i}{K_i}$$

  where:

[7] The VaR measures the risk of loss on a specific portfolio of financial assets. For a given portfolio, probability and time horizon, VaR is the threshold value such that the probability that the mark-to-market loss on the portfolio over the given time horizon exceeds this value (assuming normal markets and no trading in the portfolio) is the given probability level

$A_i = \Pi_i - \left[\Pi_{fi} + \beta_{\Pi_i}\left(\Pi_{Bi} - \Pi_{fi}\right)\right]$ is function of the factor of activity *i*'s beta and the average market return and can be considered a measure of Economic Value Added EVA[8] of the activity i; it has many uses in banking, particularly in capital budgeting (Uyemura et al., 1996)

$K_i = \frac{1}{T}\sum_{t=1}^{T} R_{bt}.K_{it}$ is the average investment in activity *i*.

2.4. *Data*

The measures of the performance are estimated for eight Malaysian Islamic banks, using financial statements data over the period 2004-2008. There are 29 Islamic banking institutions in Malaysia: 12 full-fledge Islamic banks (nine domestic stand-alone Islamic banks and three foreign Islamic banks), height conventional banks operating Islamic windows, four Islamic investment banks and five development finance institutions offering Islamic banking services (Moody's global banking, 2008). However, only eight banks offer annual reports with reliable data for our analysis. These banks do not adopt similar accounting and disclosure practices. They vary significantly in terms of presentation and content.

Some banks in our sample have already grouped retail and commercial activities together while others grouped corporate and investment banking activities. For the sake of simplicity, we distinguish two activities to keep more banks in our sample: retail and commercial activity and corporate and investment activity.

Thus, Islamic banks in our sample have four banking activities: corporate and investment activity; retail and commercial activity; treasury and others activities. Note that the data of the net operating profits (ordinary net income), the segmental results and the investments (segmental assets) in the different activities, were calculated in the annual financial statements of these banks.

The total amount of asset assigned to the banking activity *i* (*i*=1,…,4) at time t is denoted $K_{i,t}$. The total assets is equal to the sum of assets invested in each activity. The RAROC indices calculations are based on the free risk-free rate $R_{ft}$, however, as explained before, in Islamic banking interest is prohibited. Consequently, we take as risk-free rate the rate of the sovereign *Ṣukūk* of Bank

[8] EVA (Economic Value Added) measure is recently introduced in banking to measure the bank performance as a function of the true cost of capital. It includes the cost of equity capital employed by the bank.

Negara Malaysia (Central Bank of Malaysia). We choose Malaysian Islamic banks because Malaysia is the only Islamic country that issued *Ṣukūk* yearly between 2004 and 2008. The objective of Malaysian authorities is to promote transparency through disclosing such kind of information on their website [3] (website of BNM).

The following table describes our sample in 2008:

**Table-1**
**Description of the Sample of Islamic Banks used for the Analysis**

| **Bank** | **Foundation** | **Kind** | **Total Assets Millions $** | **Market Share (%)** |
|---|---|---|---|---|
| Affin Islamic Bank Berhad | 2005 | S.D.B.G | 1741 | 3.15 % |
| Al Rajhi Banking & Investment Corporation Berhad | 2005 | F.I.G | 1376 | 2.49 % |
| Bank Islam Malaysia Berhad (BIMB) | 1983 | D.S.A.G | 6775 | 12.26 % |
| CIMB Islamic Bank Berhad | 2003 | S.D.B.G | 5349 | 9.68 % |
| EONCAP Islamic Bank Berhad | 2006 | S.D.B.G | 2035 | 3.68 % |
| Hong Leong Islamic Bank | 2005 | S.D.B.G | 2329 | 4.12 % |
| Kuwait Finance House (KFH) Malaysia Berhad | 2005 | F.I.B | 2764 | 5 % |
| RHB Islamic bank Berhad | 1997 | S.D.B.G | 2687 | 4.86 % |
| **TOTAL** | | | **25056** | **45.36 %** |

Source: Moody's Global Banking (2008)

| | |
|---|---|
| S.D.B.G | Subsidiaries of Domestic Banking Group |
| F.I.G. | Financial Islamic Group |
| D.S.A.G | Domestic Stand Alone Group |
| F.I.B. | Foreign Islamic Group |

[3] http://www.bnm.gov.my/index.php?ch=12&pg=623&eId=box1 and http://www.bnm.gov.my/index.php

## 3. Results and Discussion

**Table-2**
**ROA by Activities of Eight Malaysian Islamic Banks between 2004 and 2008**

| Bank / Activities | Retail and Commercial Banking | Corporate and Investment Banking | Treasury | Others | Total Bank |
|---|---|---|---|---|---|
| Affin Islamic Bank | 2.64 | 1.73 | 0.45 | 1.72 | 1.61 (1) |
| Al Rajhi banking and Investment Corporation Malaysia Berhad | -1.62 | 0.81 | 0.8 | 0 | 0.00 (6) |
| Bank Islam Malaysia Berhad (BIMB) | -0.22 | -0.9 | 0 | 93.14 | -0.37 (7) |
| CIMB Islamic | 1.02 | 0.96 | 1.05 | -33.51 | 1.01 (5) |
| EONCAP Islamic Bank Berhad | 2.51 | -4.65 | 0.58 | 0 | -0.52 (8) |
| Hong Leong Islamic Bank | 2.19 | 1.77 | -0.34 | 0 | 1.21 (3) |
| KFH Malaysia Berhad | 0.68 | 2.13 | 0.92 | -5.58 | 1.24 (2) |
| RHB Islamic bank | 1.14 | 1.61 | 0.54 | 1.57 | 1.10 (4) |

The average rate of assets of activity *i* is $ROA_i = \frac{1}{T}\sum_{t=1}^{T=5} ROA_{it} = \frac{1}{T}\sum_{t=1}^{T=5}\frac{\Pi_{it}}{A_{it}}$ where $ROA_{it}$ is the net profit of activity *i* in year *t* divided by average assets of activity *i* during the year**.**

Table 2 presents the average return on asset (ROA) and the average profits in the four banking activities (business units) for the eight banks. ROA indicates the profitability of the firm once expenses and taxes are paid and gives an idea about the management performance (Van Horne and Wachowicz, 2005). Our statistics show that Affin Islamic Bank has the highest ROA (1.610%), which implies that it has the best performance in our sample. EONCAP Islamic Bank Berhad has a negative ROA (-0.520%), since the corporate and investments activities have a negative impact on the bank's performance and despite the fact that the other activities (retail and commercial activity and treasury activity) have a positive effect (respectively 2.510% and 0.580%). One explanation is that this bank was recently founded (2006) and has some difficulties to attract customers and depositors. We notice also that BIMB is the only bank in the sample that does not practice treasury activity unlike other banks.

**Table-3**
**Average Profits by Activities of Eight Malaysian Islamic Banks between 2004 and 2008** (thousand US$)

| **Bank/Activities** | **Retail and Commercial Banking** | **Corporate and Investment Banking** | **Treasury** | **Others** | **Total bank** |
|---|---|---|---|---|---|
| Affin Islamic Bank | 4788 *(33)* | 3097 *(21)* | 4375 *(30)* | 2302 *(16)* | 14562 |
| Al Rajhi banking and Investment Corporation Malaysia Berhad | -2307 *(-68)* | 5862 *(173)* | -165 *(-5)* | 0 | 3390 |
| Bank Islam Malaysia Berhad (BIMB) | -6727 *(-45)* | -6849 *(-46)* | 0 | -1448 *(-9)* | -15024 |
| CIMB Islamic | 1927 *(15)* | 3191 *(25)* | 16396 *(127)* | -8603 *(-67)* | 12911 |
| EONCAP Islamic Bank Berhad | 25530 *(262)* | -15383 *(-158)* | -413 *(-4)* | 0 | 9734 |
| Hong Leong Islamic Bank | 21681 *(96)* | 2763 *(12)* | -1923 *(-8)* | 0 | 22521 |
| KFH Malaysia Berhad | 4392 *(28)* | 9690 *(61)* | 4190 *(26)* | -2400 *(-15)* | 15872 |
| RHB Islamic bank | 7374 *(22)* | 8537 *(26)* | 6440 *(20)* | 10426 *(32)* | 32777 |
| Average Activity | 7964 (65) | 1116 (9) | 3504 (28) | -289 (-2) | 12295 |

( ) The average contribution of the activity in the total profit of the bank (%) .

Table 3, which presents the average profits of the 4 activities, shows that the retail and commercial activity provides 65% of the total profits in our sample: It is the most profitable activity among the four banking activities for the eight banks. It is followed by treasury activity (28%) and corporate and investment activity (9%). It is straightforward to see that BIMB and EONCAP had affected largely the results of the corporate and investment activity (respectively - 46% and - 158%). They are subsidiaries of domestic banking groups and have high market shares.

In conclusion, Malaysian banks show high standard deviation (large dispersion of results between banks and between activities). One explanation is that some banks are subsidiaries of large and multinational group while the others were recently founded so they face diseconomies of scale. Average profits vary significantly among banks and activities according to their expertise, size and market share.

The main findings in this table are the following:

Table 4 show that the performance measures (Sharpe and Treynor) for BIMB is 1.17 resulting to BIMB to score the best overall performance, followed by EONCAP Islamic Bank Berhad, Affin Islamic Bank and Kuwait Finance House Malaysia Berhad, while Al Rajhi, CIMB Islamic, RHB Islamic bank and Hong Leong Islamic bank have a negative value of the ratio. For the banks which have a negative value, this means that they generate an average rate of return lower than the rate of *Ṣukūk*. Note also that the risk-adjusted ratios provide slight different results from ROA analysis. For instance, according to RAROCS and RAROCT, the BIMB is now ranked the first (it was ranked seventh). One explanation is that BIMB's performance is mainly explained by competitive advantages over the other banks. It is the first bank operating in Malaysia, from the year 1983, and it is taking advantage of economies of scale due to its expertise.

We now analyze the contribution of each activity on the total performance of the bank. According to all the measures, the retail and commercial banking have the highest effects on the bank's performance: RAROCS = 0.56, RAROCT = 0.79 and RAROCJ = 0.0174. However, the Treasury activity had registered the worst performance value, having negative rates for all the measures: RAROCS = - 2.69, RAROCT = - 0.55 and RAROCJ = - 0.018, except KFH Malaysia Berhad which recorded positive values of the three ratios (RAROCS = 0.24, RAROCT = 0.32 and RAROCJ = 0.0113) in treasury activity. This result can be explained by the fact that this bank invests all its assets in the treasury activity. In 2008, the bank had a put all his assets (100%) in the treasury activity.

**Table 4**
**Measures of (a) RAROCS (Sharpe Index) , (b) RAROCT (Treynor Index) and (c) RAROCJ (Jensen Index) per activity i in bank j**

| Bank j/ Activity i | Retail and Commercial Banking | | | Corporate and Investment Banking | | | Trea sury | | | Others | | | Total Bank | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | a | b | c | a | b | c | a | b | c | a | b | c | a | b | c |
| Affin Islamic Bank | 1.39 | 2.16 | 0.023 | 0.79 | 1.18 | 0.013 | -0.62 | -0.16 | -0.008 | 0.52 | 0.81 | 0.015 | 0.38 (3) | 0.38 (3) | 0.0003 (4) |
| Al Rajhi banking and Investment Corporation Malaysia Berhad | -0.61 | -0.91 | 0.018 | -0.51 | -0.77 | -0.017 | -1.58 | -2.61 | -0.013 | Na | Na | Na | -0.28 (5) | -0.28 (5) | -0.011 (5) |
| BIMB | 2.33 | 2.98 | 0.041 | -0.18 | -0.24 | -0.0021 | Na | Na | Na | 0.97 | 1.39 | 0.78 | 1.17 (1) | 1.17 (1) | 0.015 (1) |
| CIMB Islamic | 0.34 | 0.46 | 0.0290 | -1.91 | -2.83 | -0.0290 | -2.57 | -3.58 | -0.0292 | -3.91 | -5.24 | -0.0343 | -1.12 (6) | -1.12 (6) | -0.0225 (7) |
| EONCAP Islamic Bank Berhad | 1.49 | 2.26 | 0.0164 | 1.04 | 3.24 | 0.0083 | -0.72 | -1.18 | -0.016 | Na | Na | Na | 0.59 (2) | 0.59 (2) | 0.007 (3) |
| Hong Leong Islamic Bank | 0.01 | 0.01 | 0.00008 | -1.82 | -5.79 | -0.0069 | -7.14 | 14.45 | -0.040 | Na | Na | Na | -15.69 (8) | -15.69 (8) | -0.0171 (6) |
| KFH Malaysia Berhad | 0.23 | 0.31 | 0.0177 | 0.48 | 0.64 | 0.0376 | 0.24 | 0.32 | 0.0113 | 0.55 | 0.74 | 0.0477 | 0.23 (4) | 0.23 (4) | 0.0120 (2) |
| RHB Islamic bank | -0.65 | -0.92 | -0.0054 | -1.84 | -39.44 | -0.0206 | -6.48 | -11.15 | -0.0334 | -0.93 | -1.34 | -0.0139 | -4.97 (7) | -4.97 (7) | -0.0247 (8) |
| Average activity | 0.56 | 0.79 | 0.0174 | -0.49 | -5.50 | -0.002 | -2.69 | -0.55 | -0.018 | -0.56 | -0.72 | 0.15 | | | |

() the average rank

Finally, we examine the performance of each activity in the whole sample. The performance is measured as a "stand alone" activity and as component of a portfolio. The main findings are:

- Affin Islamic Bank has registered a good performance explained by the share of asset assigned to priority activities such as retail and commercial activity, followed corporate and investment activity. One surprising result is that treasury activity has a negative impact on the performance despite the fact that Affin Islamic bank invests 66% of its assets in this activity. In fact, "*Treasury and Islamic money market operations are involved in proprietary trading in fixed income and foreign exchange, Islamic derivatives trading and structuring, managing customer-based foreign exchange and Islamic money market transactions, funding and investment in ringgit and foreign currencies*" (the annual report of Affin Islamic Bank, 2008). We conclude that treasury activity is a long-term investment and return on investment is realized on the long term. The latter result explains the liquidity problem in banking.

- The good performance of BIMB comes mainly from the high performance of retail and commercial activity: RAROCS = 2.33, RAROCT = 2.98 and RAROCJ = 0.041. This may explain why BIMB has assigned one third of its assets to these activities (the bank has invested nearly 31% in 2008 and 35% in 2004, see Table 5). However, the performance of the corporate and investment banking was relatively poor: all the indices have a negative value, RAROCS = - 0.18, RAROCT = - 0.24 and RAROCJ = - 0.0021.

- At CIMB Islamic, the retail and commercial banking performed well (despite the fact that only 14% of investments in 2008 are allocated to commercial services) while all the other activities performed poorly (negative values). That is why the performance of the bank is entirely negative.

- At EONCAP Islamic Bank Berhad, the good performance was derived mainly from the performance of its large retail and commercial banking (50% of the total investment in 2008 and 70% in 2006) but also from the corporate and investment banking (15% of the total investment in 2008) which have an interesting value of the RAROCS and RAROCJ index (respectively 1.04 and 3.24).

**Table-5**
**Correlation Coefficients of Profits between Banking Activities with Total Profit of Banking Groups and the System between 2004 and 2008**

| Bank /Activities | Retail and Commercial Banking | Corporate and Investment Banking | Treasury | Others |
|---|---|---|---|---|
| Affin Islamic Bank | 0.96 | 0.99 | 0.98 | 0.95 |
| Al Rajhi banking and Investment Corporation Malaysia Berhad | 0.99 | 0.98 | 0.90 | 0 |
| BIMB | 0.99 | 0.96 | 0 | 0.80 |
| CIMB Islamic | 0.99 | 0.90 | 0.95 | 0.99 |
| EONCAP Islamic Bank Berhad | 0.99 | 0.48 | 0.92 | 0 |
| Hong Leong Islamic Bank | 0.90 | 0.47 | -0.74 | 0 |
| Kuwait Finance House (KFH) Malaysia Berhad | 0.97 | 0.99 | 0.98 | 0.99 |
| RHB Islamic bank | 0.94 | 0.06 | 0.77 | 0.92 |
| Average per activity | 0.96 | 0.72 | 0.68 | 0.93 |

Table 5 shows strong correlations between the earnings of retail and commercial activity, corporate and investment activity and the bank earnings in the 8 banks (respectively 96% and 72%). Only EONCAP Islamic Bank Berhad and Hong Leong Islamic Bank show slight different results: correlation between earnings of corporate and investment banking and total earnings are not too strong (respectively 48% and 47%). In RHB Islamic Bank, correlation between the earnings of the corporate and investment banking and the total earnings of the bank is almost nonexistent (6%). On the other hand, the correlation of treasury is relatively high (68%). This measure is very high in all the banks of our sample (approximately 90%) except for the Hong Leong Islamic Bank where we find a negative value (-0.74). Finally, correlations between the activities do not vary significantly between banks, thus one may compare the performance of various activities across banks.

### 3.1. *The Modern Portfolio Theory (MPT)*

Hereafter, we estimate the optimal portfolio's structure of each bank. Then, we compare it with its current portfolio in 2008 (see Table 6). We identify the relationship between the risk and the return of a portfolio by looking at four portfolios of our banks. To calculate the optimal portfolio and the efficient frontier, MPT assumes that the portfolio return is a linear function of the weights of each asset in the portfolio. The expected return of the portfolio $E(R_p)$ is written:

$$E(R_p) = \sum_{i=1}^{m} w_i \, E(R_i)$$

where $E(R_i)$ is the expected return of asset class *i* ($i = 1,...,m$), $w_i$ is the share of money invested in asset $i$ and $m$ is the number of asset classes. Then, the expected return of portfolio can be written:

$$E(R_p) = W'[E(R)]$$

where $[E(R)]$ is the matrix of the expected returns for the portfolio assets and $W'$ is the transpose of the matrix of assets weights. The portfolio risk contains both systematic and unsystematic risks. The systematic risk depends on many factors in the market such as macroeconomic conditions and currency fluctuations. It cannot be diminished through portfolio diversification (Devinney et al., 1985). However, unsystematic risk depends on many specific factors (management, quality of labor) which are closely related to the characteristics of each asset. MPT suggests that the portfolio's standard deviation $\sigma_p$ is the appropriate measure of this kind of risk. It is based on the assumption that the level of risk of a portfolio is lower than the sum of weighted risk of its assets. The portfolio risk is then written:

$$\sigma_p = \sqrt{\sigma_p^2} = \sum_{i=1}^{m} w_i^2 \sigma_i^2 + 2\sum_{i=1}^{m}\sum_{j=1}^{m} w_i \, w_j \sigma_{ij}$$

where $\sigma_p$ is the portfolio standard deviation, $\sigma_i$ is the standard deviation of returns in asset class *i* and $\sigma_{ij}$ is the covariance of returns between asset classes *i* and *j*. Accordingly, the overall portfolio risk is given by: $\sigma_p = W'CW$ where C is the covariance matrix of assets returns. The efficient frontier and the optimal portfolio are solution of the following optimization problem:

$$\begin{cases} & Min \quad \sigma_p = W'CW \\ s/c & W'\mu = \mu_p \\ & W'e = 1 \end{cases}$$

where μ is the vector of assets returns and $\mu_p$ is the optimal vector of assets returns. Appendices provide more details.

**Table 6**
**Portfolio's Composition of Islamic Banks (December 31 2008)**

| Bank /Activities | Retail and Commercial Banking | Corporate and Investment Banking | Treasury | Others |
|---|---|---|---|---|
| Affin Islamic Bank | 13% (13%) | 15% (12%) | 66% (68%) | 0 |
| Al Rajhi banking and Investment Corporation Malaysia Berhad | 18% (11%) | 51% (0%) | 31% (89%) | 0 |
| Bank Islam Malaysia Berhad (BIMB) | 31% (35%) | 69% (65%) | 0 | 0(0) |
| CIMB Islamic | 14% (0) | 20% (0) | 60% (95%) | 7% (5%) |
| EONCAP Islamic Bank Berhad | 50% (70%) | 15% (20%) | 34% (10%) | 0 |
| Hong Leong Islamic Bank | 47% (54%) | 6% (9%) | 47% (37%) | 0 |
| Kuwait Finance House (KFH) Malaysia Berhad | 35% (0%) | 29% (0%) | 33% (100%) | 3% (0%) |
| RHB Islamic bank | 25% (24%) | 22% (22%) | 50% (57%) | 1% (-3%) |
| Average activity | 29% (26%) | 29% (16%) | 40% (57%) | 2% (1%) |

( ) the share of assets allocated to the activity *i* .

### 3.2. *Results for Optimal Portfolio Analysis*

The results of the optimal portfolio analysis were mostly consistent with our analysis in the previous section (RAROC indexes).

**Table 7**
**Optimal Composition of the Malaysian Islamic Banks Portfolio**

| Bank /Activities | Retail and Commercial Banking | Corporate and Investment banking | Treasury | Others | Total |
|---|---|---|---|---|---|
| Affin Islamic Bank | 17% | 11% | 72% | 0 | 100% |
| Al Rajhi banking and Investment Corporation Malaysia Berhad | 12.3% | 37.89% | 50% | 0 | 100% |
| BIMB | 5.93% | 93.82% | 0 | 0.2% | 100% |
| EONCAP Islamic Bank Berhad | 68% | 21% | 16% | 0 | 100% |
| Hong Leong Islamic Bank | 77% | -22% | 47% | 0 | 100% |
| Kuwait Finance House (KFH) Malaysia Berhad | -20% | 36% | 88% | -4% | 100% |
| RHB Islamic bank | 137% | -19% | -22% | 4% | 100% |

Table 7 provides the following results:

- First, Al Rajhi banking and Investment Corporation Malaysia Berhad should invest higher share of assets in treasury activity. Simultaneously, it should decrease its investment in retail and commercial activity and in corporate and investment activity. Our result is inconsistent with the actual decline of the share of the treasury activity in these banks in the recent years (from 89% in 2005 to 31% in 2008) and the increase of the share of assets allocated to retail and commercial activity (from 11% in 2005 to 18% in 2008) and to corporate and investment activity (from 0% in 2005 to 51% in 2008). Our results are also not consistent with our findings in the first part of the study. Indeed, despite the fact that treasury leads to a positive value of ROA (0.80%), all RAROC indices are negative.
- Second, BIMB should substantially increase its investment in corporate and investment activity and also boost the volume of other activities. However, a significant contraction of the retail and commercial banking must be done. These results are consistent with the movement of changes made in the bank, since the retail and commercial banking has decreased from 35% in 2004 to 31% in 2008, the commercial and investment activity increases from 65% to 69% while the other activities captured 0.01% in

2008. However, these results are not consistent with the previous findings about the RAROC indices. According to these indices, retail and commercial activity is the most profitable activity in this bank and even for the whole sample.

- Third, EONCAP Islamic Bank Berhad should make a real cutback of its treasury activity which captured at about 34 % of the bank's assets in 2008 and increase the assets allocated to retail and commercial activity. At the same time, the bank should invest more money in corporate and investment activity. These results join our previous findings and provide evidence that retail and commercial activity is the most profitable activity for this bank. Indeed, RAROCS, RAROCT and RAROCJ are positive and have higher values than in the other activities (ROA also has high value 1,49%). However, these results are not consistent with the current strategies of EONCAP in the sense that retail and commercial activity (tables 2 or 3) cut down from 70% in 2006 to 50% in 2008, while the optimal value of this activity according to MPT should be around 68%. Similarly, corporate and investment activity has decreased from 20% in 2006 to 15% in 2008, while the optimal investment in this activity should be around 21%. Finally, treasury should be diminished by 18 % in 2008 (decrease from 34% in 2008 to 16%).
- Finally, according to MPT calculations, Hong Leong Islamic Bank should assign more assets to the retail and commercial activity (77%). As shown in the first section, retail and commercial banking is the most profitable activity (RAROCS, RAROCT and RAROCJ are all negative for the other activities). Besides, the investment policy of this bank between 2006 and 2008 is based on the increase of assets allocated to retail and commercial activity and the decrease of the corporate and investment banking.

**Table 8**
**The Current Value of HHI** (%)

| Bank /Activities | Retail and Commercial Banking | Corporate and Investment Banking | Treasury | HHI Assets |
|---|---|---|---|---|
| Affin Islamic Bank | 0,0169 (0,0289) | 0,0225 (0,0121) | 0,4356 (0,5184) | 0,475 (0,5594) |
| Al Rajhi banking & Investment Corporation Malaysia Berhad | 0.0162 (0.0151) | 0.3696 (0.1436) | 0.2182 (0.2500) | 0.604 (0.4087) |
| BIMB | 0.1681 (0.0035) | 0. 36 (0.8802) | 0.0000 (0.0000) | 0.5281 (0.8837) |
| EONCAP Islamic Bank Berhad | 0.3481 (0.4624) | 0.0324 (0.0441) | 0.0529 (0.0256) | 0.4334 (0.5321) |
| Hong Leong Islamic Bank | 0.2601 (0.5929) | 0.0064 (0.0484) | 0.1681 (0.2209) | 0.4346 (0.8622) |
| Kuwait Finance House (KFH) Malaysia Berhad | 0,1225 (-0,04) | 0,0841 (0,1296) | 0,1089 (0,7744) | 0,3164 (0,8624) |
| RHB Islamic bank | 0,0625 (1,37) | 0,0484 (-0,19) | 0,25 (-0,22) | 0,361 (1,00) |

( ) the optimal value of HHI in %.

Table 8 shows that the eight banks choose diversification and invest almost in all business lines but their portfolios are not optimal. There are many measures of market concentration, like for example four-concentration ratio ($CR_4$), eight-concentration ratio ($CR_8$)[9], the Hannah-Kay ratio and the Herfindahl index (HHI). However, only the HHI index developed by Orris C. Herfindahl and Albert O. Hirschman, is suitable for bank diversification analysis and the data we have. HHI is calculated by taking the squared value of the market share of each firm competing in a market, and then adding the values to result to the market data, summing the resulting numbers. According to the HHI, some banks should diversify the allocation of their assets while others should be concentrated. We obtain the following findings:

- The current HHI value for Al Rajhi banking and Investment Corporation Malaysia Berhad is higher than what it should be. Despite that this bank

[9] $CR_4$ and $CR_8$ are used to measure the share market of firms operating in an oligopolistic market under specific conditions.

invests all most in the four banking activities, its investment policy is not optimal. We highlight on one hand a problem of overinvestment in both retail and commercial banking, corporate and investment banking and on the other hand, there is an underinvestment problem in treasury activity.

- The current value of HHI in BIMB is largely inferior to its optimal value (0.88). As mentioned before, it does not invest in treasury which is optimal. It should focus only on retail and commercial banking and corporate and investment banking. In fact, fewer assets should be assigned to retail and commercial banking in contrast with corporate and investment banking.
- For EONCAP Islamic Bank Berhad, policy investment as a whole is not too far from what it should be (optimal HHI is equal to 0.53 while its current value is 0.43). In contrast with the previous ones, it is facing an overinvestment (respectively underinvestment) problem in treasury (respectively retail and corporate activities)
- Finally, for the Hong Leong Islamic Bank, the optimal HHI is equal to 0.86 while the actual value of this index is 0.43. This comes from an underinvestment problem in all activities. Accordingly, the bank should diversify more its investments.

Hereafter, we define the efficient frontier (in terms of ROA and standard deviation) for these banks and compare them to the current position of these banks. It is another way of measuring performance: we compare the current and the optimal portfolios across banks and also over time. Hereafter, we present two figures (the rest are in the annex) showing the efficient frontiers of two banks and their current positions. We run calculations for efficient frontier for the other banks and found similar results. The analysis can be generalized to all banks in our sample.

Our results show that the current BIMB's portfolio is not efficient: it is above the efficiency frontier in the negative side. One explanation is that the current portfolio of BIMB has a negative return. The EONCAP Islamic Bank Berhad, Al Rajhi banking and investment Corporation Malaysia Berhad, KFH Malaysia Berhad and RHB Islamic Bank are also no efficient; their portfolios are below the efficient frontier. So, for a given level of risk, these banks have reached a positive rate of return (ROA) which is inferior to the optimal value. Thus none of this bank falls on the efficient frontier. They are not able to overcome their inefficiency despite the fact that they improved their performance between 2004 and 2008.

## 4. Conclusion

This paper investigates the issue of diversification among activities in Malaysian Islamic banks and analyzes the effect of diversification on their performance and efficiency. We use HHI to measure activity concentration of Malaysian Islamic banks. To analyze the bank performance, we estimate ROA and RAROC. Finally, we determine the efficient frontier according to MPT.

Despite the small sample size, this study brings some interesting results. First, we found that these banks invest almost in the four activities but their investments are not optimal. Unlike BIMB, they all have to assign assets to treasury banking. They face problems of over and under-investment.

Moreover, they are not efficient and cannot get around their inefficiency despite the fact that their performance was increasing over the period 2004-2008. One explanation is that these banks are growing but facing many challenges and more risks than their conventional counterparts, like for example legal and competitive risks.

It would be interesting to conduct a comparative study on diversification with larger sample size of conventional and Islamic banks. In the current study, we focused on diversification only among activities but it would be more appealing to study diversification among sectors since Islamic banks can invest only in investments that are Sharīʿah compliant. At a macroeconomic level, it would help to understand regional differences.

**Figure 1**
**Efficient Frontier and Current Portfolio Al Rajhi Banking & Investment Corporation Malaysia Berhad**

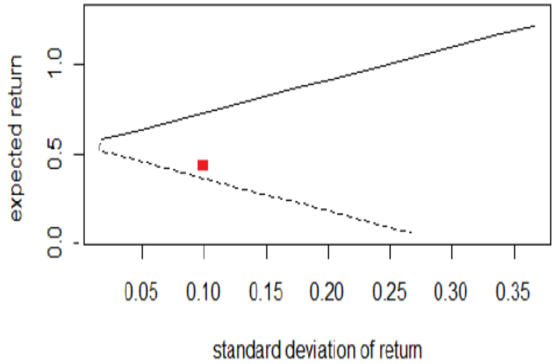



**Figure 2**
**Efficient Frontier and Current Portfolio BIMB**
**Efficient Frontier and Current Portfolio**

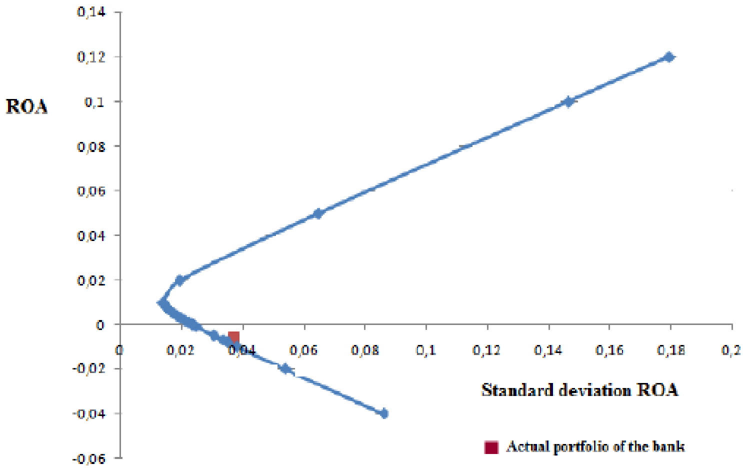


**Figure 3**
**Efficient Frontier and Current Portfolio EONCAP**

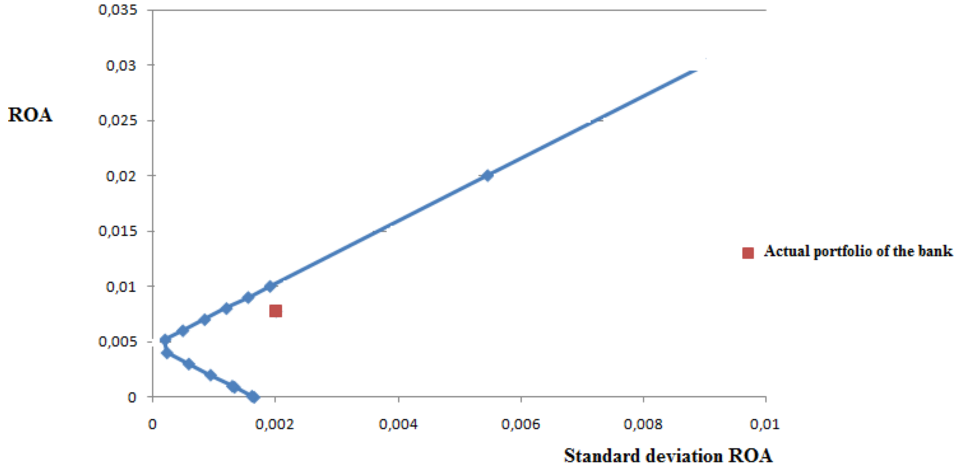



**Figure 4**
**Efficient Frontier and Current Portfolio RHB Islamic Bank**

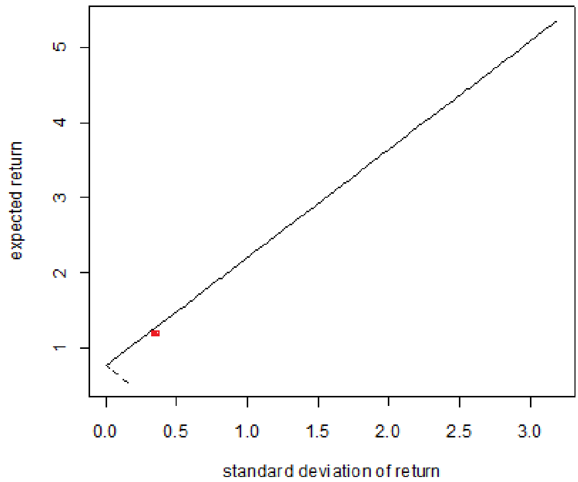
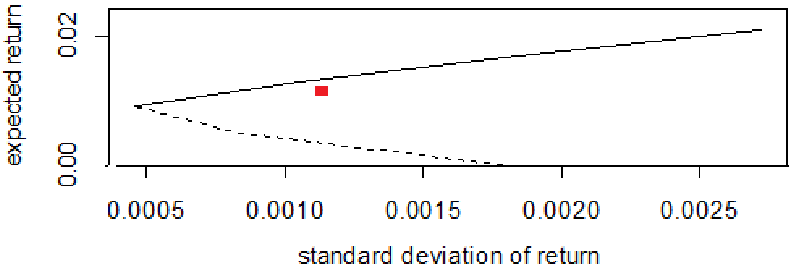


**Figure 5**
**Efficient Frontier and Current Portfolio KFH Malaysia Berhad**




Efficiency Frontier and Optimal Portfolio

To determine the efficient frontier and the optimal portfolio, we must resolve the following system:

$$\begin{cases} \quad Min \quad \sigma_p = W'CW \\ s/c \qquad W'\mu = \mu_p \\ \qquad\qquad W'e = 1 \end{cases}$$

Where $W$ is the weight vector of assets weights, $\mu$ is the vector of assets returns, C is the covariance matrix of asset returns and e = [1 1 1 … 1].

To solve this system, we determine the following Lagrangian:

$$L = W'CW + \lambda_1 (\mu_p - w'\mu) + \lambda_2 (1 - W'e)$$

where $\lambda_1$ and $\lambda_2$ are the multipliers of Lagrange. The optimality condition of the first order is written

$$\partial L/\partial W = 2CW - \lambda_1 \mu - \lambda_2 e = 0 \quad \Longleftrightarrow W = \frac{\lambda_1 C^{-1}\mu}{2} + \frac{\lambda_2 C^{-1} e}{2} \qquad (1)$$

where $C^{-1}$ is the inverse of the matrix.
The two constraints in the bank's program can be written:

$$\begin{cases} W'\mu = \mu_p \\ \\ W'e = 1 \end{cases} \Longleftrightarrow \begin{cases} \mu'W = \mu_p \\ \\ e'W = 1 \end{cases} \Longleftrightarrow$$

$$\begin{cases} \lambda_1 \mu' C^{-1} \mu + \lambda_2 \mu' C^{-1} e = 2\mu_p \\ \\ \lambda_1 e' C^{-1} \mu + \lambda_2 e' C^{-1} e = 2 \end{cases}$$

We denote by A, B and C respectively the following expressions:

$A = e'C^{-1}\mu = \mu'C^{-1}e$; $B = \mu'C^{-1}\mu$ and $\mathbf{C} = e'C^{-1}e$

The system to solve becomes:

$$\begin{cases} \lambda_1 B + \lambda_2 A = 2\mu_p \\ \\ \lambda_1 A + \lambda_2 C = 2 \end{cases} \Longleftrightarrow \begin{cases} \lambda_1 = \dfrac{2(C\mu_p - A)}{D} \\ \\ \lambda_2 = \dfrac{2(B - A\mu_p)}{D} \end{cases}$$

where $D = BC - A^2$. Finally, we replace $\lambda_1$ and $\lambda_2$ by their expressions in equation (1) which give the weight of assets in the optimal portfolio:

$$W_p = g + h.\mu_p$$

where $g = \dfrac{(BC^{-1}e - AC^{-1}\mu)}{D}$ and $h = \dfrac{(CC^{-1}\mu - AC^{-1}e)}{D}$

Then, we can represent the efficient frontier (all the efficient portfolios) in the plane ($\mu_p$, $w_p$) with

$$\sigma_p = \sqrt{w_p' C w_p} = \sqrt{\frac{C\mu_p^2 - 2A\mu_p + B}{D}}$$

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# Trade and Human Development in OIC Countries: A Panel Data Analysis

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**Abstract**

*This study examines the relationship between trade and the OIC countries' social developments as measured by the Human Development Index (HDI) using the generalized method of moments (GMM) procedure in a panel data distributed lag model for the years 1980 to 2005, with a five-year increments as well as annual data from 2000 to 2009. It addresses two questions: (i) whether trade has a positive relationship with human development as reflected by longevity, educational attainment and income in the HDI measurement, and (ii) whether trade still has a positive relationship with human development, when the income component of the HDI is excluded. Comparisons are made across OIC countries based on three World Bank Classifications by Income, namely, high income, middle income and low income countries. Trade is found to have a significant positive relationship with HDI for all income categories, but insignificant relationship with non-income HDI. The finding indicates that trade is associated with human development only through income channels, and it is not associated with other components, such as longevity, literacy level and educational attainment. More of appropriate and effective public policies need to be formulated and implemented so as to achieve the desired outcomes of multi-dimensional human development in the true sense of the word.*

Keywords: Trade, Human Development Index, OIC Countries, Generalized Method of Moment
JEL Classifications: O190, J310, C230.

## 1. Introduction

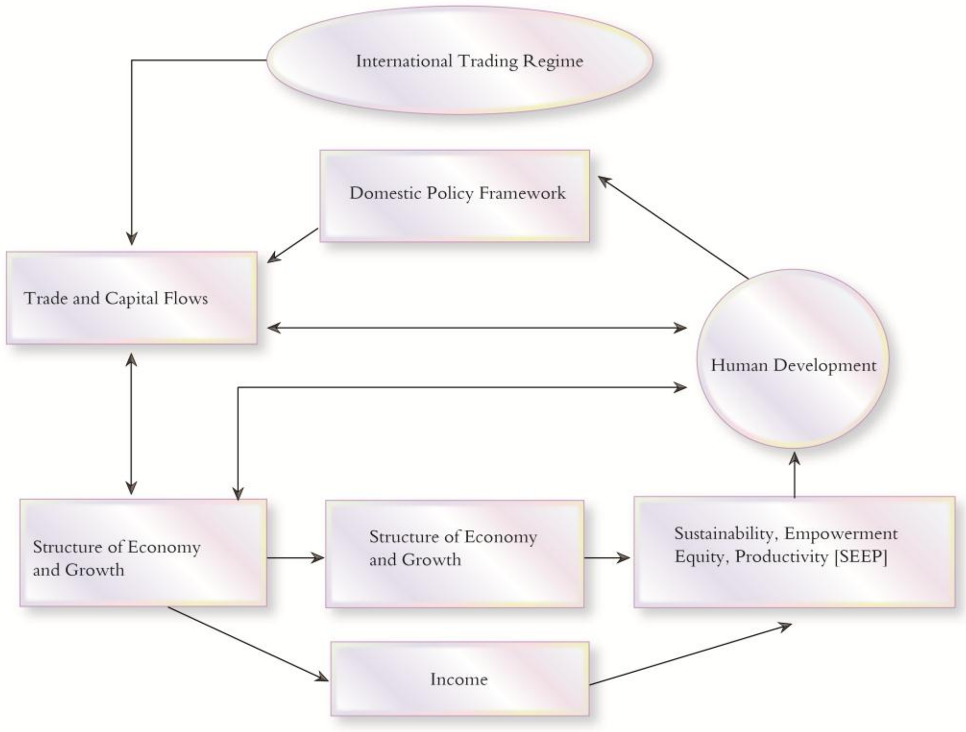
The increasingly globalized world has made countries' engagement with international markets not just unavoidable but also beneficial since trade can facilitate, promote and sustain the development process. For individual nations, trade is seen as a prerequisite for sustained growth. This is currently the dominant view—an inherent extension of the arguments on the classic theoretical exposition of the gains from trade.

The United Nations Development Program (UNDP) in its Asia Pacific Human Development Report 2006 presented a conceptual framework that relates trade to human development. The framework says that trade has been known to have the ability to change the structure of the economy as well as the rate of growth. This, in turn, has implications for employment of factors of production, particularly both labor and capital. Trade has been said to reward skilled labor more highly than unskilled labor and can lead to the adoption of capital-intensive technologies that may deepen inequality. However, such a problem can be prevented through public policies that can be used to ensure that trade benefits human development. There is also a feedback loop from human development to trade, which operates directly or is mediated through the domestic policy framework. Feedback effects work through higher income, higher technical competence and skills or through the power of advocacy on policymakers. Finally, human development can also have a direct influence upon the structure of the economy, the rate of growth and trade itself (UNDP, 2006).

The links between trade and human development can be summarized in Figure 1. There are three basic building blocks in the diagram: trade, human development and the links between the two. The hypothesized chain is: trade → growth → human development → trade. There is thus a two-way causation: from trade to human development and back to trade.

Even though traditional trade models have shown that trade liberalization and expansion will generate high income and economic growth (López, 2005), its translation into corresponding improvements in human development is not automatic. It depends on how and the extent to which the pattern and character of economic growth affect specific dimensions of human development. Trade should not be an end in itself. Rather, it should realize a broad range of human development objectives, and especially to help alleviate poverty and reduce human deprivation in the poorest and Least Developed Countries (LDCs) (UNDP, 2006).[1]

**Figure 1**
**Trade and Human Development – A Schematic View**




Source: Figure 1.1 of UNDP (2006), p. 16.

Trade and private investment are needed to provide new engines of growth and dynamism for most developing countries. With more trade and investment, the countries will be able to achieve faster growth, reduce poverty, create more jobs, and improve the knowledge, skills, and productivity of their workforce. While most developing countries have managed to achieve improvements in trade and private

[1] In order to translate trade liberalization into improvements in human development, various institutional factors must be in place such as political stability, political will and an established regulatory framework.

investments in the 1990s, the Middle East and North Africa (MENA)[2] was the only region in the world to experience a reversal (World Bank, 2003). Poverty did not improve in the last decade, but human development indicators for the region are reported to have improved tremendously, at a rate that surpassed even that of lower middle income countries (Iqbal, 2006).

The experience of the MENA countries as stated above, the majority of which are OIC countries, presents a paradox to the earlier argument that trade has a positive impact on human development. Hence, it is a cause for further analysis. The UNDP model is adopted in this study since it is, by far, the most comprehensive model that provides the distinct link between trade and human development. Since the objective of this study is not to examine the directions of causality, it will focus only on the first relationship, i.e., from trade to human development through higher growth rates. Thus, the question addressed by this study is: does trade have a positive relationship with human development (as a measure of social development)? Since human development is commonly measured by the Human Development Index (HDI) which consists of three components, namely, longevity, educational attainment and income, another question addressed in this study is: does the positive relationship between trade and social development still hold if the income component of the HDI is excluded?

The analysis in this study involves making comparisons of the results across three categories of OIC countries according to the World Bank Classifications by Income, namely: (i) High income countries (Bahrain, Brunei, Kuwait, Qatar, Saudi Arabia and United Arab Emirates); (ii) Middle income (both upper and lower middle income) countries (Albania, Algeria, Gabon, Iran, Kazakhstan, Malaysia, Turkey, Cameroon, Cote d'Ivoire, Egypt, Guyana, Indonesia, Jordan, Maldives, Morocco, Pakistan, Senegal, Sudan, Tunisia and Yemen); and (iii) Low income countries (Bangladesh, Chad, Gambia, Kyrgyzstan, Mali, Mauritania, Mozambique, Niger, Sierra Leone, Tajikistan, Togo and Uganda). Such a comparison is necessary to examine whether there is a positive relationship between trade and HDI across the three classifications of OIC countries.

[2] Based on the World bank classification, the Middle East and North Africa (MENA) region is comprised of twenty-one countries or territories, namely, namely the Gulf Cooperation Council (GCC) members (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates), and fifteen other countries or territories, i.e., Algeria, Djibouti, the Arab Republic of Egypt, Iraq, the Islamic Republic of Iran, Israel, Jordan, Lebanon, Libya, Malta, Morocco, the Republic of Yemen, the Syrian Arab Republic, Tunisia, and the West Bank and Gaza (World Bank, 2003).

This paper is structured as follows. The next section provides a brief survey of the literature on trade and human development both at the inter-country as well as intra-country analyses. Section 3 describes the data and methodology used in this study. Section 4 presents the analysis and discussion of the findings while the last section concludes.

## 2. Literature Review

There is an extensive literature on the impact of trade on social well-being (with economic growth explicitly included in some studies), both at the cross-country as well as within-country analyses. Various aspects of social well-being have been examined and the most important ones include income inequality, poverty, and human development as a composite index.

A review of the vast literature using cross-country comparisons for the impact of trade openness on poverty within countries can be found in Ravallion (2006). He highlights a number of studies that have combined survey-based measures of income inequality at country level with data on trade and other control variables to assess the distributional impacts of trade openness; the latter is typically measured by "trade volume," defined by exports plus imports as a share of GDP (examples include Bourguignon and Morisson (1990), Edwards (1997), Li, Squire, and Zou (1998), Barro (2000), Dollar and Kraay (2002, 2004), Lundberg and Squire (2003), and Milanovic (2005)). The results are mixed which implies ambiguous implications of trade on inequality.

In an influential study by Dollar and Kraay (2002, 2004), they find little or no effect of trade volume on inequality, contrary to the findings of other studies which reported adverse effects on inequality. Lundberg and Squire (2003), for instance, find evidence that higher trade volume tends to increase inequality. Some studies also report similar findings in the case of poor countries but the reverse holds at higher mean income (Milanovic, 2005; Ravallion, 2001).

The implications for poverty also depend on the growth impacts. Dollar (1992), Sachs and Warner (1995), Harrison (1996), and Edwards (1998), among others, provide empirical support for the view that trade expansion promotes economic growth. In a meta-study of all the cross-country growth regressions with an average of seven regressors (chosen from 67 candidates drawn from the literature on cross-country growth regressions), Sala-I-Martin, Doppelhofer, and Miller (2004) report that trade volume is significant in two-thirds of the regressions, though it is not among their subset of 18 robust predictors of economic growth. Whether the growth effects are strong enough such that poverty falls with trade openness remains unclear.

The findings of Dollar and Kraay (2004) and others that trade does not affect inequality but fosters growth make it very likely that it lowers absolute poverty (meaning that the poverty line is fixed in real terms). In a study on China, Ravallion (2006) tests the claim that the country's greater trade openness has been an important factor in reducing poverty. Aggregate time series data spanning the period 1980–2000 and three poverty measures were used, namely, the headcount index, the poverty gap index, and the squared poverty gap index. For all 3 poverty measures, no significant effect is found of current or lagged trade volume on poverty in China, a finding which is significantly different from earlier studies.

Very few works have attempted to look at the relationship between trade and human development as a whole. Arimah (2002) relates inter-country variations in the level of human development to inter-country differences in the macroeconomic environment, investment in human capabilities, good governance, commitment to the objectives of human development, and natural resource endowment. The study finds that the macroeconomic environment is the key determinant of inter-country differences in human development. Specifically, economic growth has a positive impact on human development.

In another study, Davies and Quinlivan, (2006) examines the impact of trade on countries' social developments as measured by the Human Development Index (HDI). The generalized method of moments (GMM) procedure in a panel data distributed lag model is used and the change in the HDI index is modeled as a function of per-capita trade. Using panel data on 154 countries for the period 1975 – 2002, the study finds that increases in trade are positively associated with future increases in social welfare.

Gunduz, Hisarciklilar and Kaya (2009) find similar results in terms of the positive relationship between trade and social development for the different classifications of 106 countries from 1975-2005. The study also reveals that this positive link is valid only for high and upper middle income countries, but diminishes with lower income when the income component of the HDI is excluded.

The survey of literature above has shown that very few studies have looked into the relationship between trade and human development, particularly whether there are cross-country variations in the different categories of income levels of OIC countries. Hence, this study is an attempt to fill this gap.

## 3. Methodology and Data Description

This study utilizes panel data estimation technique following Gunduz, Hisarciklilar and Kaya (2009) and Davies and Quinlivan (2006) with the model:

$$HDI_{i,t} = \alpha + \beta_1 HDI_{i,t-1} + \beta_2 Trade_{i,t} + \nu_i + \mu_{i,t} \quad (1)$$

where

$HDI_{i,t}$ = Human Development Index for country $i$ period $t$

$$Trade_{i,t} = \ln\left(\frac{\exp orts_{i,t} + imports_{i,t}}{population_{i,t}}\right) - \ln\left(\frac{\exp orts_{i,t-1} + imports_{i,t-1}}{population_{i,t-1}}\right)$$

$\nu_i$ = is the fixed or random effect which measures the specific characteristics of country $i$

$\mu_{i,t} = disturbances$

The Generalized Method of Moments (GMM) technique is applied on this model since it is a very general statistical method of formulating models and obtaining estimates of parameters without making strong assumptions on their distributions. The idea of the GMM is to use moment conditions that can be found from the problem with little effort. It is a method of estimating the population parameters such as mean, variance, and median, by equating sample moments with unobservable population moments and then solving those equations for the quantities to be estimated. According to Greene (2003), the GMM estimators are assumed to converge and meet the conditions of law of large numbers, they fulfill the identification conditions and they are asymptotically distributed.

Irwin and Tervio (2002) and Noguer and Siscart (2005) used the Ordinary Least Square (OLS) method to determine if trade raises income. However, the GMM method is preferred to the OLS method because the former is applicable when estimating an unknown probability distribution whereas the latter always assumed that the error term is normally distributed. Furthermore, the OLS estimation is very sensitive to outliers and with the existence of outliers in the data it will lead to biased and inefficient estimates. In other words, the OLS method is notoriously non-robust to outliers. Since we anticipate that our study will contain such category of dataset and the appropriate probability distributions may not be known, hence the moment-based estimates are preferred to OLS estimates.

Using the standard procedure in GMM estimation by taking the first difference of the variables in a distributed-lag model, equation (1) becomes:

$$\Delta HDI_{i,t} = \alpha + \beta_1 \Delta HDI_{i,t-1} + \beta_2 \Delta Trade_{i,t} + \Delta\mu_{i,t} \qquad (2)$$

where

$$\Delta HDI_i = HDI_{i,t} - HDI_{i,t-1}$$

$$\Delta Trade_{i,t} = Trade_{i,t} - Trade_{i,t-1}$$

$$\Delta\mu_{i,t} = \mu_{i,t} - \mu_{i,t-1}$$

The next stage is to determine the appropriate lag length by using the Arellano-Bond estimator and then used the lagged values of the dependent variable ($HDI_{i,t-2-j}, j = 0,1...$) as an instrument for the $\Delta HDI_i$ while deriving the moment conditions (Gunduz, Hisarciklilar and Kaya, 2009). It is assumed that the disturbances are homoscedastic within countries and over time, (possibly) heteroscedastic across countries and otherwise well behaved,i.e.,

$$\text{cov}(\mu_{i,t}, \mu_{j,v}) = \begin{cases} \sigma_i^2 & \forall\, i = j, t = v \\ 0 & \text{otherwise} \end{cases}$$

In order to examine the impact of trade on social development (i.e., HDI excluding the income component), another model is also estimated utilizing *HDI** defined as non-income HDI:

$$\Delta HDI^*_{i,t} = \alpha + \beta_1 \Delta HDI^*_{i,t-1} + \beta_2 \Delta Trade_{i,t} + \Delta\varepsilon_{i,t} \qquad (3)$$

where

$HDI^*_{i,t} = HDI_{i,t} - \left[\frac{1}{3}\left(\frac{\log(y) - \log(y^{\min})}{\log(y^{\max}) - \log(y^{\min})}\right)\right]$, $y$ = Gross national income per capita, $y^{\min}$ = PPP US\$100, $y^{\max}$ = PPP US\$40,000[3]

$$\Delta HDI^*_{i,t} = HDI^*_{i,t} - HDI^*_{i,t-1}$$

$$\Delta Trade_{i,t} = Trade_{i,t} - Trade_{i,t-1}$$

$$\Delta\varepsilon_{i,t} = \varepsilon_{i,t} - \varepsilon_{i,t-1}$$

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[3] The definition is based on the official formula at http:// hdr.undp.org/en/statistics/data/calculator/. The HDI is computed as a simple average of the three components of life expectancy, education and standard of living, where HDI = 1/3(life expectancy index)+1/3(education index)+1/3(GDP index). Hence, subtracting the third component, i.e., the income component from the HDI, results in the non-income HDI, namely HDI*.

This study uses secondary data from several sources namely the World Bank, the United Nations Development Programme (UNDP) Publications, International Financial Statistics CD-ROM, Direction of Trade Statistics (various years) and IMF World Economic Outlook Database. The HDI data are retrieved from the UNDP publications as a measure of social development while the other data sources supply the information to compute the country's per-capita trade. Data for HDI are reported in 5-year increments beginning 1975 until 2010. However, the year 1975 is excluded since the HDI data are not reported for Bahrain and Jordan while the year 2010 is excluded because four countries, namely Oman, Lebanon, Iraq and Somalia are yet to furnish their Human Development Index to the UNDP. In addition, several OIC countries in the high, middle and low income categories are excluded from the study due to data constraint. Table 1 summarizes the number of countries included in the study by income classifications containing HDI data of 5-year increments and yearly increments.

**Table 1**
**Number of Countries by Income Classifications**

| | Number of countries | | | |
|---|---|---|---|---|
| | 5-year increments (1980-2005) | % of sample | Yearly (2000-2009) | % of sample |
| High income countries | 3 | 12.5 | 6 | 15.8 |
| Middle income (both upper and lower income) | 15 | 62.5 | 20 | 52.6 |
| Low income countries | 6 | 25.0 | 12 | 31.6 |
| Total | 24 | 100 | 38 | 100 |

Based on availability of HDI data for the five-year increments, this study makes a comparison of the results across the following categories of 24 OIC countries as in World Bank (2007), namely: (i) High income countries (Bahrain, Saudi Arabia and United Arab Emirates); (ii) Upper middle and lower middle income countries (Algeria, Gabon, Malaysia, Turkey, Cameroon, Cote d'Ivoire, Egypt, Guyana, Indonesia, Jordan, Morocco, Pakistan, Senegal, Sudan and Tunisia); and (iii) Low income countries (Bangladesh, Mali, Mozambique, Niger, Sierra Leone and Togo). As shown in Table 1, HDI data for a total of 24 countries are available at five-year increments. Starting from the year 2000, HDI was reported on annual basis and with the availability of this annual data the number of countries in each classification increases to six for High income countries (Bahrain, Brunei, Kuwait, Qatar, Saudi Arabia and United Arab Emirates); 20 for Upper middle and lower middle income countries (Albania, Algeria, Gabon, Iran, Kazakhstan, Malaysia, Turkey, Cameroon, Cote d'Ivoire, Egypt, Guyana, Indonesia, Jordan, Maldives, Morocco, Pakistan, Senegal, Sudan, Tunisia and Yemen); and 12 for Low income countries (Bangladesh, Chad, Gambia, Kyrgyzstan, Mali, Mauritania, Mozambique, Niger, Sierra Leone, Tajikistan, Togo and Uganda). Therefore, for HDI data series produced annually from 2000 to 2009, a total of 38 are utilized in this study (see Table 1).

## 4. Analysis and Discussion

The trends in HDI and total trade over the period of analysis by income classifications are provided in Figures 2 and 3. The average HDI and the average total trade are highest for high income countries, followed by middle and low income countries. The average HDI shows an increasing trend over the years for all countries. The average total trade of high income countries increased rapidly beginning 2002, peaked in 2008 and declined in 2009. However, the average total trade of middle and low income countries remained almost the same throughout the period of analysis.

**Figure 2**
**Average HDI for OIC Countries Based on Income Classifications**

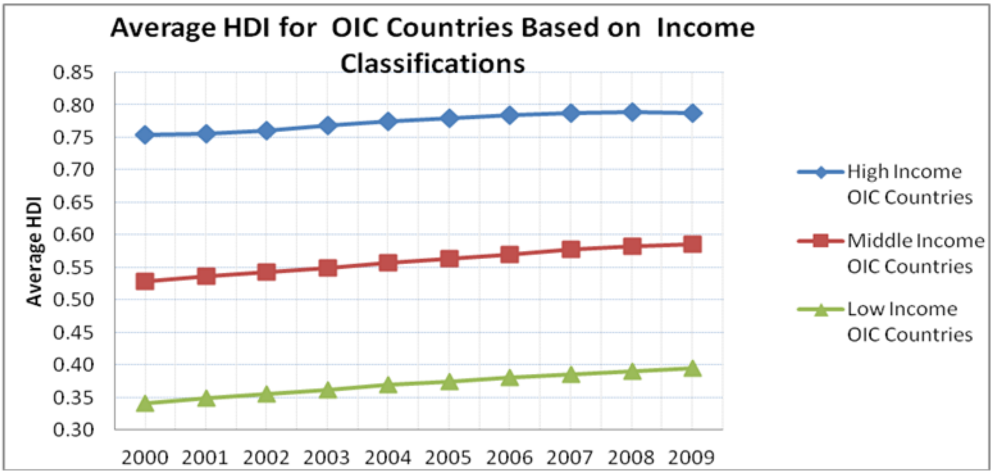
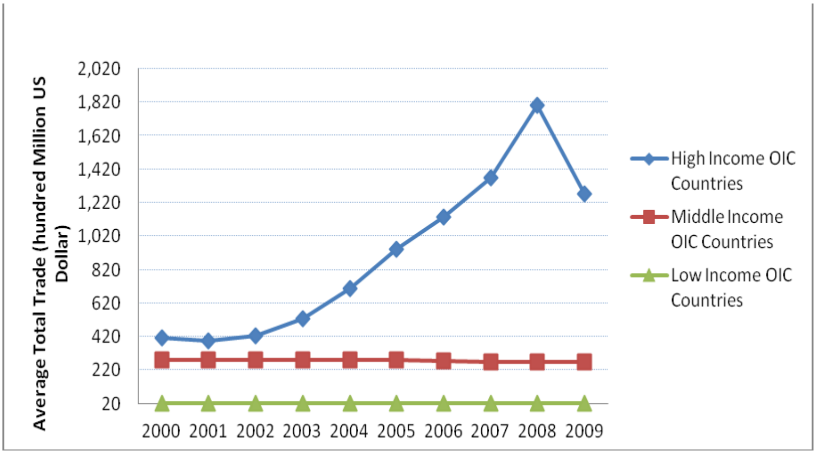


**Figure 3**
**Average Total Trade for OIC Countries Based on Income Classifications**




Two sets of estimations are performed separately for each of the three income classifications of OIC countries,[4] choosing the dependent variables as $\Delta HDI_{i,t}$ to examine the impact of trade on human development as a whole, and on $\Delta HDI^{*}_{i,t}$ to investigate further the impact of trade on actual social development, when income is excluded from HDI. The estimations utilizing five-year increments of HDI generally yields insignificant results for all variables across all income classifications. This may be due to the relatively small number of observations obtained for each income classifications due to data constraints. Hence, the results are not reported.[5]

The first estimation on yearly data from 2000 to 2009, however, yields more interesting results. Trade per capita ($\Delta Trade_i$) is positively correlated with the variation of the HDI and found to be significant (see Table 2). A similar result is found in Davies and Quinlivan (2006) where trade and social welfare is significant and positively related. However, only for the low income countries, increases in HDI levels observed over the past two years ($\Delta HDI_{i,t\text{-}1}$) have a positive relationship with the changes in total human development over the past period.

[4] The estimation using the 5-year increments is also performed in addition to using yearly data in order to capture the experience of the countries in the years prior to 2000, of which data on HDI is reported only on a 5-year intervals.
[5] The estimation results are available upon request.

**Table 2**
**Estimation Results for Model 1 (HDI)**

| | High Income OIC | Middle Income OIC | Low Income OIC |
|---|---|---|---|
| $\Delta Trade_i$ | 0.015945* | 0.031975** | 0.028499* |
| | (1.730908) | (1.311648) | (1.826700) |
| $\Delta HDI_{i,t-1}$ | 0.124217 | 0.656232 | 0.842536* |
| | (0.347137) | (1.986531) | (1.707403) |
| Constant | 0.001783 | -0.001802 | -0.003014 |
| | (0.2713) | (-0.726927) | (-0.676971) |
| *J*-statistic | 3.25E-28 | 1.04E-27 | 4.79E-27 |

Notes: *, **, *** denote significance at the 10%, 5%, and 1% level, respectively. Figures in parentheses are *t*-statistics.

**Table 3**
**Estimation Results for Model 2 (HDI*)**

| | High Income OIC | Middle Income OIC | Low Income OIC |
|---|---|---|---|
| $\Delta Trade_i$ | 0.015754 | 0.016988 | 0.005793 |
| | (0.919449) | (0.987545) | (1.351529) |
| $\Delta HDI^*_{i,t-1}$ | 0.259937 | 0.426475 | 0.756557*** |
| | (0.434948) | (1.273604) | (4.432921) |
| Constant | 0.000452 | 0.000421 | -2.31E-05 |
| | (0.377653) | (0.389446) | (-0.030823) |
| *J*-statistic | 4.21E-30 | 2.60E-27 | 1.81E-27 |

Notes: *, **, *** denote significance at the 10%, 5%, and 1% level, respectively. Figures in parentheses are *t*-statistics.

The second estimation on $\Delta HDI^*_{i,t}$ that excludes the income component of HDI shows non-significance of the trade variable for all income classifications (see Table 3). This indicates that trade relates positively only with the income component of human development, but not with the other components, such as longevity, literacy level and educational attainment as captured by $\Delta HDI^*_{i,t}$. Thus, consistent with Gunduz, Hisarciklilar and Kaya (2009), trade is found to be linked to human development only through income channels. As before, only for the low income countries, increases in HDI levels observed over the past two years ($\Delta HDI^*_{i,t-1}$) have a positive relationship with the changes in total human development over the past period. This suggests that for the middle and high income OIC countries, the level of development has reached a level where the growth in human development over the period has become small, rendering it insignificant.

Examining the validity of both models, the *J*-statistic null hypothesis states that a model is valid while the alternative hypothesis indicates that a model is invalid and the data do not come close to meeting the restrictions. The results in Table 2 indicate that the null hypothesis cannot be rejected at the 99% confidence level (or at the 1% significance level), thus both the models are, overall, valid.

## 5. Conclusion and Policy Recommendation

Trade has been known to have the ability to change the structure of the economy as well as the rate of growth. It is a means to realize a broad range of human development objectives, such as to help alleviate poverty and reduce human deprivation. This study examines the relationship between trade and the OIC countries' social developments as measured by the HDI using the GMM procedure in a panel data distributed lag model for the years 1980 to 2005, with a five-year increments as well as annual data from 2000 to 2009. It addresses two questions: (i) does trade have a positive relationship with human development as reflected by longevity, educational attainment and income in the HDI measurement? (ii) If the positive relationship between trade and human development exists, does it still hold if the income component of the HDI is excluded?

Comparisons are made across OIC countries based on three World Bank Classifications by Income, namely, high income, middle income and low income countries. The study finds that trade is positively linked to HDI for all income categories, but the link is insignificant on non-income HDI. The finding indicates that trade relates to human development only through income channels, and it does not relate to other components, such as longevity, literacy level and educational attainment.

The study also found that increases in HDI levels observed over the past two years have a positive relationship with the changes in total human development over the past period only for the low income countries. This suggests that for the middle and high income OIC countries, the level of development has reached a level where the growth in human development over the period has become less gradual, rendering it insignificant.

As mentioned in the beginning of this paper, even though trade liberalization and expansion can generate high income and economic growth, its translation into corresponding improvements in human development is not automatic. It depends on how and the extent to which the pattern and character of economic growth affect specific dimensions of human development, and this can be greatly influenced by appropriate public policies that can be used to ensure that trade benefits human development. The finding that trade no longer has a positive relationship with human development when the income component is excluded may imply that public policies in these countries have been unable to channel the benefits from trade into more meaningful dimensions of human development. Hence, more of appropriate and effective public policies need to be formulated and implemented so as to achieve the desired outcomes of multi-dimensional human development in the true sense of the word.

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# Economic and Financial Crises in Fifteenth-Century Egypt: Lessons From the History

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**Abstract**

*The present paper attempts to study the economic and financial crises of 15$^{th}$ century Egypt, which was ruled by Mamluk dynasty. Two social thinkers of the time – al-Maqrizi at the beginning of the century and al-Asadi at the middle – addressed the situation. To the former, deterioration of Egypt's monetary system was the single most important cause of its economic and financial difficulties. As a panacea, he prescribed a return to gold and silver standard and restricting copper coinage to petty transactions. The latter divided the factors responsible for economic and financial crises into socio-economic factor and monetary factor. He advocated for an overall reform and strict management of the whole economy. The main financial problem, in his opinion, was debasement of currency leading to unrestricted supply of money, not the issue of copper coins. The paper concludes with an appraisal of their diagnosis of the problem, the solution suggested by them and the lessons learned from them.*[1]

Keywords: Financial History, Financial Crisis, Islamic Economics.
JEL classifications: N15, G01, E400.

## 1. Introduction

The context of the present paper is the recent financial crisis which has drawn attention to search a parallel in the past at various stages of history. In this background some scholars threw a cursory glance at the Muslim history and

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[1] M. Fahim Khan, "World Financial Crisis: Lesson form Islamic Economics" in *Issues in the International Financial Crisis from an Islamic Perspective*, Prepared by: Group of Researchers Islamic Economic Research Center, King Abdulaziz University (Jeddah, Scientific Publishing Center, 2009), 21-22.

hurriedly concluded: 'It was the period when the poverty was non-existent. Basic needs of every one were met. No one was "poor" enough to look forward to receive charity. Worldwide famine type situations were intelligently and successfully dealt with. *There is no evidence of financial and economic crisis in the long history* (of Islam) *spread over about 1000 years* (parenthesis and emphasis added).' In fact the economic history of Muslim states largely remained unexplored. Absence of knowledge does not mean absence of existence. There are instances of economic and financial crises even in Islamic history. But the causes, intensity and frequency have not been the same which we experienced recently. The present paper aims to study the economic and financial crises of 15th century Egypt which was ruled by Mamluk dynasty.[2] In this respect the paper specially attempts to examine the contributions of two social thinkers of the time – al-Maqrizi at the beginning of the century and al-Asadi at the middle – who analyzed the situation, pointed out the causes, and suggested remedies. It will conclude with an appraisal of their diagnosis of the problem, the solution suggested by them and check their relevance in the present day situation. To provide back ground knowledge of 15th century Egypt, the papers begins with an overview of its political and socio-economic conditions.

*Fifteenth-Century Egypt: An Overview*

The Mamluk[3] sultans established their rules both in Egypt and Syria, Cairo being their capital. They were originally troops of slave-status enlisted to sustain Ayyubid power. After they took control of Egypt, they achieved the re-conquest of the last of the Crusader kingdoms in the Levant, and defeated the Mongols at the critical battle of Ayn Jalut in 1260.

The Mamluk sultan Zahir Baybars (1260-77) installed an Abbasid *amir* as caliph at Cairo, who survived the Mongol massacre in Baghdad in 1258. This made the Mamluk government the focus of Islamic world. Even Indian kings obtained their titles of sovereignty from the Abbasid caliph in Egypt. Many European kings

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[2] The Mamluk dynasty was established in Egypt in mid-thirteenth century after abolishing the Ayyubid dynasty in 1250 and it came to an end in early 16th century when Ottoman Sultan Selim First (d. 1520) defeated Mamluk Sultan Qansawh Ghawri in 1517.

[3] In Egyptian history, Mamluks are divided into an earlier group called the *Bahri* Mamluks (1250-1382), and a later group, the *Burji* Mamluks (1382-1517); the *Bahri* Mamluks were originally soldiers based on Roda Island by Cairo, on the Nile (*Bahr*), while the *Burji* Mamluks were associated with the Citadel (*Burj*). The *Bahri* Mamluks derived largely from Qipchaq tribesmen in what is now southern Russia, with Mongols and Kurds; the *Burji* Mamluks were mainly Circassians, from the Caucasus Mountains.

extended the hand of friendship towards the Egyptian sultans, and they exchanged ambassadors. Some of them signed treaty for defense and trading purposes.[4] Both Cairo and Damascus became the centre of Islamic culture and learning after destruction of Baghdad by Mongols in 1258.

It seems that in the 15th century Muslim social thinking reached its peak when Egypt saw scholars like Ibn Khaldun (d. 1406), al-Maqrizi (d. 1442), al-Asadi (15th century), Ibn al-Azraq (d. 1489) and al-Suyuti (d. 1506). For many succeeding centuries we could not see an intellectual scholarship of that stature in that number.

Fifteenth-century Egypt falls under the dynasty of *Burji* or Circassian Mamluks (1382-1517).[5] The Mamluk society was stratified into four distinct classes – the ruling class. Public administrators, educators and scholars representing the link between the rulers and the general public, then the rich class of traders and merchants and finally the group made up of the rest – farmers, laborers, craftsmen, small shopkeepers and the poor masses. As we shall see below, al-Maqrizi divides the population into seven categories to examine the effects of economic and financial crises on Egyptian people. The *fallahin* (plural of *fallah*, farmers or land tillers) were in majority and about the worst economically as they were subject to multiple taxes.[6] Al-Maqrizi saw the detrimental effect of excessive taxation and decline in collection – an idea that came to be known as Laffer's Curves in the Twentieth Century. When inhabitants are overburdened by increasing taxes, the revenue collections decrease because people abandon cultivation, leave farming and migrate from the area.[7]

Fifteenth-century Egypt saw number of outbreak of plague which led to demographic crisis. Depopulation led to decreased economic productivity;[8] while demand for health care during the epidemics increased, the fee of the physicians

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[4] Stanley Lane-Poole, *A History of Egypt in the Middle Ages* (London: Methuen 1925), 281; S. William Muir, *The Mameluke or Slave Dynasty of Egypt* (London: Smith, Elder 1896), 38.

[5] It was established by al-Zahir Barquq (d. 1399), a *burji* slave, in 1382, by overthrowing Bahri Mamluk sultan al-Salih b. Sha`ban to whom the former was a body guard.

[6] Muhammad bin Ahmad Ibn Iyas, *Bada'i' al-Zuhur fi Waqa'i' al-Duhur* (Cairo: al-Sha`b Press 1960), 2: 30.

[7] Taqi al-Din Ahmad bin Ali al-Maqrizi, *Kitab al-Suluk*, ed. Sa`id `Ashur (Egypt: Dar al-Kutub Press 1972), 4: 791-95; idem, *Ighatha al-Umma bi-Kashf al-Ghumma*, ed. Muhammad M. Ziyadah and Jamal al-Din al-Shayyal (Cairo: Lajna Talif wa-l-Tarjama 1940), 44.

[8] Boaz Shoshan, "From silver to copper: Monetary changes in 15th century Egypt," *Stvdia Islamica*, 56 (1982): 97.

augmented many fold.[9] Plague which started in 1403 remained for three years and destroyed forty villages. Death toll is estimated variously as one-third, one-half, two-third or 60 percent of the population. As an average it occurred every 1.7 years. Most destructive were those which spread during 1406, 1419, and 1429.[10] For some writers 'the complex economic problem of the later Mamluk period remains largely a population problem.'[11] In the opinion of Udovitch also, demographic decline due to frequent occurrence of plague was the main factor behind the serious decline of all the economic sectors – agriculture, industry and commerce.[12]

The size of population is, no doubt, a major determinant of the level of prices, but there are other factors which also play a part, including the amount of money in the nation and, as the economists put it, the velocity of its circulation. The period after the onslaught of the Black Death witnessed an increase of more than 100 percent in the wages of workers – both skilled and unskilled – due to shortage of man power.[13] This must have affected the prices of their products.

Egypt's agriculture has been traditionally based on rise of the Nile. Whenever it was delayed, a famine-like situation arose. Ibn Iyas never fails to report the level of its rise each season and its consequences on economic life. There was no technique to manage and utilize the rain water. Whenever, it rained heavily it caused more damage than benefit. Historians of the period note many such occasions when rain created havoc, closure of markets and destruction of crops.[14] Rise and fall of Nile level was a matter of great speculations. Whenever Nile delayed in rising to its plentitude-level in Egypt, or rainfall did not come in time in other part of the sultanate, producers, sellers, middlemen all started hoarding for the coming tough days, which multiplied the shortage and suffering. On the contrary, a little change in Nile’s water level and rainfall to the best hope of people, brought ease and decrease in prices.[15]

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[9] al-Maqrizi, *Ighatha*, 35.

[10] Amir Najib Musa Nasir, *al-Haya al-Iqtisadiyya fi Misr fi-l-Asr al-Mamamluki* (Amman: Dar al-Shuruq 2003), 91.

[11] Shoshan, "From silver to copper" 98.

[12] Lopez, Robert, Miskimin, Harry and Udovitch, Abraham, "England to Egypt, 1350-1500: Long-term Trends and Long-distance Trade", in M. A. Cook, *Studies in the Economic History of the Middle East* (London: Oxford University Press 1970), 115, 121.

[13] al-Maqrizi, *Ighatha*, 75.

[14] Ibn Iyas, *Bada’i‘ al-Zuhur*, 4: 193, 198, 199, 206; Muhammad bin Ali Ibn Tulun, *Mufakaha al-Khullan fi Hawadith al-Zaman* (Beirut: Dar al Kutub al-Ilmiyya 1998), 348.

[15] al-Maqrizi, *Kitab al-Suluk*, 4: 318, 330.

In some of the years of famine, the farmers could not cultivate land as they were unable to manage seeds.[16] The evil of lending seeds to the farmers at 11 percent interest are also reported.[17] Al-Asadi writes that when farmers came from village to the city to deposit agricultural taxes, the banker or the goldsmith checked and evaluated the content of money in such a deceitful manner that their money fell short of the required amount to an extent that they were forced to borrow money from him on interest to pay their obligations.[18]

Since Egypt and Syria were located at the centre of world trading route, international trade and commerce always existed there. However, due to frequent currency changes and debasement, it was adversely affected.[19] Merchandises were sent through Makka from India to Alexandria and thence to Europe. However, during the 15th century monopolization of major trade articles by some of the Mamluk Sultans hard hit the foreign trade. It discouraged the private traders and retailers. Fifteenth-century also saw the end of Karimi merchants who could prove a contending force against European mercantilists had they received the state patronage.[20] Mamluk history is full of instances of monetary mismanagements. As early as in 14th century Mamluk rulers used debasement and unrestricted money expansion to meet the deficit in their spending. The great scholar of early Mamluk period Ibn Taymiyya (1261-1328) who witnessed the turmoil resulted due to debasement practiced by Mamluk rulers of his time suggested that, ‘the authority should mint the coins (other than gold and silver) according to the just value of people’s transactions without any injustice to them’.[21] He advised the ruler, 'not to start business in money by purchasing copper and minting coins and thus doing business with them …… He should mint coins of real value without aiming at any profit by so doing.'[22] The story was repeated during our study period also.

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[16] Idem, *Ighatha*, 41-42; 44-45.

[17] Ahmad bin Abd-Allah al-Nuwayri, *Nihayat al-Arab fi Funun al-Adab* (Cairo: al-Mu'assasa al-Misriyya, undated), 8: 252.

[18] Muhammad bin Muhammad bin Khalil al-Asadi, *al-Taysir wa-l-’I‘tibar wa-l-Tahrir wa-l-‘Ikhtibar*, ed. Abd al-Qadir Ahmad Tulaymat (n.p., Dar al-Fikr al-Arabi 1967), 122.

[19] al-Maqrizi, *Kitab al-Suluk*, 3: 281; 4: 437.

[20] Abdul Azim Islahi, *Muslim Economic Thinking and Institutions in the 10th AH/16th AD Century* (Jeddah: Scientific Publishing Center, King Abdulaziz University 2009). 91-92.

[21] Ibn Taymiyya, *Majmu` Fatawa Shaykh al-Islam Ahmad Ibn Taymiyya* (Riyadh: al-Riyad Press 1368 H.), 29: 469.

[22] Abdul Azim Islahi, *Economic Concepts of Ibn Taimiyah* (Leicester: the Islamic Foundation 1988), 141.

Generally three kinds of monetary units – *dinar* (gold), *dirham* (silver) and *fals* (copper coin, plural = *fulūs*) circulated. While the *dinar* was very scarce, the *fals* was the predominant coin. Circulation of *dirham*s always fluctuated. At the beginning of the Mamluk era the *dirham* contained two-third of silver and one third of copper. But in the course of time the proportions were reversed.[23]

One of the reasons why Mamluk Sultans resorted to copper money was lack of their own resources of precious metals, and the same was reason for the spread and dominance of European gold money in Egypt. Shoshan, a specialist of Mamluk monetary system, observes that the reason for wide spread of copper money was Egypt's dependence on import of precious metals, especially silver, from Europe which was adversely affected in the 15th century known as "silver famine".[24]

Like currency in Mamluk regime, prices were also highly unstable. The first half of 15th century saw frequent rise of prices of grains, especially during the years 1403-1405, 1415, 1419-1421, 1425, 1428, and 1449-53.[25] Apart from monetary expansion, decrease in agricultural product was the major factor for the increase in prices of foodstuffs. For example, when Nile did not rise to the desired level in 1403 and in 1415 and all the grain storage emptied, prices increased to a very high level.[26] In Many cases, the reason for rise in prices was hoarding and speculative practice by traders, thus creating artificial shortage, and monopolization of trade by elites and rulers worsened the situation many fold.[27] Examples of efforts by some of the sultans to fix the prices of essential goods and subject the offender to punishments are also not rare.[28]

In Mamluk period scope of *ḥisbah* (market supervision) was widened and collection of certain duties was included in its functions. Due to corruption on a grand scale in the government and in its institutions, the *ḥisbah* also became a profit earning office for the *muḥtasib* (the in-charge of *ḥisbah*). Instances are reported when a person offered bribery to obtain the position of *muḥtasib*. In such a situation generally the office was held by those who lacked the basic qualities for that position. Sometimes *muḥtasib* accepted bribery to ignore his duty of price

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[23] Ahmad bin Ali al-Qalqashandi, S*ubh al-A'sha* (Cairo: Dar al-Kutub al-Khadiwiyya 1913), 3: 443.
[24] Shoshan, "From silver to copper", 98-103.
[25] Nasir, *al-Haya al-Iqtisadiyya*, 254.
[26] al-Maqrizi, *Kitab al-Suluk*, 4: 338.
[27] Ibid., 4: 691, 711, 782-83.
[28] Ibid., 3: 818; 4: 334-35.

checking.[29] Whenever an honest market officer was appointed the situation improved and objective was achieved. Otherwise, it defeated the purpose. Examples are also found when price control resulted in black marketing or further shortage.[30] Subsidy and rationing was adopted to solve the problem of shortage arising out of administrative fixation of the price.[31]

Al-Maqrizi notes the extravagance and misappropriation of public treasury by the rulers. Silk Carpets were laid down for the sultan to walk over from his residence to the fort while people were suffering from hard living.[32] Deficit was also met by debasement of currency, issue of copper money,[33] and through auction of government offices.[34]

## 2. Economic and Financial Crises

During the 15th century, especially in its first half, Egypt faced horrible economic crisis caused by rulers' ill-governance and corruptions sometimes and sometimes by natural catastrophe such as over flooding of Nile or its drying up, outbreak of epidemics, crop diseases etc. as noted above. In many cases two or more factors simultaneously existed. Financial crisis mainly emanated from monetary mismanagement which adversely affected people's lending and borrowing, saving and investment, trade and commerce, production and consumption, exchange and distribution, etc. From such situations both ruling class and common man suffered but the suffering of the latter was many fold greater as the rulers tried to recoup resources by imposition of regressive taxes, monopolizations of business and hoarding of foodstuffs. The most affected class was that of small farmers, labors, and artisans.

The profound change in Egypt's monetary system had affected the Egyptian economy throughout the larger part of 15th century. It was manifested at around the year 1400 in the emergence of copper money as the country's basic currency instead of the two precious metals, gold and silver. Copper money no more

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[29] Ibn Iyas, *Bada'i' al-Zuhur,* 4: 378; Ibn Tulun, *Mufakaha al-Khullan*, 216; Abd al-Qadir bin Muhammad al-Jaziri, *al-Durar al-Fara'id al-Munazzama fi Akhbar al-Hajj wa Tariq Makka al-Mu`azzama,* (Riyad: Dar al-Yamama, undated), 1000, 1144.

[30] Ibid., 978.

[31] Ibid., 1164.

[32] al-Maqrizi, *Kitab al-Suluk,* 3**:** 1016.

[33] Ibid., 4: 27

[34] Idem, *Ighatha*, 43.

remained the poor man's money.[35] Situation so much worsened that the chief justice of Cairo was forced to decree that money quoted in deeds and contracts should be specified in terms of copper *fulūs*.[36] It became almost the only means of payment for domestic transactions. However, foreign trade required gold or silver coins.

In 1403 it was officially announced to deal in *fulūs* by weight only. This was because of decreasing weight of *fulūs* due to cutting and shedding. In the 14th century it weighed 4.25 grams. In early 15th century it ranged between 1.5 and 3 grams.[37] Not only weight but quality of metallic contents also declined by mixing iron and lead.[38] One clear reason for this malpractice was decline of the quantity of copper which was caused due to wear and tear, its increasing use for utensils, and its outflow to other countries.[39] "The copper *dirham* of account"[40]was substantially devalued between 1402 and 1404, but later on remained stable until 1423. Thereafter, until 1450, debasement was accelerated again. Thus, in 1429 and 1435 the money of account was devalued by about 50 per cent and in 1448 by 30 per cent. [41]

Al-Suyuti, the great scholar of late Mamluk period, notes that during the year 1414, the *fulūs* became expensive after being abundant and cheap. It became very difficult for those who were indebted to repay their loans in term of *fulūs*. Earlier, the *fulūs* had had an exchange rate of 8:1 or 9:1 to the *dirham*; and they had an exchange rate with *aflori dinar* 260:1, with the *harja* 280:1, with the *nasiri* 210:1, and with the *Egyptian qintar* 600:1 (1 *qintar fulūs* = 100 Egyptian *ratl*). After the *fulūs* became expensive, their exchange rate to the *dirham* became 7: 1. As far *dinar* is concerned, all kinds of it – *aflori, harja, nasiri,* and *Egyptian qintar* - lost 50 *fulūs* in exchange. That is, an exchange rate with the *aflori dinar* of 210: 1, with the *harja* of 230: 1, with the *nasiri* of 160: 1, and with the *Egyptian qintar* of 550:

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[35] Idem, *Kitab al-Suluk,* 4**:** 165, 205, 280, 306; idem., *Ighatha,* 71.
[36] Idem, *Kitab al-Suluk,* 3**:** 1117.
[37] Shoshan, "From silver to copper" 108.
[38] al-Maqrizi, *Kitab al-Suluk*, 4**:** 549, 623-30.
[39] Shoshan, "From silver to copper", 110-11.
[40] During the Mamluk period, a new monetary element "copper *dirham* of account" *(dirham min al-fulus*) was introduced. for example, see *Kitab al-Suluk,* 3: 1059 in the events of 804 H. (1401), and 4: 944. Some rendered it as 'trade *dirham*'. It originally represented one real copper coin of a *dirham* weight (about 3 grams), but with the continuous debasement and decline of the weight of copper coinage the 'copper *dirham* of account' no longer stood for one single *fals*; instead it equaled a gradually increasing number of copper coins.
[41] Boaz Shoshan, "Money Supply and Grain Prices in 15th Century Egypt", *The Economic History Review*, 36 (1983): 59.

1. The situation was reversed at the end of the century when it was announced that 30 *dirham* would be exchanged for 1 *ratl* (450 grams) *fulūs*, while earlier 36 *dirham*s were exchanged for a *ratl fulūs*.[42] This seems to be an improvement in the metallic content of the copper coin.

As we noted above, debasement severely affected the lending and borrowing relations. It benefited the debtors to the detriment of lender as it diminished the value of *dirham* of account (*dirham min al-fulūs*). This let to frequent controversies. Here is an example. In 1429, following one of the periodic change in the value of *dirham* of account, its value declined to one-third as compared to its value in 1403. Debtors tried to return their loans according to the newly established value of *dirham* to *ratl* of *fulūs*, which meant paying less than would have to pay earlier. Creditors insisted that the debts should be settled according to the value at the time of contract. The problem generated a debate among legal scholars which was finally resolved in an opinion given by Cairo's chief justice. He decreed that in every document sums of money had to be specified in gold or silver terms only.[43] In this way he abrogated the decree issued in 1403, noted above, which had recognized the copper money as the basis for all kinds of contracts.

Increasing costs and falling profits discouraged investment.[44] For example, cost of collection of flowers exceeded revenue obtained by selling them. This adversely affected horticulture.[45] In many cases ready crops could not be harvested due to high wages. [46]Both al-Maqrizi[47] and al-Asadi[48] blame the Sultan for negligence of land development and irrigation facilities which badly affected the farming and agricultural product. The latter provided data of this decline.[49] A major portion of arable lands was granted to army and ruling elites who exploited the tenants.[50]

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[42] Jalal al-Din Abdal-Rahman bin Abu Bakr al-Suyuti,, *al-Hawi li-l-Fatawi* (Beirut: Dar al-Kutub al-Ilmiyya 2000) I: 96.
[43] al-Maqrizi, *Kitab al-Suluk*, 4**:** 795.
[44] Idem, *Ighatha*, p. 47.
[45] Idem, *Al-Mawa'iz wa'l-'I'tibar bi Dhikr al-Khitat wa'l-'Athar* (Undated, Beirut, Dar Sadir), 2**:** 24.
[46] Idem, *Kitab al-Suluk*, 4**:** 179.
[47] Ibid., 4**:** 225
[48] al-Asadi, *al-Taysir*, p. 92
[49] Ibid., 93.
[50] al-Qalqashandi, *Subh al-A`sha*, 3**:** 451.

### *Al-Maqrizi[51] on Causes and Remedy of the Crisis*

Distressed by Egypt's acute economic and financial crises, in the early years of 15th century, al-Maqrizi authored his famous work *Ighatha al-Umma bi-Kashf al-Ghumma*[52] in the year 1405. The main theme of the book is the high price (*al-ghala'*) and economic fluctuations of the early 15th century in Egypt arising out of wrong political, economic and monetary policies of the Mamluk sultan. He criticized the excessive coinage of copper *fulūs*, the cessation of gold and silver coinage and the adoption in 1403 the *dirham* of *fulūs* as a unit of account. He believed that the Egyptian ruler deliberately stopped the minting of silver.[53]

While describing the economic crisis of his time, al-Maqrizi gives an account of the past periods of inflation and bygone disastrous years. He visualizes that the difference between past incidences of high prices, famine and starvation and the present ordeals is that in the past generally they occurred because of natural calamity, such as paucity of rain, failure of Nile to reach its plentitude-level, spread of epidemics, etc. The government intervention could have diluted the impact of those crises through forcing the hoarders and speculators to release grains, or by

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[51] Taqi al-Din Ahmad b. 'Ali al-Maqrizi, a prolific writer historiographer and economic historian, was born in last days of the *Bahri* Mamluk dynasty in the reign of al-Ashraf Sha`ban (d. 1377). Al-Maqrizi saw the fall of *Bahri* sultans. The last sultan of this dynasty was al-Salih b. Sha`ban who was overthrown by his body guard Barquq (d. 1399), a *burji* slave, in 1382. At that time al-Maqrizi was 18 years old.

[52] There is a misconception that *Ighatha* is a work on famine. No doubt, al-Maqrizi mentioned a few cases of famines in Egypt in the past that caused high prices and starvation. But the main theme of the book is the high price (*al-ghala'*) and economic and financial difficulties of the early 15th century in Egypt arising out of wrong political, economic and monetary policies of the Mamluk sultan. Generally a famine is accompanied by high prices but not the other way round. According to Allouche (Adel Allouche, trans. and ed., *Mamluk Economics, A study and Translation of al-Maqrizi's Ighatha* (Salt Lake City: University of Utah Press 1994, 13) the book is 'a critique, if not an outright indictment, of the Circassian administration's economic and monetary policy. It is a polemical work written by a former official of the *ḥisbah* that focuses on the etiology of a specific economic crisis'. The work is a valuable source of the economic history of Egypt in early 15th century especially in the area of money and coinage. It has served for the author as a basis for another work entitled *Shudhur al-`Uqud fi Dhikr al-Nuqud* or *al-Nuqud al-Islamiyya* in which he retained some of the sections of *al-Ighatha* while making certain additions and improvements. In this way al-Maqrizi became the first who wrote an exclusive tract on money in Islam. It was presented to Mamluk Sultan al-Mu'ayyad Shaykh in 1415 with the hope that he would bring reform in the corrupt monetary system prevailing since more than a quarter century. The book succeeded in its objective to some extent.

[53] al-Maqrizi, *Kitab al-Suluk*, 4: 28-29.

imposing price control or by importing grains from unaffected areas. But the existing ordeals (in 1405) befallen Egypt is due to human fault.[54]

As al-Maqrizi himself writes, his intention in his book *Ighatha al-Umma* is to discuss the factors behind the prevailing worst situation of the Egyptian economy and its ruining effects and to prescribe the remedy.[55] He says: "Anyone who takes the stock of the situation will realize that the people's suffering is due to malfeasance of the rulers and the leaders and their negligence of people's welfare. This is not like what dearth and destruction occurred in the past."[56]

According to al-Maqrizi, there were three main factors behind this sad situation – political, economic and monetary instability. He gives a brief account of those factors: First, government, judiciary and administrative posts are obtained through bribery. Second, high cost of land and consequently very high cost of production; the rent has increased ten times what it used to be before these events. Third, debasement of the currency and unrestricted supply of *fulūs* (copper coins).[57] Perhaps, to him the most important of all these three factors was the last one which he dealt most extensively. He concentrates on coinage in Islam and writes its detailed history up to his own time to point out how deviant is coinage system of his own age and advocates for reform in the existing monetary structure.

Al-Maqrizi claims that gold had been the only money in Egypt in pre-Islamic period as well as in Islam. It is Europeans[58] who introduced *dirhams* (silver coins) after their occupation.[59] The situation worsened when copper coins became the main currency during the early Circassian Mamluk regime. In his opinion, this unrestricted expansion of copper money resulted into high inflation. He seems to have an idea of relation between quantity of money and prices. In the events of 1404 he writes that gold coins have been cancelled. Gold price increased from 20 *dirham* a *mithqal* to 240 *dirhams*.[60]

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[54] Idem, *Ighatha,* 4, 41.
[55] Ibid., *Ighatha,* 3-4.
[56] Ibid., 4.
[57] Ibid., 43, 45, 47.
[58] It seems that al-Maqrizi has referred to the later history of Egypt. Otherwise in early Islamic history both types of coins were in use. Byzantines had gold *dinar* and Iranian *Kisra* had silver *dirham.* Arabs used both. They did not have their own money.
[59] Ibid., 23.
[60] al-Maqrizi, *Kitab al-Suluk,* 4: 27, 306.

Monetary situation improved during the time of sultan al-Mu'ayyad Shaykh (d. 1421) who carried monetary reform at the suggestion of al-Maqrizi to whom the latter presented his treatise on money entitled *Shudhur al-`Uqud*. Sultan al-Mu'ayyad minted *dirham* of silver and after a gap of thirty years first time in Egypt *dirham* of pure silver circulated.[61] Al-Maqrizi praises the Sultan for this reform. However, worsening situation of money continued, *fulūs* dominated the scene and value of al-Mu'ayyad's silver *dirham* was still mentioned in term of copper *fulūs*. He suggests the Sultan certain measures how to correct this 'shameful' situation.[62]

Al-Maqrizi considers gold and silver as real and natural money. He supports his stand by the fact that each nation used them as money. The Prophet (peace be upon him) mentioned *zakāh* in term of silver *dirhams*.[63] He claims that since the known history of mankind only gold and silver were used as money, and the system worked smoothly. This does not mean that al-Maqrizi is unaware of the evolution of money. He accepts that various nations have used different commodities as medium of exchange such as eggs, loaves of bread, leaves, skins of trees, cowries, etc., but to him all these substances of money were for petty sale and purchase. They never assumed the status of legal tender or fiat money. The situation was completely changed in the year 1403 when the copper coins became the dominant form of money. Even the value of gold *dinar* was expressed in term of copper *dirham*, used as unit of account.

Al-Maqrizi examines the impact of the crisis on different sections of the society. For this purpose he classifies the entire population into seven categories. Al-Maqrizi has very clear concept of money income and real income when he says that though the rulers, rich merchants, and small shopkeepers, in the first second and third categories respectively, receive much greater amount, their condition is no more better than what it used to be because they could buy only smaller quantities. The fourth category, cultivators and land tillers, who could irrigate their crops during the years of drought, increased their fortunes. Al-Maqrizi has the idea that during the inflation, the groups of people who have fixed income are hard hit as is the case of fifth category that consists of jurists, scholars, and circle army. The sixth category, manufacturers, artisans and wage earners, benefit because their income is not fixed. They are getting enhanced wages especially because majority population of this group has died of plague. Finally the poor and needy (the seventh category) have already perished and the remaining are near to

[61] Ibid., 289.
[62] Ibid., 31-36.
[63] Idem, *Ighatha*, 51.

annihilation.[64] In the last he presents his proposal to redress the situation. His solution is to revert to the silver coinage and to base the currency on gold and silver only.[65]

To sum up, for al-Maqrizi, the deterioration of its monetary system was the single most important cause of Egypt's economic and financial difficulties. As a panacea, he prescribed a return to gold and silver standard and relegation of copper coinage to the role that God and custom had ordained for it, viz., restricting it to petty transactions.[66]

## *Al-Asadi[67] on Causes and Remedy of the Crisis*

After the second decade of 15th century, economic condition stabilized for the next two decades before experiencing again similar crisis around the midcentury. The intensity of the midcentury economic crisis can be imagined by the fact that in Ramadan 855 (1452), meat and cheese disappeared from the market and wheat price reached seven *Ashrafi* per *irdabb* (about 70 kilograms). This situation continued for four years before returning to the normalcy.[68] Economic and financial crisis distressed the population. Due to high grain prices, it became difficult for farmers to get seeds. [69] People looted shopkeepers in the market.[70] At that time another scholar Muhammad bin Khalil al-Asadi, a contemporary of al-

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[64] Ibid., 73-75.

[65] Ibid., 80-81.

[66] Ibid., 47.

[67] Muhammad bin Muhammad bin Khalil al-Asadi's birth, life and death remain obscured. He authored four valuable works on socio-economic problems of his time but only survived entitled *al-Taysir wa-l-I'tibar wa-l-Tahrir wa-l-Ikhtibar* in 1451. His work itself is the only source to know about him. He lived in Damascus. At that time Egypt and Syria were ruled by Circassian Mamluk. The Caliph was al-Qa'im bi-Amr-Allah Hamza bin Muhammad (d. 1451). A study of al-Asadi's work would reveal that he occupied position of a *muḥtasib*. His book is a rich source on economic thinking and economic history of Mamluk regime. In addition to some other useful information that it contains, it deals with burning issues of the time such as how to reform monetary situation, various economic transactions, abolition of oppressive taxes, cheating and fraud in weight and measures, and corruptions causing shrinkage of public money. It also consists of policy suggestions to rectify the situation and protect lives, property and dignities (al-Asadi, *al-Taysir*, 180). It is surprising that in spite of its significance as a source material for economic history and Muslim economic thinking, the book has not received attention of researchers. In English language there is no work on Asadi's economic thought, while in Arabic there are only a few articles).

[68] Ibn Iyas, *Bada'i` al-Zuhur*, 2: 291.

[69] Ibid., 435.

[70] Ibid., 411.

Maqrizi from Syria, addressed the economic and financial crises and the prevailing inflation in the year 1451. It is not known whether he was aware of and influenced by al-Maqrizi's work. He studied the decayed economic condition of his time arising out of decrease in production, rise in prices, widening gap in the income of various sections of the society, drought and starvation, flight of peasants and workers. He laments the terrible economic condition and divides the factors responsible for the existing economic and financial crises into two main categories – socio-economic factor and monetary factor. In the former category he includes neglect of agriculture, disturbances of bedouins, oppression of farmers, and sales of government positions.[71] He considers the existence of coercion, tyranny and oppression as the most damaging factor in development activities and exhorts to eliminate them.[72] The foreign trade was also adversely affected because of various custom duties charged from the merchants.[73] Sale and purchase of administrative positions was a common source of corruption. In this way incompetent persons got appointment. Those who obtained a position through bribery, their first and main concern was to get back their money and then earn the additional amount.

As far monetary factor is concerned, he deals it separately and holds that the bad currency system is the reason behind the high price (*al-ghala*'). In addition to monetary factor, he notes irresponsible role of *ḥisbah*, un-standardized weights and measures, hoarding and monopoly, and middlemanship. His proposals to solve these issues include correction of weights and measures, monetary reform, rationing of foodstuffs and increase in production.[74]

According to al-Asadi, at the government level, the corruption emanates, on the one hand, from ignorance of Sharīʿah sources of income, like *zakāh*, *kharāj*, *jizya*, *ʿushr*, *khumus*, etc., and resorting to various non- Sharīʿah taxes, on the other hand.[75] He says that apparently the income derived in this way is considered as supporting and beneficial to the ruler but in fact it is not. It weakens the foundation of the sultanate.[76] Over and above is the fact that these public incomes are not spent on productive heads and building of infrastructure for the development of the economy. He cites an example, 'A village belonging to *bayt al-māl* that could support ten military personnel and their families was granted by the authority to his relative with no return to the public treasury. Had it been retained by the

[71] al-Asadi, *al-Taysir*, 92-96.
[72] Ibid., 93.
[73] Ibid., 83-84.
[74] Ibid., 115-46.
[75] Ibid., 78-79.
[76] Ibid.

government and that relative was provided with sustenance from the *bayt al- māl* according to Sharīʿah rules, it would have proved better."[77] He expresses his concern for development programs and emphasizes on undertaking of development activities like improvement of lands, excavation of canals and provision of water resources, removal of obstacles in cultivation of fields, building of irrigation system and bridges, management of drainage and floods in every region as was the practice from the early Islamic period throughout this period till gradually corruption prevailed.[78]

*Al-Asadi's Measurement of Inflation*

Al-Asadi tries to calculate inflation rate. To him if wheat price is one *dinar* per *irdabb* (about 70 kilograms) in Egypt, one *ratl* (450g) Egyptian bread is available at one copper *dirham*, This he considers a normal rate. If wheat is sold at 2 *dinar*s per *irdabb*, the price of one *ratl* bread will be two *dirham*. This he considers as *ghala'*[79] (inflation) or highly abnormal price. On the other hand if price goes below one *dinar* per *irdabb*, the *rakha*' or low price will be at the same rate. He never saw price of bread had gone below one *ratl* per *dirham* even if wheat price went below one *dinar*[80] as it happened during the Ashrafiyya[81] and Zahiriyya[82] regimes when one *irdabb* wheat was sold at 100 copper *dirham* of account (*dirham min al-fulūs*), i.e. 40 percent of *dinar*; it means at less than half a *dinar*. Even sometimes its price decreased to 3 *irdabbs* per *dinar*.[83] In the year 1450 when he started writing his treatise, the price of bread reached to 6 *dirham* per *ratl*. Then it jumped to 8 *dirham* per *ratl* of bread. This means a price rise (*ghala*') of 600 to 800 percent. However, people got some relief when next year, Ramadan 855 (1451), the price fell down and ranged between 4 to 5 *dirham* per *ratl* of bread. This happened in spite of ware houses being full of grains because of hoarding and hiding.

It may be pointed out that al-Asadi measured the price rise by taking an important and essential commodity, the bread. This perhaps represented the other

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[77] Ibid., 81-82.

[78] Ibid., 93

[79] It may be noted that in modern Arabic the term used for 'inflation' is '*tadakhkhum'*. In old days the *ghala'* was used for all kind of high prices.

[80] The reason may be the fact that in production of bread the value added at flour and at baking stage may have been the major constituent of the bread price.

[81] Refers to the reign of Sultan al-Ashraf Barsbay (1422-38).

[82] Refers to the reign of Sultan al-Zahir Jaqmaq (1438-53).

[83] al-Asadi, *al-Taysir*, 143. During that period an average exchange rate of *dinar* to *dirham* was 1: 250.

commodities as well. Had he included a basket of commodities, he would have been considered the first economist who guided to the measurement of inflation.

There were many reasons for rising price in spite of grainary being full such as men blocking the arrival of grain in the open market, hoarding and hiding grain by millers and storekeepers, adulteration, and monopolies enjoyed by certain sections.[84] He presented the case of foodstuffs, being a necessary good, just an example. The same situation prevailed in all kind of commodities.[85]

*Suggestions for Monetary and Economic Reform*

Al-Asadi recommends issue of gold and silver coins of four denominations: a coin of full standard weight, its half, quarter and one-eighth. This will facilitate all kind of transaction. Copper coins (*fulūs*) may also be used for daily small purchases. But they should be issued by the sultan, to put a check on uncontrolled expansion. Al-Asadi believes that undue price increase (*ghala*') due to debased currency will be controlled after monetary reforms suggested by him.[86] He does not insist on limiting money to precious metals. The other metals can work and should work as money but they must be controlled by the government.

According to al-Asadi, attention should be paid to properly manage the non-monetary factors also. For example, to ensure the supplies and keep the price stable the officials concerned must calculate what quantity of foodstuffs each city and village needs daily. Then on the basis of that, calculate the requirement for a month and for the whole year. When crop is ready, acquire the quantity such calculated including provision for the seeds, and leave the rest to be sold in the free market. The stored grains must be brought to the market whenever required. This would ensure flow of supply that would keep the prices at the normal level.[87] To prove this point he presents a statistical model of Egypt and Cairo. He says that if in this way calculated, it will appear that Egypt and Cairo need 360,000 *irdabb* (one *irdabb* = about 70 kilograms) wheat each year and that quantity can be obtained from one *kura* (district) only whereas in Egyptian territory there were originally 103 such *Kura*; now remained eighty-four only.[88] In this way al-Asadi may be considered the inventor of quantitative analysis in the history of Islamic economic

[84] al-Asadi, *al-Taysir*, 143-44.
[85] Ibid., 145.
[86] Ibid., 129-30.
[87] Ibid., 141-42.
[88] Ibid., 142-43.

thought. But his quantitative model, to the best of our knowledge, could not be further improved.

## 2. Comparison and Appraisal

We have seen in the preceding pages that 15th century Egypt passed through a period of economic difficulties. Especially its beginning and midcentury saw severe economic and financial crises which were addressed by al-Maqrizi and al-Asadi respectively. In the opinions of both scholars, Egypt's economic difficulties were due to incompetent and corrupt administration, oppressive taxation, increasing bedouin's encroachments on agricultural areas, the flight of the rural population, the loss of cultivated lands to the desert, disruption of lucrative long distance trade and to a debased monetary system in which copper coins predominated and coins of the precious metals were exceedingly rare. In the opinion of al-Maqrizi, the deterioration of its monetary system was the single most important cause of Egypt's economic difficulties. Therefore he dealt extensively with this aspect of the economy and advocated for return to gold and silver standard and restricting copper coinage to petty transactions only.

Many experts of the economic history of 15th century Egypt do not agree with the analysis of al-Maqrizi. For example, Udovitch observes, 'What Maqrizi did not, and possibly could not understand was that Egypt's monetary problems were not the result of its unfortunate financial policy, but a manifestation of its unfavorable position in the international trade.' [89] Thus, the issue of copper coins was not due to corruption but because of compulsion, as Egypt lost its stock of precious metals and was passing through a period of "silver famine". Egypt did not have its own mines of silver. It depended for supply of precious metal on external sources: West Africa for gold and Europe and Central Asia for silver.[90] Favorable trade balance and arrival of pilgrims constituted two major streams of supply of these metals. Any disturbance in these two sources had drastic effects on monetary matters of Egypt. Towards the year 1400 the flow of Western silver eastward is reported to have been only a trickle; there were some contemporary claims that the traditional direction of the silver movement from West to East, was reversed, and that the "*métal blanc*" started to flow westward instead.[91] Contraction of the sources of

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[89] Lopez, Miskimin and Udovitch, "England to Egypt…", 123-24.

[90] E. Ashtor, *A Social and Economic History of the Near East in the Middle Ages* (London: Collins 1976), 291-92.

[91] Taqi al-Din Ahmad b. Ali al-Maqrizi, *Kitab Shudhur al-'Uqud fi Dhikr al-Nuqud*, edited by Bahr al-`Ulum and published as the fourth edition under the titles *al-Nuqud al-Islamiyya* (Najaf: al-Maktaba al-Haydariyya 1967), 39.

Egypt's precious metals supply and its unfavorable balance of trade caused the loss of gold and silver during 15th century.[92] It was 'the shortage of gold and silver which led to the abundant monetization of copper.'[93]

Al-Asadi experienced scarcity in plenty; prices rose in the wake of granary being full of foodstuffs. This means it was not time of famine or starvation. Nor was the corrupt monetary system the sole cause of inflation. Al-Asadi was not only against debasement, but also against leaving any chance for the public to play with the quality and quantity of money issued by the state. He foresaw the detrimental effects of such activities on the economy. It is, therefore, that he suggests issue of coins with 100 percent purity, and standardized shape and weight that could not be tempered with.[94]

Al-Maqrizi concentrated on monetary phenomenon only. Measures to solve other socio-economic problems, and increase production could not get his due attention. Al-Asadi does not confine his analysis to monetary problem only. He advocated for overall reform and strict management of the whole economy, monetary aspect being one of them. He stressed upon maintenance of peace and security and healthy environment conducive to efficient economic activities. He emphasized not only proper distribution of the cake but also suggested measures for enlargement of the size of cake and its equitable distribution. He does not restrict money to gold and silver. To him precious metals and copper, all have their utility as money and all can be used at the same time. However, issue of money and minting of coins should be in such a way structured that they cannot be copied and debasement is avoided. The main financial problem, in his opinion, was debasement of currency leading to unrestricted supply of money, not the dominance of copper coins.

## 3. Concluding Remarks

Al-Maqrizi believed that the major factor behind economic and financial crisis of 15th century Egypt was its corrupt monetary system and the ruler deliberately stopped the minting coins of precious metals and called for return to bimetallic standard. But the history of the period shows that it is because of short supply of silver that 'copper emerged as Egypt's most widely used currency'. This was the reason for the dominance of copper *fulūs* in the first half of the 15th century.

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[92] Lopez, Miskimin and Udovitch, "England to Egypt… ", 126-28.
[93] Ibid., 125-26.
[94] al-Asadi, *al-Taysir*, 129-33.

Being a champion advocate of a monetary system based on precious metals, al-Maqrizi has been extensively quoted in the present day controversy of gold *dinar*.[95] But the empirical study of the past has shown that it is no guarantee that gold money will succeed in all circumstances. Reliance on issue of copper money in al-Maqrizi's time was due to lack of precious metals. This made his panacea irrelevant to his own time. Surely, it has no relevance in today's complex situation of economy and finance.[96] It may be noted that Sultan al-Mu'ayyad Shaykh, to whom al-Maqrizi presented his treatise on money *Shudhur al-Uqud fi Dhikr al-Nuqud*, implemented the latter's recommendations and issued silver *dirham* in 1415 known as al-Mu'ayyadi.[97] But the outcome was not as al-Maqrizi expected. He expresses his dismay and counts it a "shameful situation" that the value of *dirham* is attributed to copper *fulūs*, not the other way round.[98] In fact, there was not sufficient silver coinage due to shortage of silver in Egypt. Therefore Shaykh's initiative to restore the traditional role of silver did not succeed.[99] People did not stop use of copper in bulk. Since their all exchange needs were fulfilled by copper money, they did not bother Mu'ayyadi *dirham*s. Copper coins predominated in internal circulation and on all levels of transactions. The result was that in 1423, the successor of al-Mu'ayyad Shaykh had to renounce the silver coins and return to 'copper standard'.[100]

It is also proved that the economic and financial crises during 15th century Egypt occurred not due to use of money based on non-precious metals and that bimetallism would have ensured price stability. There are instances of increase in prices even when gold and silver coins were in use.[101] Al-Maqrizi being a top

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95 For example, see M. Aslam Haneef, and E. Rafiq Barakat, "Must Money be Limited to Only Gold and Silver: A Survey of *Fiqhi* opinions and Some Implications," *Journal of King Abdulaziz University – Islamic Economic*, 20 (2006) 1: 21-34.

96 For details one may refer to Zubair Hasan, "Ensuring exchange rate stability: Is return to gold possible?" *Journal of King Abdulaziz University – Islamic Economics*, 21(2008) 1: 3-24.

97 Comparing Shaykh's *dirham* with that issued by Umayyad caliph Abd al-Malik (664-705), al-Maqrizi said that while Abd al-Malik's *dirham* had three qualities, Shaykh's *dirham* had six merits or even more (al-Maqrizi, *Shudhur*, 33-34).

98 Ibid., 35-39.

99 One of the strongest arguments against introduction of gold *dinar* in the present day Muslim countries is also the fact that they produce 'annually less than 10% of total output of the yellow metal' (Hasan, 2008, p. 20) and their stock of precious metals is not enough to fulfill the need of supply of money.

100 al-Maqrizi, *Kitab al-Suluk*, 4: 629-30.

101 According to Hasan ("Ensuring exchange rate stability" 11. Cited from Paul Einzig, *Inflation*, (London: Macmillan 1950), "Paul Einzig, for example, had long back shown in the very opening chapter of his book *Inflation* that prices in the world have been rising over the past five thousand

historian and expert of traditions must have been aware that prices increased at the time of the Prophet as well when gold *dinar*s and silver *dirham*s were in use.[102] The prices increased continuously during the period of second caliph Umar and he had to adjust at least three times the blood money (*diya*) because camels, fixed as compensation, became very expensive.[103] No doubt, money is the blood of economy. So there is need to maintain a suitable quantity of it for the economy to avoid high or low pressure of it, as both cases are destructive for the health of economy. It is, therefore, in all ages it has been considered prerogative and responsibility of the government to issue money and to supervise it.[104] This does not mean that the other aspects of the economy got no significance. Al-Maqrizi recognized some other causes of economic and financial crises, but he gave importance to monetary factor only. The weakness of his prescription is that he sought the solution in adoption of only gold or gold and silver standard of money and ignored the other causes.

There is no doubt that the gold standard had some advantages when it was in practice. Its merits as compared to "a man-made currency not tied to a metal" are admitted even by modern economists.[105] To Crowther, a gold standard ensured stability of exchange rate and provided built-in control on expansion of money supply.[106] But the mankind has passed that standard as it crossed the earlier stages of barter economy, commodity money and metallic money. It is at the threshold of electronic money. Now after fall of bimetallism, it is not practicable to take the economic world back into history.

As compared to al-Maqrizi, al-Asadi's analysis of the situation is more pragmatic. He realized that the economy's fundamental flaws cannot be cured by simply introduction of *dinar* and *dirham*. The financial crisis was product of debasement and counterfeiting, be it *dinar*, *dirham* or copper *fulūs*. Therefore he

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years: the upward legs of the cycles tended to grow longer, and downward turns sharper, while the bottoms were agonizingly broader, recovery being slow and painful".

[102] It is reported that prices soared in Madinah and people requested the Prophet (peace be upon him) to fix the price, but he did not agree and said: "Allah grants plenty or shortage; He is the sustainer and the real price maker (*musa'ir*). I wish to go to Him having done no injustice to any one in blood or in money" Abu Dawud, *Sunan*, (Beirut: Dar al-Kitab al-Arabi undated), 3: 286.

[103] Abu Bakr Ahmad bin al-Husayn al-Bayhaqi, *Kitab al-Sunan al-Kubra* (Hyderabad: Majlis Da'ira al-Maʻarif al-Nizamiyya 1344 H.), 8: 77. As the history of the period shows, the prices of other goods had also increased because of increasing income through spoils of war and other sources.

[104] Muhi al-Din al-Nawawi, *al-Majmu',* ed. M.N. al-Mutiʻi, (Jeddah, Maktaba al-Irshad undated), 6: 10.

[105] *The New Palgrave Dictionary of Money and Finance* (London: Macmillan 1962), 2: 265.

[106] Geoffrey Crowther, *An Outline of Money* (London: Nelson 1967), 281, 284.

insists on standardization of money in such a way that the others cannot imitate it and possibility of debasement is eliminated. In other words, he argues for efficient monetary management. He also pays attention to other factors responsible for economic crisis and recommends measures that include not only monetary reform but also elimination of corruption, removal of discrepancy in weight and measures leading to fraud and deception, correct management of public distribution, enlargement of production through strengthening agricultural relations, and promotion of trade and commerce. This kind of comprehensive internal economic reform is fully relevant to present day complex economic situations. It is a pity that al-Asadi and his work were ignored in his own time and it still missed the attention of researchers today.

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# EVENTS AND REPORTS

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# 8th IDB Global Forum on Islamic Finance

**Role of Islamic Finance for the Development of**
**IDB Member Countries in Central Asia**
Dushanbe, Tajikistan
Kokhi Somon Palace Conference Center
May 19, 2013 (09 Rajab 1434H)

The IDB Global Forum on Islamic Finance is an annual event that provides an excellent platform for academics, experts and practitioners to participate in a strategic policy dialogue and share the experiences of countries and institutions towards the development of the various segments of the Islamic Financial Services Industry (IFSD). The Forum also aims at identifying key challenges to the industry's development in an integrated manner, promoting cooperation and knowledge sharing, thus enhancing its competitiveness and stability. It is a regular annual event since 2006, organized by IRTI in close collaboration with various international organizations and IDB Group.

This year, the theme for the Forum was *"Role of Islamic Finance for the Development of IDB Member Countries in Central Asia"*. Centred on the IDB Group Annual Meeting theme of innovation, the Forum discussed how Islamic finance can become an effective mechanism for central banks and governments to foster economic growth and sustainability. This eighth Forum in the series, was organized in collaboration with the General Council for Islamic Banks and Financial Institution (CIBAFI); the National Bank of Tajikistan; and the State Committee on Investment and State Property Management of the Republic of Tajikistan.

## Session 1: Opening Session

The opening session commenced with a welcoming note by Dr. M Azmi Omar, Director General of IRTI, followed by welcoming speech by Dr. Ahmed Mohammed Ali the President of IDB Group. The opening speech was delivered by the H. E. Mr. Davlatali Saidov, Chairman IDB Board of Governors. Dr. Omar

Hafiz presented a statement on behalf of H.E. Sheikh Saleh Kamil, Chairman of CIBAFI. In the inaugural ceremony IRTI Occasional Paper 1434H on the theme of this forum was also launched along with presentation of some IRTI books translated into Russian language. It was followed by a short presentation on IRTI and its programs for development of Islamic economics and finance.

The key note addresses were given by Mr. Neil D. Miller and Dr. Zamir Iqbal. Mr. Neil D. Miller explored the meaning of ‘development’ in the financing context; considered the role of ‘for profit’ organizations, as opposed to governmental or ‘not for profit’ organizations in economic development; and examined whether the ethical imperative embedded in Islamic finance demands a substantively different approach. He emphasized that the role that ‘law’ might play in helping stakeholders enforce different behavior. He suggested an alternative modus operandi is needed to achieve the objectives of Sharīʿah.

Dr. Zamir Iqbal spoke on the aspect of financial inclusion or access to finance as an essential contributor to economic development. Islam's perspective on financial inclusion is based on a balanced approach through risk-sharing in business transactions complemented by the redistributive instruments targeted at the poor segments of the society. Policy makers in IDB member countries can take certain steps to enhance the inclusion.

The final presentation in the Session 1 was made by Mr. Khaled Al-Aboodi, CEO of ICD who spoke on the ICD’s role and experiences in Central Asia and Caucasus.

**Session 2: Role of Islamic Finance for the Development of IDB Member Countries in Central Asia**

*Role of Islamic Finance for the Development of IDB Member Countries: A Case Study of Kyrgyz Republic and Tajikistan*

The IRTI Occasional Paper for 1434H on this title authored by Dr. Salman Syed Ali, Dr. Nasim Shirazi and Dr. Mahmoud Sami Nabi was presented. This paper seeks to explain how Islamic finance can promote equitable and sustainable development of IDB Member countries. It specially focuses on Kyrgyz Republic and Tajikistan by firstly reviewing their socioeconomic development and analyzing the binding constraints on their sustainable economic growth. A broader approach has been followed in the study for highlighting the underlying issues and indicating how Islamic finance can address them to alleviate some of the identified constraints. The paper also discusses some specific sectors, in the countries under study, where Islamic finance can make a difference. It concludes that Islamic finance can play a great role in promoting inclusive growth and enabling the considered countries to follow a more equitable development path with the objectives to achieve high income and social cohesion simultaneously. Since Islamic finance is not currently practiced in these countries, the study also explains the nature of Islamic finance before pointing to the ways in which it can help address the challenge of alleviating the development constraints.

*Islamic Social Finance Report*

Key findings of the study on Islamic Social Finance sector in South Asia and South East Asia were presented by Dr. Mohammed Obaidullah and Dr. Nasim Shirazi. The findings primarily related to comparative analysis of regulatory framework for *Zakāt*, *Awqāf* and Islamic microfinance sectors. Findings also included good practices e.g., efficiency, transparency and governance in selected successful entities. The countries covered were Indonesia, Malaysia, Brunei Darussalam, India, Pakistan and Bangladesh. It examines the broad regulatory and policy environment at the macro level as well as good practices at the micro level to facilitate policy dialogue.

**Session 3: Role of Islamic Finance for the Development of IDB Member Countries in Central Asia – Practitioners Perspective**

*Proposed Suitable Islamic Financial Instruments for Central Asia Countries*

Dr. Akram Laldin of ISRA made a presentation about the different options available to kick start Islamic finance in Central Asia region taking into account the experience of other jurisdictions, which have embarked on the journey of Islamic finance. It focused on the different instruments of banking, Islamic insurance and capital market that are available and which are the priorities in Central Asia. In addition, the challenges in developing a comprehensive legal, regulatory, taxation and Sharīʿah governance framework for Central Asia region were also discussed.

*Capital Market Development in IDB Member Countries of Central Asia*

Mr. Faheem Ahmad, CEO of IIRA focused his presentation on the importance of a well-developed capital market to a balanced and inclusive financial system. The presentation highlighted the role of rating agencies and particularly national scale ratings in the development of the same. The presentation also comprised a section on the contribution of the SME segment to various developed economies, its relevance in developing economies and how improving their access to capital markets through ratings can play a role in the economic development of Central Asia countries.

*Role of Islamic Finance in the Development of IDB Member Countries in Central Asia - Opportunities and Challenges*

Dr. Adalet Djabiev of Badr Finance and Investment said that at the time of independence of CIS countries, a population of approximately 300 million was fraught with a mixture of fears, uncertainty and at the same time, hopes for a better life, prosperity, development, political and socio-economic sovereignty. Since that time much has been achieved, however, a lot more needs to be done in terms of socio-economic development. It is, therefore, feasible for these countries that in addition to the current economic and financial models, they should also adopt the Islamic finance model, which entails fairness and results in a just society.

*IDB's Contribution to the Development of Islamic Finance in Central Asian Member Countries*

Mr. Wasim A. Abdulwahab, IFSD, IDB Group said that one of IDB's main strategic thrusts as identified in the 'Vision 1440' is the "Expansion of the Islamic financial services industry". In this context, IDB Group is working in Tajikistan, Kyrgyzstan and Kazakhstan to develop the Islamic financial sector. The presentation highlighted IDB's global achievements in the development of Islamic finance in general and elucidated the work being carried out in the Central Asia countries in particular.

*Summarized by Salman Syed Ali*

# 9th International Conference on Islamic Economics and Finance

### "Growth, Equity and Stability: An Islamic Perspective"

The 9th International Conference on Islamic Economics and Finance (9th ICIEF) was held during 9-10 September 2013 in Istanbul, Republic of Turkey on the theme of "Growth, Equity and Stability: An Islamic Perspective". The conference was jointly organized by the International Association for Islamic Economics (IAIE), Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESRIC), Center for Islamic Economics and Finance (CentIEF) at the Qatar Faculty of Islamic Studies (QFIS) of the Hamad Bin Khalifa University, and the Islamic Research and Training Institute (IRTI) of the Islamic Development Bank Group.

It is an important academic and policy discussion event with a long tradition. The First Conference in the series was held in Makkah Al Mukaramah, Kingdom of Saudi Arabia in 1976. Since then the conferences of this series have been held in Islamabad, Pakistan, in 1983; Selangor, Malaysia in 1992; Loughborough, U.K in 2000; Bahrain in 2003; Jakarta, Indonesia in 2005; Jeddah, Saudi Arabia in 2008; and Doha, Qatar in 2011. IRTI-IDB and IAIE are the permanent partners in organizing this series of conferences.

The 9th Conference provided a distinct opportunity to discuss the diverse issues in Islamic economics and finance through plenary sessions and five parallel streams that accommodated 32 sessions where more than 130 papers, in English and Arabic, were presented and discussed. The authors came from over 29 countries. The conference focused on theory, practice and policy issues facing the world in its quest for equitable economic and financial development with stability. It was well attended by academics, professionals and policy makers.

All papers of the conference along with the program are now available for free download from the net at http://9icief.sesric.org/agenda.php while the other details of the conference can be seen at http://9icief.sesric.org

*Some Highlights of the Conference*

- Plenary Session-1 was focused on the ‘State of Islamic Economics’. A number of pioneers of Islamic economics participated as panelists in this session. The Panelist were: Dr. Umer Chapra, Prof. Dr. Nejatullah Siddiqi, Prof. Nevzat Yalçıntaş, Prof. Dr. Monzer Kahf, Dr. Volker Nienhaus, and Dr. Adam Esen.
- Plenary Session-2 was on ‘Islamic Finance for Inclusive Development’ in which two IRTI reports were presented, namely, the Islamic Social Finance Report and the IRTI Occasional Paper on Role of Islamic Finance in Economic Development. Both were policy oriented documents that highlighted policy and possible applications of Islamic finance while identifying further questions for pursuit in future.

- A Symposium on 'Islamic Economics and Finance Education' was also held during the conference. It was participated by INCEIF (Malaysia), IIUI (Pakistan), IIUM (Malaysia), Durham University (UK), Sabahattin Zaim University (Turkey), Sakarya University (Turkey), HPIF (USA), MIHE (UK), QFIS (Qatar). These institutions not only introduced their education and research programs but also highlighted the challenges they face in development of Islamic economics and finance as academic disciplines. Some also discussed the ways they are attempting to solve these challenges. The floor discussion and sharing of information helped in generating ideas and strategy for future.
- Presentation of 130 papers in 32 sessions held over two days covering various aspects of Islamic economics and finance. The sessions showcased the research efforts but also provided opportunity to new and old researchers in the area to share ideas and network. This is one of the most important contribution of IRTI and other co-organizers of this conference series over the years that have helped in keeping the pursuit of research in the area active and bringing in new thoughts and new people in the fold of Islamic economics and finance.
- Promotion and information stalls in the exhibition area were set up by many educational and financial institutions. These were visited by many participants.
- The conference ended with a formal concluding session where the speakers highlighted the importance of actionable and policy oriented research in Islamic economics and finance and urged the community of researchers and practitioners to focus on putting the concepts into practice. The President IDB also reaffirmed IDB's support for the future conferences. The Conference Communique issued on the occasion also highlighted the need for policy oriented research and confirmed that the next conference in this series (10th ICIEF) will be organized during 2014-15 in Doha Qatar.
- The conference was followed immediately by the International Forum on Financial Systems (IFFS) on 11 and 12 September, 2013 at the same venue. All participants of the 9ICIEF also participated in this extended event. The President of the Republic of Turkey, the President of IDB and other heads of institutions also delivered speeches in the inaugural session.

*Conference Communiqué*

The 9th International Conference on Islamic Economics and Finance (9ICIEF) was organized on 9-10 September 2013 in Istanbul, Republic of Turkey on the theme “Growth, Equity and Stability: An Islamic Perspective”. The Conference was jointly organized by the Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESRIC), Islamic Research and Training Institute (IRTI) of the Islamic Development Bank Group, Qatar Faculty of Islamic Studies (QFIS) of the Qatar Foundation’s Hamad Bin Khalifa University, and the International Association of Islamic Economics (IAIE).

The participants in the 9ICIEF thank SESRIC for the excellent organizational arrangements made for ensuring the success of the event and for the generous hosting and hospitality. They also thank and appreciate the leadership of the Republic of Turkey, the host country of the event, for their support and encouragement of innovation, education, development of knowledge-based economy and promoting Islamic economics and finance. The participants also thank all the co-organizers, sponsors, and all those who worked for the success of the Conference.

The Conference provided a distinct opportunity to discuss many and various pressing issues in Islamic economics and finance through plenary sessions as well as parallel sessions where more than 130 papers, in English and Arabic, were presented and discussed.

The participants believe that Islamic economics and finance, as a modern scientific discipline, has recently showed a high potential as a new paradigm, particularly in the aftermath of the latest global financial crisis and given the current economic and political changing environment in the Muslim countries.

Through policy-oriented research, Islamic economics and finance must be ready more than ever before to align the vision of the urgent need for more justice, fairness, and equitable and sustainable development. In this context, as a platform for dialogue and discussions between academics, researchers, graduate students, policy-makers, and practitioners, the Conference contributes significantly to the process of mobilizing quality policy-oriented and basic research in the field of Islamic economics, banking and finance, with a focus on issues related to inclusive economic growth, equity, poverty alleviation and macroeconomic stability.

By doing so, the Conference plays a significant role in enriching the literature and the agenda for contemporary research in Islamic economics and finance and thus promotes the official global recognition of Islamic economics and finance as a modern scientific discipline.

The participants believe that while a significant progress has been made over the last four decades, the focus of research has moved primarily to Islamic banking and finance, and there is a need to work more on economic theory and its applied and practical applications from an Islamic perspective.

In this connection, the participants emphasised the role of educational institutions in enriching the literature and the agenda for contemporary research in Islamic economics, as well as their role in promoting and enhancing the production of basic and applied research to support the Islamic financial industry.

Similarly, there is a need to highlight the role of Islamic finance in economic development and the potential of *zakāt*, *awqāf* and voluntary sectors in promoting financial inclusion and contributing to policy discourse on poverty alleviation.

On the other hand, the participants are cognizant of the fact that there is currently a growing demand for significant reforms in the global economic and financial system, particularly in the aftermath of latest financial crisis. In this connection, they believe that a financial system based on Islamic principles could avoid the fundamental problems and shortcomings of the conventional financial system that led the world into crisis.

Although, the contemporary practice of Islamic banking and finance has rapidly transformed in the last decade to become internationally recognised and accepted as a competitive and robust form of financial intermediation by all communities, the expansion of Islamic finance industry and its integration into the global financial system, are still to be tested by the risks and developments in the international financial system.

In this context, it is argued that in order to enhance its capacity to address the increased risks and vulnerabilities in the newly evolving international financial environment, Islamic financial services industry should continue thriving to achieve higher levels of growth and greater integration into the international financial system.

On the other hand, the participants believe that, in practice, serious efforts should be made to ensure the realization of the institutional and policy aspirations of the original Islamic economic thinking. In particular, to ensure that the basic fundamentals of Islamic economics and finance support the process of mobilisation and allocation of funds to generate productive real economic activity based on the profit-loss sharing principle.

Overall, the participants are cognizant of the need to review and evaluate what has been done so far over the last four decades since the 1st ICIEF, which was held in Makkah al-Mukarramah in 1976. In particular, the need for a critical evaluation of what went wrong, especially in the emerging field of Islamic banking and finance, as an alternative paradigm to the conventional economic and financial system.

In this connection, the participants recommended that the upcoming 10th ICIEF should focus on areas where more efforts should be made in the spirit for setting an agenda for future action, and should deliberate, among other issues, on how we can develop a framework for facilitating the Islamic financial system to take its deserved place in the global financial arena.

The participants welcomed the offer of the Qatar Faculty of Islamic Studies (QFIS) of the Qatar Foundation's Hamad Bin Khalifa University, and the International Association of Islamic Economics (IAIE) to organize and host the 10th ICIEF in Doha during December, 2014.

*Summarized by Salman Syed Ali*

## Mid-Term Review of the Islamic Financial Services Industry Development: Ten-Year Framework and Strategies

In March 2007, the Islamic Financial Services Board (IFSB), in collaboration with the Islamic Research and Training Institute (IRTI), published The Islamic Financial Services Industry (IFSI) Development: Ten-Year Framework and Strategies (Framework). In light of the increasingly challenging economic and financial environments as well as the significant developments taking place in the international financial landscape post-crisis, the IFSB and IRTI are collaborating on a project to review the Framework to ensure that it remains relevant in serving as a guide for various Islamic finance jurisdictions to assist them in charting the future direction of the industry.

Following this, a draft report of the Mid-Term Review (MTR) of the Framework has been prepared and circulated by the IFSB-IRTI Drafting Committee to the Review Committee, taking into consideration the following:

a) Feedback received in the MTR Roundtable on the progress and development of the global IFSI, including the four segments of the industry (held on 6 April 2013 in Doha, Qatar);

b) Feedback received in the MTR Forum on the initial findings of the progress of the recommendations made in the 2007 Framework (held on 14 May 2013 in Kuala Lumpur, Malaysia);

c) Comments and feedback received from the Review Committee members on the first draft of Sector-level Assessments, which is the main section of the report (circulated on 2 August 2013); and

d) Findings from an industry-wide survey undertaken in mid-June to end-July 2013 in various jurisdictions of Islamic finance to gather information on the progress of various segments of the IFSI, in particular with respect to the institutional and infrastructure developments of the industry.

The Review Committee meeting, which was part of the initiatives identified for the MTR project, aimed to obtain further comments and inputs, as well as suggestions for further improvement on the draft Report (if any), on the following key areas (as per the mandate of the Review Committee):

(a) Key observations of the existing Ten-Year Framework which include, but not limited to the:

  (i) Current status of the existing recommendations and the progress of its implementation; and

  (ii) Relevance of the Ten-Year Framework, given new challenges post-crisis; and

(b) Findings and recommendations which include, but not limited to: (i) key issues identified in meeting recommendations in the Ten-Year Framework; (ii) proposed measures to close the gaps; and (iii) new recommendations.

In the first session, the lead consultant from Fajr Capital provided the background and shared with the Review Committee Members an overview of the mid-term review of the Framework, including commentary on:

- The development of the Islamic financial services industry since 2007
- Objectives and methodologies of the mid-term review

- Overall progress and assessment on framework recommendations, and
- Salient issues and questions raised in Review Committee feedback to date

Sector level assessment was discussed in the second session which also explored the outlook on various sectors and infrastructure institutions of the IFSI. The consultants and IRTI representative presented their findings and views with respect to, among others, progress on earlier recommendations, opportunities and challenges ahead, additions or amendments to framework recommendations, initiatives to support implementation, and immediate sector priorities.

The key areas which were discussed comprised the strategic questions and salient issues raised by the Review Committee on the first draft of the Sector-level Assessments, which also consist of the following:

- The diversity of prevailing regulatory models, their relative benefits and drawbacks;
- The merits and drawbacks of "standardization" of regulations, Sharīʿah guidelines, products, and services;
- The merits and drawbacks of setting Key Performance Indicators (KPIs) for the development of the industry;
- How the opening of new markets to the Islamic finance industry affects its strategic roadmap

Having identified the status and progress of each segment of the IFSI, the last session was aimed to synthesize the outcomes of the previous discussions, with particular focus on the following:

- Amendments to the framework recommendations and key performance for measuring the progress of the recommendations over the next five years
- Initiatives undertaken at various levels to implement the recommendations
- Key drivers for successful implementation of the recommendations: On-going review and commitment by the various stakeholders of the IFSI

*Summarized by Hylmun Izhar*

# BOOK REVIEW

*Islamic Economic Studies*
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# Sharīʿāh Maxims Modern Applications in Islamic Finance

Author: Muhammad Tahir Mansoori
Sharīʿah Academy, International Islamic University, Islamabad, 2nd edition, 2012. ix+271 pp.

Reviewed by Abdul Azim Islahi*

Sharīʿah Maxims Modern Applications in Islamic Finance by Muhammad Tahir Mansoori is a second updated and revised edition of his previous work published under the same title in 2007. The author is presently Director General of Sharīʿah Academy, International Islamic University, Islamabad, Pakistan. In producing this work the author has banked on his experience of teaching courses on legal maxims in the field of Islamic banking and finance. He has also gained practical experience of Islamic banking as being Sharīʿah Advisor to a leading banking institution in Pakistan, and a member of the Task Force on Islamic Banking, State Bank of Pakistan.

The book begins with a preface in which the author tell us that the book is meant to be used as a text book for the students of M Sc. (Islamic Banking and Finance) programs. He has selected in the book those maxims which are relevant to the commercial law of Islam and more specifically, to the field of Islamic banking and finance. In the preface he also points out importance of Sharīʿah maxims for Muslim jurists, muftis, and judges in finding rules in new incidences, exercise of *ijtihād* and decision making as they 'convey the spirit, wisdom, logic and philosophy of Islamic law.' They also serve as an 'interpretative aid with the help of which Sharīʿah rules can be interpreted.' However, he does not mention anywhere what improvements and additions he has made in the second addition, something which a reader may like to know. The Preface is followed by a valuable Foreword which was written by (late) Dr. Mahmood Ahmad Ghazi for the first edition of the book.

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The book has two parts. The first part deals with five major maxims with their applications to Islamic business transactions and banking. The second part discusses some important themes of Islamic commercial law, such as contractual stipulation, status of promise, disposition of others' property, concept of liability and trust, *gharar*, *ribā*, and sale and agency. An attempt has been made to trace the origins of respective maxims.

The first chapter is devoted to introduction of Sharīʿah maxims. It deals with the nature and functions of *qawāʿid fiqhiyyah,* their application and legal status, differences between principles of jurisprudence and Sharīʿah maxims. He also differentiates between *qawāʿid fiqhiyyah* and *ḍawābit fiqhiyyah*. The former "represents a general rule, or principle and covers a large number of *fiqhi aḥkām* relating to a particular theme" pp.1-2, while *ḍawābit* (plural of *ḍabitah* = rule) are "the controlling rules, and abstractions of rules, of *fiqh* on specific themes" p. 3. At the end it surveys the historical development of Sharīʿah maxims and major works on the subject in various schools of jurisprudence as well as works by modern scholars. However, development portion is confined to Hanafi School only.

There is very close relation between Sharīʿah maxims and Sharīʿah objectives (*maqāṣid* Sharīʿah). Although a brief discussion has come about Sharīʿah objectives while discussing necessities pp. 95-100, the book could have been enriched by adding a separate chapter on *maqāṣid* Sharīʿah and its relation with Sharīʿah maxims.

Chapter two is on "Intention and motivating cause of contract" that plays 'a pivotal role in determination of its legal status'. It is based on a *ḥadīth*: 1) "Verily, the acts are judged by the intention." Three maxims are derived from this: "Basis of all acts is objective thereof (*al-umūr bi-maqāṣidiha*), 2) "In contracts, effect is given to the objectives and meanings not to the words and phrases", and 3) "Every legal artifice whereby nullification of a right, or affirmation of a wrong, is devised is unlawful". The author fully explains these maxims and demonstrates their applications in the field of banking and finance. In the light of these rules correct positions of controversial contracts like *bayʿ al-inah, bayʿ al-wafa, tawarruq,* commodity *murābaḥah*, and sale and lease back *ṣukūk* can be determined. This provides a context to deal with the stands of various schools of jurisprudence towards the legal devices and stratagems (*ḥiyal*). In this connection, the author discusses Hanafi, Maliki and Hanbali positions only and missed to give the Shafi'i stand. At the end, the author rightly observed that "there are certain legal devices which do not frustrate the purpose and spirit of Islamic law." Such devices can be accepted as they are way out of certain difficulties if they are not in conflict with the Sharīʿah objectives. The author thinks that 'legal devices in Islamic banks predominantly belong to this category' p. 56.

Chapter three deals with the concept of elimination of detriment. The maxims relevant to this are: "Harm and retaliation by harm is not allowed" p. 65, "Harm has to be redressed" p.77, "Repelling evil supersedes securing benefits" p. 90, and "harm cannot compensate harm" p. 92. The author gives meaning and applications of these maxims. For example, laws related to inhibition, pre-emption, continuation of crop sharing contract till harvesting, liability of craftsmen, and penalty for default in *murābaḥah* and *ijārah* financing come under "No harm should be caused and none should be suffered" (*la ḍarar wa lā ḍirar*). Similarly, option of defect (*khiyār al-ʿayb*), option of fraudulent lesion (*khiyār al-ghabn*) and various rules to achieve them come under the maxim "harm has to be redressed." Thus, Sharīʿah maxims help not only in finding rule where there is no rule in new incidence, but they also help understand wisdom and objectives behind various Sharīʿah rules.

Chapter four discusses rules of relaxation in Islamic law. In this connection the author notes two main maxims: "Hardship begets ease" and "Necessities relax prohibitions". He presents some modern *fiqh* rulings based on these principles, such as 'verdict of Islamic Fiqh Academy of India on permissibility of insurance for Indian Muslims', and 'verdict of European Fiqh Council about mortgage financing for purchase of houses'. He rightly cautions that these rules are not absolute or unrestricted and presents certain counter rules which define and restrict the scope of relaxation based on necessity and hardship. A closely related maxim is "A *hājah* (need) whether of private or public nature, is treated like *darurah* (necessity)". It is this rule which worked behind permission of *bayʿal-salam*, *istiṣnāʿ*, *bayʿ al-wafa*, *ijārah*, etc. pp. 106-7. In the *fiqh* literature, there is no demarcation when a *hājah* will be considered as *ḍarūrah* (necessity). Jurists generally leave it to the person or institution facing the situation (*mubtala bihi*). But this leaves scope to misuse or abuse this maxim. Perhaps, because of this feeling the author at the end of the chapter suggests that "in order to avoid the abuse of *hājah*, in legislation, it seems appropriate that a competent body of Muslim scholars, instead of few scholars, should frame concessionary laws, based on *hājah* ascertaining its necessity and magnitude" p. 117.

In every society customs and common practices among the people have been given a place in legislation, and judges have recourse to such customs if no clear law exists in such matters. Islam has also recognized such customs, called *ʿurf*, as a source of law in Sharīʿah. Chapter five examines 'status and authority of customs in Islamic law'. The author gives a number of Sharīʿah maxims based on *ʿurf*. Using this maxim the jurists have decided issues concerning *ʿarbūn* sale, penalties on various economic offences, cash *waqf*, compensation for vacating occupation (*badl al-khulūww*), and forms of possession (*qabḍ*) in modern commercial practices. It may be stressed that not every custom is effective in juridical decision making. It should be a common practice and widely accepted, and it should not be contradictory to the injunctions of Sharīʿah. If a *ʿurf* is changed, the rule based on such a *ʿurf* will be modified according to the existing *ʿurf*. In this connection, however, the author's following statement is confusing and may create misconception: "In the classical Islamic law, if two parties exchanged one *mudd* of wheat with two *mudd* of wheat, they were said to have committed *ribā'l-faḍl*. But today wheat is calculated through weight, so *ribā-al- faḍl* will take place *only* when, say, 5 kg is exchanged with 8 kg" (emphasis added) p. 120. Does he mean, if a person exchanges today 5 *mudd* wheat with 8 *mudd*, there will be no *ribā'l- faḍl*? Or conversely, if in old days 5 *ratl* wheat was exchanged with 8 *ratl*, was there no *ribā'l- faḍl*?? In fact the difference of quantity is prohibited and *ribā'l- faḍl* will occur whether it is done through measure, weight or estimation so for wheat is considered as *mal ribāwi*. It is the causation (*ʿillah*) that may be a subject of discussion in the light of present custom of wheat being a commodity exchanged through weight.

Chapter six deals with the Sharīʿah maxim related to certainty versus doubt and presumption of continuity. According to this maxim "Certainty is not dispelled by doubt" 'a rule of law, or thing, established with certainty continues to remain so, and the doubt, as to change in the position, does not affect the established position' p. 139. The author presents several examples of the application of this maxim.

There are many maxims based on the rule of presumption of continuity such as: "The original rule for all things is permissibility"; "Freedom from liability is the fundamental principle"; "No weight is given to mere supposition"; "No argument is admitted against supposition based upon evidence"; and "No statement is attributed to a man who keeps silence, but silence is tantamount to a statement where there is necessity for speech" pp. 140-50. The author substantiates these maxims with Sharīʿah evidences and shows their applications in economic life.

Chapter seven is on 'legal status of contractual stipulations' which are "inserted in the contract by mutual consent, to modify and change the effect which the Sharīʿah accords to a contract, and to impose some extra liability on a party, with a view to give some extra advantage to the other party" p. 151. This has been a controversial issue among the jurists. The author presents the viewpoints of main schools of jurisprudence about such ancillary conditions. A number of maxims has been developed to reflect the authentic position on contractual stipulations, such as: "Every condition that violates definitive principles of Sharīʿah is void"; 'The principle in contracts and stipulations is permissibility"; "Condition has to be abided by as far as possible"; and "A contract contingent upon condition will take effect only when the condition is fulfilled". The author has fully explained the meanings and applications of these maxims.

Chapter eight discusses 'status of promise in Islamic law'. Under this the author states that "the prominent viewpoints in classical law are that simple promises are not legally enforceable." However, a promise that is made in the form of a guarantee is unanimously enforceable. While discussing the Sharīʿah stand on promise (*waʿd*) he quote verses of the Qur'ān which are about covenant (*ʿahd*) p. 161. There is clear difference between *waʿd* and *ʿahd*. The only maxim noted in this chapter is "Promises that entail guarantee are binding". This maxim has been applied "to every promise in which the promisee incurs some risk, and liability, and performs the act demanded in the promise" p. 164.

Chapter nine is regarding maxims on disposition of others' property. Under this the author notes rules like: No person may deal with the property of another, without latter's permission; any order given to dispose off the property of another is void; no one may take the property of another, except with a legal cause; and authority in respect of people's affairs should be exercised for their welfare only, p. 172. These rules have been enacted because protection of property, earned through lawful means, is one of the objectives of Sharīʿah and the Qur'ān and *sunnah* have forbidden to devour others' property through wrong means. The author has clearly noted when interference in one's property is permissible and justified.

Chapter ten traces maxims that differentiate liability (*ḍamān*) versus trust (*amānah*). If a person holds an object in fiduciary capacity, it is called *amānah*. But if he holds it as guarantor, it is called *ḍamān*. The two have different rules in case of any loss or damage to the object. The maxim is: "Trustee is not liable to guarantee the trust". Deposits, capitals of *muḍārabah* and *mushārkah, ariyah,* etc. are considered as *amānah*. The holders of these objects cannot be held liable for any injury to them, if he has exercised due care and diligence, and the loss or injury occurs without his negligence or fault. On the other hand, if an object is held in custody by a person to own it, like buyer or usurper, borrower of money, etc. and something happens to the object, then he will held liable to it. Again, agency and personal guarantee cannot be combined because such an arrangement in respect of an investment turns the transaction into an interest based loan, when the capital and the proceeds of the investment are guaranteed, pp. 179-80. In this regard the maxim is: "Entitlement to profit depends upon liability for loss".

Chapter eleven deals with the Sharīʿah maxim on *gharar*. The author gives various definition of *gharar* by past and present scholars. But he is not explicit which definition he prefers. However, he concludes that "*gharar* contains characteristics such as risk, hazard, speculation, uncertain outcome and unknown future benefits. A contract involving *gharar* causes undue benefits, and enrichment, for a party, at the cost of other party" p. 189. The author notes various *aḥādīth* from which prohibition of *gharar* is derived. According to him, "a close examination of *aḥādīth* on *gharar*, reveals that four types of risks and uncertainty are involved in the *gharar* transaction." They are gambling and speculation, uncertain outcome, unknown future benefits, and inexactitude. Maxims related to *gharar* are as follows: To sell what one does not have, is unlawful. A *gharar*, when found in the principal object of contract, renders it invalid. *Gharar* invalidates commutative contracts, not gratuitous contracts. A trifling *gharar*, which is not related to a principal object, is permissible. He explains these maxims with relevant examples. It is true that most of Muslim scholars are against conventional insurance as it involves *gharar* and they suggest *takāful* as substitute. Here the author goes into unnecessary details of various models of *takāful*, such as *waqf* model, *muḍārabah* model, *wakālah* model, etc. 202-06.

Chapter twelve is concerned with a very important topic of Islamic economics and finance – Sharīʿah maxim of *ribā*. At the outset the author gives various definitions of *ribā* and mixes up *ribā'l*-Qur'ān (the conventional interest) with *ribā'l-ḥadīth* (prohibition of barter exchange of specific commodities with unequal quantity and/or time of delivery, termed as *ribā'l-faḍl* and *ribā'l-nasiah* respectively). In a work on maxims, the two types of *ribā* should have been distinguished clearly. *Ribā* or interest has been known since ancient days: charging extra amount on loans in lieu of time given for use. Also known as *ribā'l-qurūḍ* (interest on loans) or *ribā'l-duyun* (interest on debts). *Ribā'l-ḥadīth* is also called *ribā'l-buyūʿ* (interest in exchange or trading as it takes the form of barter exchange). *Ribā'l*-Qur'ān is prohibited purposely while *ribā'l-ḥadīth*, for many scholars, is prohibited as a precautionary measure so that it may not become a means of taking actual interest. Obviously the prohibition of the latter is less severe than that of the former.

The author notes two main maxims with respect to *ribā*: "Every loan that entails benefit is *ribā*", and "If a *ribā* bearing counter value is exchanged for similar counter value, equality and immediate possession are obligatory, and if it is exchanged for different species, immediate possession alone, is obligatory. When effective causes are different, none of these obligations arise" p. 210. Clearly the second maxim is specific to *ribā'l-ḥadīth.*

The last chapter discusses maxims on sale and agency which "belong to a number of topics , such as contractual capacity of contracting parties, lawfulness of subject matter, void, irregular and suspended sales, nature and scope of agency, and include many other issues of sale and agency". The author notes here more than a dozen of maxims. Indeed, some of them are so important that they deserve separate chapter.

At the end the book contains a very useful annexure: Sharīʿah maxims of *al-Majallah* - English translation with Arabic text. This helps the reader to go through the relevant maxims at a glance.

It may be noted that there is very strong relation between Sharīʿah maxims and behavioral *fiqh* (*al-muʿāmalāt*). Economics and finance being behavioral science, knowledge of Sharīʿah maxim is essential for Islamic economics and finance. It helps the students and decision makers develop insights in new economic matters and reach correct conclusions.

As a whole, the book is well documented but no reference is given to the opinion of Vogel and Samuel p.165. On p.197, he quotes various scholars on *gharar* without references. Similarly, references have not been provided for *aḥādīth* quoted on pp. 206, 213, 215, etc.

The bibliography part of the book needs many improvements. It does not follow consistently a standard method of listing the books and articles. In some cases full bibliographical details are missing. Hasanuzzamn's work "The Economic Relevance of The Sharīʿah Maxims" is published by Scientific Publishing Center, King Abdulaziz University, Jeddah, 1997, but it is listed as a publication of Islamic Development Bank. In addition, there are many typographical errors, for instance: *Faqhiyyah* [*fiqhiyyah*] p.viii; twelve [twelfth] century p. 11; *istismar* [*istithmār*] p.21; Ibn Tamiyyah [Ibn Taymiyyah] p. 31n; *al-dara'i'* [*al-dharaʿi'*] pp. 64, 59; Salam *Salam* [repetition] p.109; *La Dina laman [li-man] La 'Ahadall hu [la 'ahda la-hu]* p. 161; Ibn Juzy [Ibn Juzayy] p. 162n; *ghabn i-fahish* p. 119 and *Qarḍ-e-Ḥasan* p. 204 [Persian/Urdu style]; *rub-ul-mal* [*Rabb al-māl*]; al-Muhaddab [al-Muhadhdhab] p.211n; 'attab Ibn Asid ['Attab Ibn Usayd] p. 214; Moulana p.55 and Mowlana p. 214 [Mawlana]; *'Ilah* [*ʿIllah*] p. 216; Haidth [*ḥadīth*] and *rabwi* [*ribāwi*] p. 222; maximums [maxims] p. 227, etc. It is hoped that the author will take care of these oversights in the next edition.

The present book is, perhaps, the first text book on Sharīʿah maxims with modern application in Islamic finance. The author's simple language and his lucid style are highly suitable for this purpose. Tahir Mansoori and Sharīʿah Academy have done a good job in producing this book and making it as much easy and interesting for the students to master a subject that is a new and a tough subject.

# ANNOTATED LIST OF IRTI'S RECENT PUBLICATIONS

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# The Role of Islamic Finance in the Development of the IDB Member Countries: A Case Study of the Kyrgyz Republic and Tajikistan

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Finance is expected to play a major role in equitable and sustainable economic development. However, the track record of conventional finance is not encouraging for the task. It has not been very successful in addressing unemployment and poverty. Indeed, the stylized facts show that many countries suffer from increasing income and opportunities inequalities along with economic and financial instabilities. Can Islamic finance offer a solution where conventional finance has failed in the task of equitable socio-economic development? The present paper seeks to explain how promotion of Islamic finance can help in the development of low-income countries.[1] This potential role of Islamic finance is discussed in the context of a case study of Kyrgyz Republic and Tajikistan. Development of Islamic financial sector is high on the agenda of Islamic Development Bank in its efforts to partner in the socio-economic development of its member countries and restoration of human dignity.

The paper notes the achievements as well as identifies some key constraints faced by Kyrgyz Republic and Tajikistan in their aspiration for socio-economic development. These constraints are a combination of financial, governance and

[1] For operational and analytical purposes, the World Bank classifies economies into four groups according to gross national income (GNI) per capita. The groups are: low income, $1,025 or less; lower middle income, $1,026 - $4,035; upper middle income, $4,036 - $12,475; and high income, $12,476 or more.

political factors that are interlinked. Therefore, a broader approach is followed in the present study of highlighting the issues and indicating as how Islamic finance can address them to alleviate some of the identified constraints. It also discusses, as examples, some specific sectors in the countries under study where Islamic finance can make a difference.

## Socio-Economic Progress and Challenges

Kyrgyz Republic and Tajikistan have made a considerable progress since their independence given the huge task of socio-economic transformation that they faced. For example, Kyrgyz Republic has been successful in transforming the economy from central control to the market economy and has achieved a great success in economic growth and poverty reduction compared to the early years. Similarly, Tajikistan has been successful in many fronts. It has been recognized as a democratic country internationally. It has focussed its efforts on socio-economic and political reforms, converting a socialist to a market economy, building good relations with other countries for the promotion of trade and creating an investment environment in the country. It has been successful in achieving growth and controlling unemployment.

However, like many other developing countries, due to many internal and external factors the economies in these countries have been vulnerable to shocks and face constraints in sustaining the economic growth. They also face high inflation, high incidence of poverty and worsening income distribution. Kyrgyz Republic registered high unemployment during the last decade, but Tajikistan reduced the unemployment due to the emigration of workers to Russia and other countries and benefitted from the receipt of huge foreign remittances. Both countries are facing high saving-investment gap, declining foreign direct investment (FDI), declining net official assistance and foreign aid, huge trade and current account deficits, increasing fiscal imbalances and increasing burden of external debt.

The financial markets are not sufficiently developed in the whole Central Asian Region. The financial market in Kyrgyz Republic and Tajikistan is shallow as indicated by the M2-GDP ratio. Availability of domestic credit to the private sector is very low along with very high and discouraging lending interest rate. Small firms are getting insignificant finance from the banking system compared to large firms.

Microeconomic risks appear very strong in both Kyrgyz Republic and Tajikistan. Although Kyrgyz Republic has made efforts to create business friendly environment which has improved its doing-business indicators such as starting a business, registering property, protecting investors, but weaknesses remain in getting electricity, paying taxes, trading across border and closing contracts. Business firms consider policy instability, corruption, Government instability, inefficient government bureaucracy and access to finance as the major factors constraining doing business in Kyrgyz Republic. Similarly, firms in Tajikistan are exposed to a very weak business environment and experience constraints on doing business in the area of access to finance, tax rates, tax regulation, corruption, foreign currency regulation and inefficient government bureaucracy. Furthermore, the countries under this study are urged to improve their governance, human development, labour productivity and overall level of development toward industrialization and eventual transition to the knowledge economy. Furthermore, Kyrgyz Republic and Tajikistan are characterised with poor quality of infrastructure, weak quality of institutions and are very weak in terms of global competitiveness.

**Binding Constraints**

Analysis of these challenges brings out three factors as binding constraints on the sustainable development of Kyrgyz Republic: i) Low level of public investment (about 6 percent per annum during the last decade), ii) declining private investment & FDI and iii) weak software of growth. Low public investment is caused by budget deficit, poor governance, weak institutions and lack of human capital. The private investment has been high compared to public investment. However, it has been declining over the recent years and can be a potential binding constraint in the sustainable development. Similarly FDI is also falling. The low private investment and low FDI inflow are caused by poor physical and human capital, microeconomic risks factors and macroeconomic vulnerabilities including huge deficit in trade and current account, budget deficit, increasing debt services, high unemployment and high lending cost. Overall economic growth is also constrained by the weak software of growth such as weak global competitiveness due to the low expenditures on R&D, low quality of education, low overall level of development towards the knowledge economy and the low labour productivity

In Tajikistan, the binding constraints on sustainable growth are (i) the low level of private investment (4.36 percent per annum during the last decade), (ii) low public investment and (iii) weak software of growth. The low private investment is caused by weak financial sector, low domestic savings, poor intermediation, microeconomic risk factors, and macro risks such as trade and current account deficits, huge budget deficit, low foreign exchange reserves, increasing debt services, and high inflation. Low public investment is affected by budget deficit, poor governance, weak institutions and lack of human capital. Weak software of growth is resulted by weak global competitiveness due to the low R&D expenditures, low quality of education and low level of development toward the knowledge economy and relatively low labour productivity.

## Relationship between Finance and Growth

Although economics literature finds positive association between the financial development and economic growth, the traditional finance has failed to prevent crises, encouraged pro-cyclical policy-making and rendered the national financial systems non-transparent and impossible to regulate. It has failed in providing sustainable and equitable growth, reducing unemployment and poverty.

The countries under study have been experiencing a number of constraints as pointed out above. The Islamic finance can play a great role in promoting inclusive growth and enabling the considered countries to follow a more equitable development path with the objectives to achieve high income and social cohesion simultaneously. Since Islamic finance is not currently practiced in these countries, the study also explains the nature of Islamic finance before pointing to the ways in which it can help address the challenge of alleviating the development constraints.

## Islamic Finance and Development Constraints

Islamic finance is different from conventional finance in its close attention to all aspects of society's development. Islamic financial system: (i) help and stimulate economic activity and entrepreneurship, (ii) addresses poverty and inequality, (iii) ensures financial and social stability, and (iv) promotes comprehensive human development and fairness. It links finance with the real economy and maintains that link at each point in time in fair and transparent manner.

## How Islamic Finance Can Alleviate the Development Constraints?

The challenges of low public and private investment, gap between savings and investment and declining foreign direct investment can be addressed through measures and incentives that rationalize government borrowing; but increase development expenditures; enhance financial inclusion; and promote entrepreneurship.

*Limiting Budget Deficits and Rationalizing Government Borrowing:*

High and persistent government budget deficits are usually the result of government assuming too many responsibilities outside its main areas of concern, which necessitates borrowing from public and abroad. The possibilities to borrow on interest and the perceived needs by the government for higher expenditure often reinforce each other to create a spiralling cycle of public sector borrowing and spending, which also contributes to the crowding out of the private sector investment and consequently economic growth.

Prohibition of interest would constraint excessive government borrowing by removing the incentive to lend and by disallowing the rollover of debt. However, the governments will be able to raise finance either for pure public goods and services or for other revenue generating social projects. It will also have other sources of revenue such as taxation and voluntary contributions from the public. *Zakāt* (and *ʿushr*) will be earmarked exclusively for supporting the poor, the needy and for the other prescribed categories. Many social needs will be met through voluntary philanthropy for which the government will only need to provide coordination and encouragement services. Thus Islamic financial system along with abolishment of interest would constraint government borrowing and ensures best use of its internal and external resources in socially and economically useful projects while it frees up resources for investment and economic growth through private sector.

*Savings and Investment Gap, High Cost of Finance, Financial Access, and Developing Entrepreneurship:*

Islamic finance can foster better financial access and financial inclusion through making finance compatible with the religious and social values of solidarity as exemplified by the profit and loss sharing principle which reduces reliance on collateral. Moreover, by avoiding interest it makes credit tied to economic activity. Islamic financial system, by emphasizing profit and loss sharing, develops healthy risk appetite in the society at all levels. This would develop entrepreneurship and willingness for real investments, which are key drivers for innovation, economic growth and stability. This key advantage when combined with higher financial inclusion leads to faster, diverse and broad-based growth.

*Linking Finance to Real Economy:*

It is one of the hallmarks of Islamic finance that it always keeps finance linked to the real sector activity. The delink between the real and financial sectors is avoided by prohibiting interest (*ribā*) and the selling of debts and the rolling-over of the unpaid debts as well as the prohibiting of excessive uncertainty or avoidable uncertainty (*gharar*) in contracts, and promoting ethical norms that ensure fairness and transparency. The linkage between finance and real economy ensures that stability and economic progress is not lost by frequent crises.

## What Islamic Finance can do in Various Economic Sectors of Countries Understudy?

*Cotton Sector:*

Cotton is one of the major exports of Tajikistan contributing a substantial portion of its GDP. In the cotton sector, Islamic finance modes such as *salam, murābaḥah* and *ijārah* can be used to provide inputs like seeds, fertilizer, sowing and harvesting machines. At the output harvesting stage Islamic financial modes can be utilized to buy and process cotton. At the export stage, Islamic finance can be used for export financing and pre-shipment financing. It can also be used in creating a mechanism to store, transport and smoothly sell cotton. Islamic finance can also be used as a way to bringing FDI in the yarn manufacturing and weaving sectors to produce high value added products for exports.

All this will add to creating new possibilities and freeing the farmers from the double exploitation of monopoly and monopsony that they currently face. To promote cotton exports at better terms a network of local storage facilities and certification system for the quality and quantity of cotton can be created and institutionalized. Warehouse certificates against these cotton bales can serve as guarantees as well as sale instruments for execution of international trade and trade financing by Islamic financial institutions.

*Foreign Direct Investment:*

Another avenue is to attract FDI in processing of fine quality yarn and cloth from the raw cotton. This will result not only in high value added goods but a whole line of associated services will also come into play for economic development. However, the business environment and official procedures need to be made investment friendly. By recognizing and institutionalizing Islamic modes of finance and allowing Islamic financial institutions to operate in the countries there is more likelihood that the Gulf capital may flow to the region and contribute in various projects, cotton and cotton related industry being one of them, through FDI. Thus allowing for operations of Islamic financial institutions itself will attract FDI.

*Energy Sector:*

Kyrgyz Republic and Tajikistan are facing electricity shortages for use in the household and industrial sectors. The problems are not only insufficient production of electricity but also the poor distribution networks. Many electric lines that exist from pre-independence era are such that they now go cross border after the creation of new countries instead of supplying to local consumers. In this context, project financing based on Islamic modes can be utilized for construction of electrical power generation units and creating suitable distribution networks for local use of electricity as well as for exporting it to the neighbouring countries on quid pro quo basis. Islamic project finance will utilize combination of *istiṣnāʿ*, *murābaḥah, ijārah,* and *salam* contracts at various stages of the project to address the economic development needs. Project specific *ṣukūk* are another alternative to raise funds from internal and external sources. These instruments will also be useful in developing a secondary capital market providing additional features of flexibility and liquidity. If these are issued in small denominations they can attract more diversified investors base that include individuals as well as large institutions.

*Infrastructure Sector:*

Roads are very important for trade and commerce in landlocked countries. Not only new roads for intra- and inter-city transportation are needed but old ones also require maintenance and expansion. Islamic modes of financing such as *istiṣnāʿ* and lease-to-sell (*ijārah muntahi bi-tamlīk*) are some of the suitable modes for this purpose. The financing of toll road projects can also be undertaken through issuance of *ṣukūk*.

*Tapping of Remittances and putting them to Productive Use:*

Remittances constitute substantial part of the GDP of the countries under study. These are currently being used either for consumption or remain idle as savings outside the formal financial sector. Channelling of these financial resources and remittances into national level investment would first require promoting localized and regional investments. For this the use of appropriate institutions and such financial instruments are needed that enable local investment and build confidence and trust at all levels, individuals, firms and the government. Moving towards national level investments government issued project specific *ṣukūk* for funding of specific projects that pay out from the returns of these projects are likely to develop new avenues of cooperation and trust in the efficiency of the government. The support infrastructure institutions and practices created for such *ṣukūk* will also become useful for the functioning of private sector businesses and reducing the cost of doing business for private firms as well.

**Use of Voluntary Sector and Cooperation for Economic Development**

Activation of voluntary sector, such as *awqāf* and *Zakāt* institutions, is another source for creation of such support and infrastructure that can improve corporate governance and reduce cost of doing business. Many of the *awqāf* properties are amenable to securitization through issuance of *ṣukūk*. The proceeds can be used to expand the operations and build new social projects. *Awqāf* can be used not only for poverty alleviation through simple transfers but they can be used as a system of social protection and assistance in addition to *Zakāt* and targeted to a wider group than the *Zakāt* recipients. *Awqāf* can even be used to build the missing social and public institutions which the private for-profit-sector may not have incentives to develop but which nevertheless are needed for economic development. For example, institutions for better governance, development of accounting standards, providing education and training, creation of system for property and collateral registration, and institutions to settle minor trade disputes all are possible through *awqāf*.

Obligation of *Zakāt* and encouragement of charity directly addresses the poverty issues and provide mechanisms to bring people in the mainstream economic activity including their access to formal financial sector. There are studies showing that *Zakāt* has the potential to alleviate poverty form Tajikistan by raising the income of the poor who earn below 1.25 dollar a day above this threshold. However, if *Zakāt* is used in more planned manner to enable the poor not only meet their immediate consumption needs but also develop their skills and provide them capital to start their own small businesses and become self-sustained then the impact of *Zakāt* will be higher.

*Improving Business Environment and Relations with Neighbouring Countries:*

Improving the business environment and managing relations and promoting cooperation with the neighbouring countries is necessary in stimulating private investment and flow of foreign direct investment, and more so in the context of landlocked Central Asian countries. The translation of Islamic teachings of rights and responsibilities, justice and benevolence into economic and financial dimension will enhance efficient enforcement of contracts and rules, protection of rights of both the investors and the workers, and promotion of sale. All of these matter very much for inflow of funds, their investment, and economic growth. Cooperation and harmonization of relationships are fundamental to a healthy society and economic growth. In the countries understudy growth in GDP and social wellbeing requires attention to growth in trade, agriculture, cotton sector, and SMEs as targets for near future. For the longer term development of non-cotton agriculture, power, mining, and human capital will be the key to growth.

*Microfinance Institutions:*

The efficiency of MFIs depends on their outreach, the available infrastructure and support institutions. Regulatory frameworks for MFIs exist in countries under study and lending and leasing both are already recognized within these frameworks. The need is to add mark-up sale (*murābaḥah*) and partnership opportunities in the allowable transactions and create necessary infrastructure for their use by MFIs. In addition to deposit taking MFIs, cooperative based structures for MFIs are also needed to promote Islamic finance. At present the credit rating institutions and collateral registration institutions are either non-existent or very weak requiring urgent attention. Efficient working of such infrastructure institutions will give a boost to MFIs. To make the micro-finance programs a success social capital formation and cooperation is necessary. In addition to group-based mutual guarantee schemes there is a need to build the cooperation by inculcating Islamic norms of cooperation and mutual help. The smallest unit of social cooperation is family, to which Islam gives more importance. Therefore, the family as a unit should be supported to grow out of poverty and get linked to the chain of mainstream economic activity at the next higher level of scale and scope.

*Harnessing the Untapped Opportunities:*

The declining FDI can be reversed and the exports can also be diversified by making financial sector laws conducive for Islamic banking and finance. Indeed, Islamic banks and financial institutions from other countries where such finance is more developed would find attractive opportunities to enter the market. Such banks and financial institutions would bring with them expertise of Islamic finance and can help in developing the necessary financial infrastructure and training of human resources. The entry of Islamic financial institutions is also likely to bring in foreign investors interested in other economic sectors and doing business through these financial institutions. However, stable policies, currency convertibility and easy currency transfer policies are also needed for entry of financial firms. Another potential area in exports that can be developed through Islamic finance is *ḥalāl* products of processed and fresh meat, poultry and agricultural commodities that can find a good market in the GCC and other countries.

# ABSTRACTS OF ARTICLES PUBLISHED IN *DIRASAT IQTISADIAH ISLAMIAH* IN VOL. 19 No. 2

*Islamic Economic Studies*
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# صفحات من تاريخ المصرفية الإسلامية: مبادرة مبكرة لإنشاء مصرف إسلامي في الجزائر في أواخر عشرينات القرن الماضي

عبد الرزاق بلعباس[1]

## ملخص البحث

تكشف هذه الدراسة عن مقالة، يرجع تاريخها إلى عام 1347هـ / 1928م، تدعو إلى إنشاء مصرف إسلامي يعمل في الجزائر وفق قواعد الفقه الإسلامي، وتحلل مضمونها. وقد أسفرت هذه المقالة عن محاولة إنشاء مصرف إسلامي، على الأرجح قبل أواخر جمادى الآخرة من عام 1348هـ / أواخر عام 1929م، تحت تسمية "البنك الإسلامي الجزائري" بعد أن تمّ إعداد قانونه الأساسي وجمع رأسماله الاسمي من قبل بعض كبار رجال أعمال مدينة الجزائر من المسلمين، لكن سلطات الاحتلال الفرنسية تصدت لهذا المشروع وأجهضته. ويتطلب الكشف عن هاتين الواقعتين مراجعة تاريخ المصرفية الإسلامية من الناحية النظرية والتطبيقية وضبط منهج كتابته.

الكلمات المفتاحية: المصرفية الإسلامية، التاريخ، المنهج، المغرب العربي، الجزائر.

**A Few Pages from the History of Islamic Banking: An Early Initiative to Establish an Islamic Bank in Algeria in the Late 1920s**

**Abstract**

This study reveals and analyses the content of an article, dating back to 1928, that calls for the establishment of an Islamic bank in Algeria that operates

[1] باحث بمعهد الاقتصاد الإسلامي، جامعة الملك عبد العزيز، جدة، السعودية، وعضو كرسي "أخلاقيات وضوابط التمويل" بجامعة باريس، السوربون، وعضو فريق البحث في التمويل الإسلامي بجامعة ستراسبورغ.

according to the rules of Islamic jurisprudence. This article led to an attempt to create an Islamic bank, probably before the end of 1929, under the name of "The Algerian Islamic Bank", after preparing its statute under French law and collecting its capital by some of Algiers's Muslim business leaders. But the French authorities stood against this project and aborted it. The discovery of these two facts calls for a revision of the history of Islamic banking at theoretical and practical levels and a proper record of its writings.

Keywords: Islamic banking, history, methodology, Maghreb Region, Algeria

## النوافذ الإسلامية في المصارف الحكومية العراقية

احمد خلف حسين الدخيل[2]

## المستخلص

نتيجة للضغوط التي مارسها الوقفان السني والشيعي على الحكومة العراقية قررت الأخيرة مع بداية العام 2012 فتح نافذة إسلامية في كل مصرف من المصارف الحكومية لتواجه الطلب المتزايد من المجتمع الإسلامي العراقي الذي يرفض التعامل مع المصارف الربوية، وقد قام الباحث بدراسة تجربة العراق الحديثة في هذا المجال من خلال توضيح الكثير من التفاصيل والوقوف على مواطن القوة والضعف فيها واقتراح بعض الإجراءات التي تساهم في النهوض بهذه التجربة في ظل تعليمات المصارف الإسلامية رقم 6 لسنة 2011، إذ أثبتت الدراسة أن فتح النوافذ الإسلامية في المصارف الحكومية العراقية جاء خطوة أو نواة للتحول في الصيرفة الحكومية العراقية نحو الصيرفة الإسلامية والابتعاد عن الصيرفة التقليدية من جهة، وأنها تعد خطوة مؤقتة يراد لها أن تعمم على عمل المصارف الحكومية بأكمله.

### Islamic Windows in Iraqi State Banks

### Abstract

As a result of the pressure exerted by the Aelloukvan Sunni and Shiaa Iraqi government decided last with the beginning of year 2012 opened an Islamic

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[2] أستاذ المالية العامة والتشريع المالي، رئيس قسم القانون، كلية القانون- جامعة تكريت – جمهورية العراق.

window in each bank from government banks to face the growing demand of the Muslim community Iraqi who refuses to deal with the banks usury, The researcher studied the experience of modern Iraq in this area by clarifying a lot of details and stand on the strengths and weaknesses and propose some actions that contribute to the advancement of this experiment under the instructions of Islamic banks No. 6 for the year 2011, as study proved that the windows open Islamic banks Iraqi government came a step or the nucleus of a shift in the banking Iraqi government Islamic banking towards and away from traditional banking on the one hand, it is a temporary step meant to be circulated to the entire work of the government banks.

# CUMULATIVE INDEX OF PAPERS

 DOI No. 10.12816/0001564

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The thrust of this study is on mobilizing and utilizing financial resources in the light of Malaysian Tabung Haji experience. It is an excellent example of how a specialized financial institution can work successfully in accordance with the Islamic principle.

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*Habib Ahmed*
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☐ **OPERATIONAL STRUCTURE FOR ISLAMIC EQUITY FINANCE: LESSONS FROM VENTURE CAPITAL (Research Paper No. 69), (2005),** pp.39 **Price $ 10.00**
*Habib Ahmed*
The paper examines various risks in equity and debt modes of financing and discusses the appropriate institutional model that can mitigate theses risks.

☐ **ISLAMIC CAPITAL MARKET PRODUCTS DEVELOPMENTS AND CHALLENGES (Occasional Paper No. 9**), **(2005),** pp.93 **Price $ 10.00**
*Salman Syed Ali*
The paper will serve to increase the understanding in developments and challenges of the new products for Islamic financial markets. The ideas explored in it will help expand the size and depth of these markets.

☐ **HEDGING IN ISLAMIC FINANCE (Occasional Paper No.10), (2006)**, pp.150 **Price $ 10.00**
*Sami Al-Suwailem*
The book outlines an Islamic approach to hedging, with detailed discussions of derivatives, *gharar* and financial engineering. It accordingly suggests several instruments for hedging that are consistent with Sharī‘ah principles.

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*Habib Ahmed*
The research presents some issues concerning capital structure of firms under Islamic finance.

☐ **ROLE OF MICROFINANCE IN POVERTY ALLEVIATION: LESSONS FROM EXPERIENCES IN SELECTED IDB MEMBER COUNTRIES (Occasional Paper),** (2008), pp.73 **Price $ 10.00**
*Mohammed Obaidullah*
The book proposes a two-pronged strategy to poverty alleviation through micro-enterprise development based on the dichotomy between livelihood and growth enterprises. With a focus on provision of Sharīʻah-compliant financial services for micro-enterprises, it reviews thematic issues and draws valuable lessons in the light of case studies from three IsDB member countries – Bangladesh, Indonesia, and Turkey.

☐ **ISLAMIC ECONOMICS IN A COMPLEX WORLD: AN EXTRAPOLATION OF AGENT-BASED SIMULATION, (2008), pp. 149** **Price $ 15.00**
*Sami Ibrahim al-Suwailem*
This research paper (book/occasional paper) discusses the possible use of recent advances in complexity theory and agent-based simulation for research in Islamic economics and finance

☐ **ISLAMIC MICROFINANCE DEVELOPMENT: INITIATIVES AND CHALLENGES (Dialogue Paper No. 2), (2008), pp. 81.** **Price $ 10.00**
*Mohammed Obaidullah and Tariqullah Khan*
This paper highlights the importance of microfinance as a tool to fight poverty. It presents the "best practices" models of microfinance and the consensus principles of microfinance industry.

☐ **THE ISLAMIC VISION OF DEVELOPMENT IN THE LIGHT OF *MAQĀṢID* AL-SHARĪʻAH**, **(1429H, 2008),** pp.65 **Price $ 15.00**
*M. Umer Chapra*
This paper asserts that comprehensive vision of human well-being cannot be realised by just a rise in income and wealth through development that is necessary for the fulfilment of basic needs or by the realization of equitable distribution of income and wealth. It is also necessary to satisfy spiritual as well as non-material needs, not only to ensure true well-being but also to sustain economic development over the longer term.

☐ **THE NATURE AND IMPORTANCE OF SOCIAL RESPONSIBILITY OF ISLAMIC BANKS, (1431H, 2010),** pp. 460 **Price $ 15.00**
*Mohammed Saleh Ayyash*
This book attempts to analyse the essential aspects of social responsibility of Islamic Banks and the means to achieving them. Apart from encapsulating the Sharīʻah formulation of the social responsibility and its relation to the objectives of Sharīʻah, the book also addresses the linkage between social responsibility and the economic and social development of Muslim communities. Furthermore, it demonstrates the impact of the nature of social and developmental role which should be undertaken by Islamic banks, not only for achieving socio-economic development but also for making the earth inhabitable and prosperous.

☐ **ISLAMIC BANKING STRUCTURES: IMPLICATIONS FOR RISK AND FINANCIAL STABILITY, (1432, 2011),** pp 50 **Price $ 10.00**
*Abd Elrahman Elzahi Saaid Ali*
The results of this research are expected to be valuable to the management of Islamic banks and to those who are engaged in the fields of Islamic banking and finance.

☐ **HANDBOOK OF ISLAMIC ECONOMICS, Vol. 1, Exploring the Essence of Islamic Economics, (1432, 2011),** pp.348 **Price $ 35.0**
*Habib Ahmed & Muhammad Sirajul Hoque*
This "Handbook of Islamic Economics" is part of the project to make important writings on Islamic economics accessible by organizing them according to various themes and making them available in one place. The first volume of this Handbook subtitled "Exploring the Essence of Islamic Economics" collects together the eighteen important articles contributed by the pioneers of the subject and presents them under four broad themes: (i) Nature and Significance of Islamic Economics, (ii) History and Methodology, (iii) Sharīʻah and *Fiqh* Foundations, (iv) Islamic Economic System.

☐ **BUILD OPERATE AND TRANSFER (BOT) METHOD OF FINANCING FROM SHARĪʻAH PERSPECTIVE, (1433, 2012),** pp.115 **Price $ 15.00**
*Ahmed Al-Islambouli*
Literature on BOT techniques from Sharīah perspectives are few and far between. This book surveys and reviews the previous studies as well as experiences of BOT financing by individuals and institutions and concludes with a Sharīʻah opinion. It finds BOT to be a combination of *Istiṣnāʻ* and other contracts. The BOT would be a valid method after appropriate modifications

☐ **CHALLENGES OF AFFORDABLE HOUSING FINANCE IN IDB MEMBER COUNTRIES USING ISLAMIC MODES (1433, 2012),** pp.266 **Price $ 20.00**
*Nasim Shah Shirazi, Muhammad Zulkhibri Salman Syed Ali & SHAPE Financial Corp.*
The focus of this book is on financial products and infrastructure innovation for housing finance. It quantifies the demand for housing in IDB member countries, estimates the financial gap, and evaluates the current Islamic house financing models and practices in the IDB member countries and elsewhere in the world. It also identifies niche areas where intervention by the IDB Group can promote development of housing sector to meet the housing needs in its member countries.

## Lectures

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| ☐ | **THE MONETARY CONDITIONS OF AN ECONOMY OF MARKETS: FROM THE TEACHINGS OF THE PAST TO THE REFORMS OF TOMORROW (1993),** pp.64<br>*Maurice Allais*<br>This lecture by the nobel laureate covers five major areas: (1) potential instability of the world monetary, banking and financial system, (2) monetary aspects of an economy of markets, (3) general principles to reform monetary and financial structures, (4)review of main objections raised against the proposed reforms and (5) a rationale for suggested reforms. | **Price $ 10.00** |
| ☐ | **THE ECONOMICS OF PARTICIPATION (1995),** pp.116<br>*Dmenico Mario Nuti*<br>A case is made that the participatory enterprise economy can transfer dependent laborers into full entrepreneurs through changes in power sharing, profit sharing and job tenure arrangements. | **Price $ 10.00** |
| ☐ | **TABUNG HAJI AS AN ISLAMIC FINANCIAL INSTITUTION: THE MOBILIZATION OF INVESTMENT RESOURCES IN AN ISLAMIC WAY AND THE MANAGEMENT OF HAJJ (1995),** pp.44<br>It provides history and objectives of Tabung Haji of Malaysia, outlines saving and investment procedures of the Fund and gives an account of its services to *hajjis*. | **Price $ 10.00** |
| ☐ | **ISLAMIC BANKING: STATE OF THE ART (1994),** pp.55<br>*Ziauddin Ahmad*<br>The paper reviews and assesses the present state of the art in Islamic banking both in its theoretical and practical aspects. | **Price $ 10.00** |
| ☐ | **ROLE OF ISLAMIC BANKS IN DEVELOPMENT (1995),** pp.54<br>*Ahmad Mohamed Ali*<br>The paper analyses the concept of development from an Islamic perspective, highlighting the role of Islamic banks in achieving the same. | **Price $ 10.00** |
| ☐ | **JURISPRUDENCE OF *MAṢLAḤAH* AND ITS CONTEMPORARY APPLICATIONS (1994),** pp.88<br>*Hussein Hamid Hassan*<br>The paper discusses the Islamic view as well as applications of *Fiqh al Maṣlaḥah* in the field of economic and finance. | **Price $ 10.00** |
| ☐ | ***AL GHARAR* (IN CONTRACTS AND ITS EFFECT ON CONTEMPORARY TRANSACTIONS) (1997),** pp.79<br>*Siddiq Al Dareer*<br>This study presents the Islamic Sharīʻah viewpoint regarding *gharar* and its implications on contracts, particularly in connection with sale contracts and other economic and financial transactions. | **Price $ 10.00** |
| ☐ | ***ISTIHSAN* (JURISTIC PREFERENCE) AND ITS APPLICATION TO CONTEMPORARY ISSUES (1997),** pp.148<br>*Mohammad Hashim Kamali*<br>The lecture deals with an important subject. It is a common knowledge that Qur'ān and *Sunnah* are the primary sources of Islamic jurisprudence. It presents a cross section of Islamic legal issues, which are of vital importance to Islamic countries. | **Price $ 10.00** |

- ☐ **ECONOMIC COOPERATION FOR REGIONAL STABILITY (1996),** pp.34 — **Price $ 10.00**
  *Bacharuddin Jusuf Habibie*
  The paper highlights significance and implications of economic cooperation for regional stability in the context of Asian countries. Given the importance of economic cooperation between the developing countries in general and Islamic countries in particular.
- ☐ **WHAT IS ISLAMIC ECONOMICS? (1996),** pp.73 — **Price $ 10.00**
  *Mohammad Umer Chapra*
  This lecture deals with an important subject. It explained both the subject matter of Islamic economics as well as its methodology in his usual mastering fashion.
- ☐ **DEVELOPMENT OF ISLAMIC BANKING ACTIVITY: PROBLEMS AND PROSPECTS (1998),** pp.24 — **Price $ 10.00**
  *Saleh Kamel*
  This lecture explores the origin of Islamic banks and explains their problems and prospects which have attracted the attention of scholars.
- ☐ ***AL-QIYAṢ* (ANALOGY) AND ITS MODERN APPLICATIONS (1999)**, pp.132 — **Price $ 10.00**
  *Muhammad Al-Mukhtar Al-Salami*
  The paper presents the juridical theory of *Qiyās* and its applications to contemporary issues.
- ☐ ***MUḌĀRABAH* AND THE PAKISTAN PERSPECTIVE (2000),** pp.46 — **Price $ 10.00**
  *Justice (Retd.) Tanzilur Rahman*
  The lecture deals with *Muḍārabah* characteristics and its applications in accordance with Sharīʻah and the Pakistan perspective.
- ☐ **SUSTAINABLE DEVELOPMENT IN THE MUSLIM COUNTRIES (2003),** pp.104 — **Price $ 10.00**
  *Monzer Kahf*
  IDB Prize Lectures analyses the concept of sustainable development from an Islamic perspective and surveys the state of development in Muslim countries.

## Others

- ☐ **TRADE PROMOTION ORGANIZATIONS IN OIC MEMBER COUNTRIES (1994),** pp.40 — **Price $ 10.00**
  A directory of trade promotion organizations. A reference for those interested in trade promotion in OIC member states.
- ☐ **A BIBLIOGRAPHY OF ISLAMIC ECONOMICS (1993),** pp.840 — **Price $ 20.00**
  A very significant bibliography of Islamic economics organized according to (1) Call Number Index, (2) Descriptor Index, (3) Subject Term Index for Call Numbers, (4) Author Index (5) Corporate Author Index.
- ☐ **PETROCHEMICAL INDUSTRY IN OIC MEMBER COUNTRIES (1994),** pp.89 — **Price $ 10.00**
  Useful and up-to-date information on Petrochemical Industry in OIC member States are brought together in this study to promote trade among them in this area.

☐ **FERTILIZER INDUSTRY AND TRADE IN OIC MEMBER COUNTRIES (1995),** pp.603 **Price $ 20.00**
It serves as a useful and up-to-date guide to fertilizer industry, technology and trade in OIC member countries.

☐ **CEMENT INDUSTRY IN OIC MEMEBR COUTNIRES – (SECOND EDITION) (1993),** pp.560 **Price $ 20.00**
It is a guide to the Cement industry in the OIC member countries to promote trade among them in the area of cement and to enhance the quality and productivity of cement.

☐ **FINANCIAL DEVELOPMENT IN ARAB COUNTRIES (BOOK OF READINGS, No.4) (2005)**, pp.298 **Price $ 20.00**
This book of readings provides fruitful policy recommendations on various financial development issues in the Arab World such as operational efficiency and service quality in banking. It also examines different aspects related to stock markets development such as efficiency, volatility, hedging, and returns

## Actes de Séminaires

☐ **L'ORGANISATION ET LE FONCTIONNEMENT DU CONSEIL MALAIS DE DIRECTION DES PELERINS ET DU FONDS DU PELERINAGE (1987),** 109 pages **Prix $ 10.00**
Comme institution consacrée à l'organisation du pèlerinage, TABUNG HAJI (Conseil de Direction des Pèlerins) a servi comme modèle type à cette journée d'étude.

☐ **L'ADMINISTRATION PUBLIQUE DANS UN CONTEXTE ISLAMIQUE (1995),** 150 pages **Prix $ 10.00**
*Yassine Essid* and *Tahar Mimm, (éd.)*
Outre l'histoire de l'administration en Islam, cet ouvrage traite de nombreux aspects tant théoriques que pratiques de l'administration d'un point de vue islamique et qui touchent à l'actualité du monde islamique.

☐ **LA ZAKĀT: ASPECTS JURIDIQUES, ECONOMIQUES ET SOCIAUX (1995),** 248 pages **Prix $ 20.00**
*Boualem Bendjilali* and *Mohamed Alami (éd.)*
Actes de séminaire sur LA ZAKĀT dont l'objectif est d' ouvrir de nouvelles voies à la reflexion et de faire connaître les concepts, la méthodologie et les principes de base de la collecte et de la répartition de la Zakāt.

☐ **DEVELOPPEMENT D'UN SYSTEME D'INSTRUMENTS FINANCIERS ISLAMIQUES (1995),** 328 pages **Prix $ 20.00**
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Actes de séminaire dont l'objectif principal était d'identifier les voies et moyens pour l'émission d'instruments financiers islamiques viables qui pourraient préparer le terrain à une mobilisation efficace des ressources financières dans les pays membres de la BID.

☐ **INTRODUCTION AUX TECHNIQUES ISLAMIQUES DE FINANCEMENT (1997),** 210 pages **Prix $ 20.00**
Actes de séminaire don't l'objectif principal était d'offrir aux cadres supérieurs des pays francophones membres de la BID une introduction d'ordre théorique et pratique sur les modes de financement islamiques utilisés par les banques et les institutions financières islamiques.

☐ **CONFERENCES EN ECONOMIE ISLAMIQUE (1996),** 555 pages **Prix $ 20.00**
*Ausaf Ahmed* and *Kazim Awan*
Actes de séminaire dont l'objectif principal est de servir comme outil de base pour les étudiants et aux enseignants en économie islamique.

☐ **LE DEVELOPPEMENT DURABLE, (1997),** 256 pages **Prix $ 20.00**
*Taher Memmi* (éd.)
Actes d'un séminaire sur le développement durable qui présente, entre autres, la stratégie en cette matière de quelques pays membres de la BID.

☐ **PROMOTION ET FINANCEMENT DES MICRO-ENTREPRISES (1997),** 187 pages **Prix $ 10.00**
*Taher Memmi* (éd.)
Actes de séminaire sur la promotion et financement des micro-entreprises qui peuvent être utiles à tous ceux, décideurs, hommes et femmes du terrain, soucieux de faire de la micro-entreprise un outil efficace et durable de lutte contre la pauvreté.

☐ **LA ZAKĀT ET LE WAQF : ASPECTS HISTORIQUES, JURIDIQUES, INSTITUTIONNELS ET ECONOMIQUES (1998),** 387 pages **Prix $ 20.00**
*Boualem Bendjilali* (éd.)
Actes de séminaire qui visent à faciliter l'accès des lecteurs francophones à la littérature sur l'économie islamique en général et la Zakāt et le Waqf en particulier.

☐ **LES MODES DE FINANACEMENT ISLAMIQUES (1993),** 48 pages **Prix $ 10.00**
*Boualem Bendjlali* (éd.)
Rapport d'un séminaire sur les modes de financement islamiques tenu en Mauritanie en 1413H (1992).

☐ **LES SCIENCES DE LA CHARI'A POUR LES ECONOMISTES: LES SOURCES DU FIQH, SES PRINCIPES ET SES THEORIES; LE FIQH DES TRANSACTIONS FINANCIERES ET DES SOCIETES; ET SON APPLICATION CONTEMPORAINE (2001),** 572 pages **Prix $ 25.00**
*Boualem Bendjilali* (éd.)
Actes de séminaire sur les sciences de la Chari'a pour les économistes dont l'objectif principal est de servir comme outil de base aux chercheurs, étudiants et enseignants en économie islamique sur les sources du *Fiqh.*

## Recherches

☐ **LA COOPERATION ECONOMIQUE ENTRE LES PAYS DU MAGHREB (1985),** 138 pages **Prix $ 10.00**
*Ridha Saadallah*
Cet ouvrage traite de nombreux thèmes dont les ressources naturelles et humaines au Maghreb, le potentiel de coopération agricole et industrielle au Maghreb, etc.

☐ **PROFITS ET INTERETS BANCAIRES ENTRE L'ANALYSE ECONOMIQUE ET LA CHARI'A (1994),** 150 pages **Prix $ 10.00**
*Abdelhamid El-Ghazali*
Cet opuscule traite de l'intérêt bancaire face au profit en tant que mécanismes de gestion de l'activité économique. Une analyse de deux points de vue différents, celui de l'économie conventionnelle et celui de la Chari'a.

☐ **LA MOUDHARABA SELON LA CHARI'A ET SES APPLICATIONS CONTEMPORAINES (1994),** 83 pages — **Prix $ 10.00**
*Hassan El-Amin*
Cette étude traite de nombreux aspects pratiques: légal, économique et bancaire.

☐ ***JOUALA* ET *ISTISNA,*** — **Prix $ 10.00**
***Analyse juridique et économique* (1994) ,** 65 pages
*Chaouki Ahmed Donia*
L'intérêt de cette recherche réside dans le fait qu'elle aborde un nouveau domaine d'application des transactions économiques islamiques se basant sur deux contrats, à savoir "La Jouala et L'Istisna".

☐ **LA PROPRIETE FONCIERE EN ISLAM (1994) *(Enquête),*** 52 pages — **Prix $ 10.00**
*Mahmoud A. Guilaid*
Le but de cette étude est d'examiner les questions les plus importantes concernant le droit de propriété foncière en Islam.

☐ **LES RELATIONS COMMERCIALES ENTRE LE CONSEIL DE COOPERATION DU GOLFE ET LA COMMUNAUTE EUROPEENNE (1995),** 152 pages, — **Prix $ 10.00**
**Du Passé Récent au Lendemain de 1992**
*Ridha Mohamed Saadallah*
Cette étude procède à une analyse minutieuse des statistiques passées, des échanges commerciaux entre les pays du CCG et ceux de la Communauté Européenne en vue de dégager les tendances profondes et les caractéristiques structurelles du commerce Euro-Golfe.

☐ **ERADICATION DE LA PAUVRETE ET DEVELOPPMENT DANS UNE PERSPECTIVE ISLAMIQUE (1995),** 180 pages — **Prix $ 10.00**
*Abdelhamid Brahimi*
Cette recherche, divisée en deux parties, traite dans la première des facteurs internes et externes de blocage et de l'impasse. La seconde est consacrée à la conception et à la mise en oeuvre de politiques économiques dans une perspective islamique.

☐ **JUGEMENT DU TRIBUNAL FEDERALISLAMIQUE DU PAKISTAN RELATIF A L'INTERET *(RIBĀ)* (1995),** 478 pages — **Prix $ 25.00**
Ce document constitue un outil de travail et une référence indispensables à tous ceux, parmi les décideurs politiques et chercheurs dans les pays membres de la Banque, qui sont désireux de voir se développer l'alternative d'un système financier exempt d'intérêt.

## Eminents Spécialistes

☐ **LES CONDITIONS MONETAIRES D'UNE ECONOMIE DE MARCHES DES ENSEIGNEMENTS DU PASSE AUX REFORMES DE DEMAIN (1993),** 64 pages — **Prix $ 10.00**
*Maurice Allais (Prix Nobel d'Economie - 1988)*
L'auteur, dans son examen, critique du système monétaire international, appelle à des réformes tant économiques que morales.

☐ **JURISPRUDENCE DE LA *MAṢLAḤAH* ET SES APPLICATIONS CONTEMPORAINES (1995),** 92 pages — **Prix $ 10.00**
*Hussein Hamed Hassan*
L'étude, présente le point de vue islamique se rapportant à la question de l'intérêt publique, son lien avec la législation, ses conditions et ses dimensions juridiques; avec un certain nombre d'applications contemporaines.

☐ **JURISPRUDENCE DE LA NECESSITE (*FIQH* DE LA *DHARURA*) ET SON APPLICATION DANS LA VIE CONTEMPORAINE : PERSPECTIVE ET PORTEE (1996),** 259 pages — **Prix $ 20.00**
*Abd al-Wahab I. Abu Sulayman*
Cette recherche sur le *Fiqh de la Ḍarūrah* aborde le point de vue de la Chari'a islamique par rapport à la notion de *Ḍarūrah* (nécessité), ses conditions et ses perspectives juridiques.

☐ **COOPERATION ECONOMIQUE POUR UNE STABILITE REGIONALE (1996),** 37 pages — **Prix $ 10.00**
*Bacharuddin Jusuf Habibie*
Cet ouvrage porte sur l'importance coopération économique entre les pays en développement en général et entre les pays islamiques en particulier.

☐ **LE QIYAS ET SES APPLICATIONS CONTEMPORAINES (1996),** 139 pages — **Prix $ 10.00**
*Mohamed Mokhtar Sellami*
Uni conférence qui traite de l'une des sources de la jurisprudence, reconnue dans la science des fondements du droit sous le nom d'analogie (Qiyâs) et reconnue par l'ensemble des écoles juridiques comme preuve légale et méthode d'extraction des jugements.

## Prix de la BID

☐ **LE SYSTEME BANCAIRE ISLAMIQUE : LE BILAN, (1996),** 65 pages — **Prix $ 10.00**
*Ziauddin Ahmed*
Le but de ce papier est d'examiner et d'évaluer la situation actuelle dans le domaine des banques islamiques aussi bien du point de vue théorique que pratique.

☐ **QU'EST-CE QUE L'ÉCONOMIE ISLAMIQUE? (1996),** 81 pages — **Prix $ 10.00**
*Mohammad Umer Chapra*
Conférence donnée par Dr. Chapra lauréat du Prix de l'économique islamique 1409H (1989) sur : l'économie conventionnelle et l'économie islamique.

☐ **EVOLUTION DES ACTIVITES BANCAIRES ISLAMIQUES: PROBLEMES ET PERSPECTIVES (1998),** 30 pages — **Prix $ 10.00**
*Saleh Kamel*
Conférence donnée par Cheikh Saleh Kamel lauréat du Prix de la BID en système bancaire islamique pour l'année 1416H (1995/96). Elle constitue une grande contribution à la compréhension de l'économie et du système bancaire islamiques et à leur évolution.

## Traductions

☐ **VERS UN SYSTÈME MONÉTAIRE JUSTE, (1997),** 352 pages **Prix $ 20.00**
*Mohammad Umer Chapra*
Ce livre développe avec habilité la logique islamique de la prohibition du *Ribā*, et démontre avec rigueur la viabilité et la supériorité du système de financement basé sur la participation au capital.

## Documents occasionnels

☐ **DEFIS AU SYSTEME BANCAIRE ISLAMIQUE, (1998),** 90 pages **Prix $ 10.00**
*Munawar Iqbal, Ausaf Ahmad et Tariquallah Khan*
Le but de ce document occasionnel est que les théoriciens et praticiens dans le domaine bancaire islamique doivent explorer les voies et moyens permettant au système bancaire islamique de soutenir son rythme de progrès au moment où il entre dans le 21ème siècle.

# TRANSLITERATION TABLE

## Arabic Consonants

- Initial, unexpressed medial and final:

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| ء | ’ | د | d | ض | ḍ | ك | k |
| ب | b | ذ | dh | ط | ṭ | ل | l |
| ت | t | ر | r | ظ | ẓ | م | m |
| ث | th | ز | z | ع | ‘ | ن | n |
| ج | j | س | s | غ | gh | هـ | h |
| ح | ḥ | ش | sh | ف | f | و | w |
| خ | kh | ص | ṣ | ق | q | ي | y |

- Vowels, diphthongs, etc.

| | | | | | | |
|---|---|---|---|---|---|---|
| Short | ـَ | a | ـِ | i | وِ | u |
| Long | أ | ā | ي | ī | و | ū |
| Diphthongs | ؤ | aw | ئ | ay | | |

# Notes To Contributors

1. The papers submitted to *IES* should make some noticeable contribution to Islamic economics, either theoretical or applied, or discuss an economic issue from an Islamic perspective.
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5. All papers should have an introductory section in which the objectives and methodology of the article are explained and a final section, which summarizes the main points, discussed and the conclusions reached.
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7. Detailed derivations of the main mathematical results reported in the text should be submitted separately. These will not be published.
8. References should be listed at the end of the text in the following style:
9. Articles: Al-Qari, Mohamed Ali (1993), “Towards an Islamic Stock Market”, *Islamic Economic Studies*, Vol. 1, No. 1; Books: Khan, A. R. (1993), *Financial Intermediation*, New York: Springer Publishers. Page references to works referred to in the text should take the following form: Al-Qari (1993:17). Citations within the text should follow Harvard APA style.
10. The verses of the Qur’ān quoted should carry *surah* number and *ayah* number as (3:20).
11. Complete reference to the source of ahādith quoted should be given.
12. Contributions may be sent in English, Arabic or French and should be addressed to the Editor, *Islamic Economic Studies*, on the following

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# Islamic Development Bank (IDB)

## Establishment

The Islamic Development Bank is an international financial institution established in pursuance of the Declaration of Intent issued by the Conference of Finance Ministers of Muslim Countries held in Jeddah in Dhul Qa'dah 1393H (December, 1973). The inaugural Meeting of the Board of Governors took place in Rajab 1395H (July 1975) and the Bank was formally opened on 15 Shawwal 1395H (20 October, 1975).

## Vision

By the year 1440H Hijrah, IDB shall have become a world-class development bank, inspired by Islamic principles that have helped significantly transform the landscape of comprehensive human development in the Muslim world and help restore its dignity.

## Mission

The mission of IDB is to promote comprehensive human development, with a focus on the priority areas of alleviating poverty, improving health, promoting education, improving governance and prospering the people.

## Membership

The present membership of the Bank consists of 56 countries. The basic condition for membership is that the prospective member country should be a member of the Organization of Islamic Cooperation (OIC), pay its contribution to the capital of the Bank and be willing to accept such terms and conditions as may be decided upon by the IDB Board of Governors.

## Capital

As of the month of Rajab 1431H, the Authorized Capital of the Bank was ID 30 Billion, and the Issued Capital was ID 18 Billion, of which ID 17.474 Billion was subscribed with ID 4.031 Billion Paid-Up.

## Group

At present the IDB Group is made up of Islamic Research and Training Institute (IRTI), International Islamic Trade Finance Corporation (ITFC), The Islamic Corporation for Insurance of Investments and Export Credit (ICIEC) and The Islamic Corporation for the Development of the Private Sector (ICD).

## Headquarters and Regional Offices

The Bank's headquarters is in Jeddah in the Kingdom of Saudi Arabia. Four regional offices were opened in Rabat, Morocco (1994), Kuala Lumpur, Malaysia (1994), Almaty, Kazakhstan (1997) and Dakar, Senegal (2008).

## Financial Year

The Bank's financial year is the lunar Hijra year.

## Accounting Unit

The accounting unit of the IDB is the Islamic Dinar (ID), which is equivalent to one SDR – Special Drawing Right of the International Monetary Fund.

## Languages

The official language of the Bank is Arabic, but English and French are also used as working languages.