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MAKING ISLAMIC FINANCE A WAY TO SALVATION

The Islamic Finance has emerged at global level in the last decade of the 20th Century and developed fast with the dawn of 21st Century and by now the Islamic banking has crossed the milestone of forty years since the Dubai Islamic Bank and the Islamic Development Bank were established in 1975.The age of 40 years is considered as age of maturity, age of rushd رُشد but Islamic Finance is still in the age of infancy.

The policy makers in Islamic Finance need to ponder seriously on the point as to why conversion to Islamic finance is so slow even in Muslim majority countries like Indonesia, Bangladesh, Pakistan, and the GCC countries. Turkey and Indonesia that represent key growth markets have set the target of reaching 15% Participation share in banking assets by 2023. Pakistan aspires to reach the 15% mark by 2019. According to State Bank of Pakistan in next 40 years Islamic banking will reach up to 50% of the conventional Banking.[1]

The reasons of slow conversion of Conventional Banking to Islamic Banking are not difficult to seek. These are;

a. Lack of political Will on the part of the Government.
b. Lack of interest of Regulatory Bodies to provide congenial environment.
c. The Monetary Polices & Framework of the Regulatory Bodies are promotive of the Conventional Banking as such the level playing field has not been provided to the Islamic Banking.
d. Lack of resources and allocation or meager resources and incentives for conversion.

[1] Reply filed by the State Bank of Pakistan before the federal Shariat Court Islamabad in the Riba case

In addition to above ambiguity on taxation and accounting standards are also the factors responsible for impeding the progress.

The finance mangers, the regulators and particularly the Shariah Boards / scholars may keep in view that replication of the conventional products will create problems for Islamic banks – both credibility and business related because they cannot use conventional risk management models and techniques.

Objective for introducing Islamic finance has to be realization of the goal - value creation by channeling the community's funds towards production and exchange of goods and services, and closing all uses of finance that inflate the financing relative to real production and exchange activities.

Bernardo Vizcaino (2015) of Zawya, Thomson Reuters, observes in a blog that despite success there are doubts over whether Islamic finance is living up to all of its principles as*, "it was launched not merely to make money, but to promote Muslim values such as equity, risk-sharing and social inclusion*".[2]

Reference to objectives for introducing Islamic Finance and their realization essentially lay emphasis on "social inclusion" which essentially falls under Maqasad-e-Shariah. The corporate social responsibility under Islamic Financial System underlines the elimination of poverty and stability of society. One of the tools provided by the Islamic System is the employment & establishment of Waqf Institution. Development of Awqaf will be effective in making our community free of hunger, illiteracy and extreme poverty. The takeover of the Waqaf properties by the Administrator general and the legal scheme in vogue presently should undergo a change to promote private Awqaf under the management of members of community itself. The legislation recently promulgated by the Turkish Government should be a case in point to revive private waqf. This institution of Awqaf has served as a powerful institution to fight extreme poverty in Islamic history for about 1000 years. The first victim of Britishers after takeover of the Suez Canal to abolish the Awqaf System in Egypt which was providing

[2] Bernardo Vizcaino; *IMF to include Islamic finance in surveillance*; November, 11,2015.

healthcare and other social services to the public in the private sector. This Institution was destroyed during the colonial rule of the Muslim World. Let us revive this institution at Community level, Mosque level or locality throughout Pakistan and use it to eliminate hunger, illiteracy and extreme poverty and Show the World that word of ALLAH is the uppermost'

(wakalimatu Allahi hiya al-'ulya.)

The problems pit falls and the deficiencies being pointed out in the working of Islamic Finance needs to be noticed. There is problem of credibility because IBIs use equivalents of almost all conventional finance products for financing and liquidity and risk management- from 'over draft' to the most toxic derivatives like swaps to compete with the conventional banks in profitability. According to a recent IMF Working Paper (Hussain M., *et al*; IMF WP/15/120, 2015), there are only "*few significant differences in business orientation, asset quality, efficiency, or stability".*[3]

Currently, IFIs are doing exactly what conventional counterparts are doing – practically earning money on money and crowding out the commodities and production sectors.

The last two decades of the 20th Century were marked with explosive growth of finance at global level due to creation of interest based money, the financial derivatives and short selling. A famous example of short selling is that of George Soros who caused huge loss to the Bank of England in 1992, where he shorted $10 billion worth of Pounds for one day gain of over $1 billion. As a result, we saw that more the developed financial in a country, the more severe have been the crises and income inequality there.

As indicated by A.A. Jobst[4] an IMF economist, financial derivatives never involved delivery; then how Islamic financial institutions could be expected to

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[3] Hussain M., Asghar Shahmoradi, and Rima Turk , IMF WP (2015); An Overview of Islamic Finance; WP/15/120

[4] Jobst, A.A. (2008); Derivatives in Islamic Finance; *Islamic Finance news (Volume 4, Issue 50).*

abide by the rules suggested by Shariah scholars while allowing them when they tend to use them to get competitive returns as their conventional counterparts do. This was the reason that tawarruq, though legally allowed, was prohibited by the Jeddah and the Makkah based Islamic Fiqh Councils as its practice with requisite conditions was not possible due to the bankers approach to get money on money.

Moreover emphasis on form over substance has led to abuse of Sharīʻah principles to justify the contracts which undermine the objectives of the Sharīʻah.

Hence, Islamic finance that is theoretically resilient to shocks, practically may be prone to risk and crises.

These deficiencies have been pointed out so that the policy makers and the managers of the Islamic financial system keep an eye on these deficiencies and provide corrective actions otherwise huge potential is there "*The real potential captive market is six times bigger, but requires a different banking model…...*[EY, 2016], but different approach and business structures are required to avail of the potential.

Islamic banks need to become role model for the global finance by adopting 100% reserve banking, with complete disclosure for just and equitable distribution of profits, resources and wealth among all members of the societies.

To be innovative for proper linkage between the real and the finance sectors of the economy – to discipline the finance - has to be an international agenda to solve the problems facing global as also national economies and finance;

Different strategies could be applied for different jurisdictions. For Countries like Pakistan following model is suggested:

1) The controversy about the interpretation of *ribā,* as the case of Pakistan*, must* be resolved – interest is Riba in the light of decision of Jaddah and

Makkah based Fiqh councils, our Council of Islamic Ideology and fatwa of religious authorities around the world; The decision of Shariat Appellate Bench of Supreme Court of Pakistan on “Riba” should be accepted as valid and final as regards the definition and meaning of the term “Riba” and thus accept that the Bank Interest is “Riba”. Islamic Banking in Pakistan is being carried out by the Islamic Banks on this very basis. The State and the regulatory authorities need to spell out before the Federal Sharī‘at Court that they believe in prohibition of ‘*interest’.* They need to change the structure of the financial institutions and business procedures and resort to phasing approach for coverage of different sectors and subsectors;

2) Dealing with Financing public debt – State’s financing may be separated from the core banking and finance - the 'holding company model' may be adopted to finance all business sectors and sub-sectors in the economy by the fully owned subsidiaries of the banks that will be doing different activities like trade related banking, investment banking, commercial banking, etc;

3) Trading Companies may maintain inventory on the basis of which ‘Tradable Inventory Certificated’ could be issued and traded for short and medium term liquidity management;

4) Treasury functions may be undertaken by the each Parent Company for investments of its equity. Detailed operations could be discussed by the experts prior to adoption of such system.

5) *‘Prevention is always better than a cure’!* : Transformation of the public debt system requires serious deliberations and re-organisation focusing on balanced budgeting by the government and the PSEs in a phased plan and exploring interest free alternatives of public sector financing.

6) The ‘*non-interest based banking*’ (NIB) system introduced in Pakistan during 1980-85, declared un-Islamic by the Federal Shariat Court, is still being offered as is evident from various SBP Circulars with regard to ‘PLS’

deposits, returns thereon based on *Principles of Sharī'ah* (BPD Circular 20 of 2003) and the use of the phrase 'mark-up' in place on interest by the conventional banks.

7) BCD Circular No. 13 of 20th June 1984 be taken back, in addition to adoption of the unique profit distribution and pool management system introduced by the SBP vide IBD Circular No. 03 dated November 19, 2012,

8) The contract documents used currently by the IBIs might be mandated for the NIB banks, instead of 32 documents implemented in 1980 – the system would be transformed as required by our Constitution.

9) The banks may be asked to remit certain part, say 50 %, of the Current Accounts balance (on which they pay nothing to the depositor) to the government with or without service charge; private banks, doing business with the funds provided by the society, are socially bound to serve the society, and remitting a part of the current account deposits in the form of repayable loan to the State; it is a kind of social service.

10) General public may be provided facility to maintain Current Accounts with Savings Centres, all branches of the Public sector banks (NBP, Bank of Punjab, Bank of Khyber, Sind Bank, Women bank, ZTBL, Khushhali bank), some newly created savings banks, with as minimum personnel as possible, may provide C/A facility with anytime withdrawal facility as be interest free loan to the Government.

External Finance

Accepted that transforming the external finance to interest free bases is bigger challenge than the domestic debt; However, it must be kept in view that debt based international financing provided generally with certain conditions, as in the case of IMF, has not enabled any country to come out of poverty or bring stability. Rather, the economies that avoided the IMF's emergency loan packages, referred to as structural adjustment programs (SAPs), were able to control short term crises with their own will and efforts;

The problems in developing economies worsen by currency speculation added by kick-backs, corruption and international politics[5]. Rather than providing remedy against the causes and resolving the problems faced by the recipient economies, the SAPs or other donors' packages render the recipient economies vulnerable forever.

Some people are suggesting to name Islamic Banking as Green Banking, Ethical Banking or Responsible Banking to make it acceptable to Non-Muslims or those who are opposed to Islamic Thought, Culture and View point. With change of the name the very base of the Islamic Financial System that is Quran and Sunnah will be lost with the passage of time and it will then be the rudderless ship lost in the wilderness away from its destined path. It is necessary to stick to the base firmly so as to remain on the chartered path and to achieve the Maqasa-e-Shariah to the benefit of the Muslims and human beings and to gain Raza of Allah SWT. Islamic Financial Institution can serve as role model for this change it has to be supplemented by rigorous regulations to restrict all types of financial institutions to create money without any genuine basis. Islamic financial institutions can serve as role model for this change.

While Sharīʻah encourages proper measures for safeguarding the resources and wealth of the societies as also of individuals, it draws a clear line between *halāl* and *harām* and recommends avoiding doubtful things and activities

For this, the Shariah scholars associated with IFIs and the Islamic finance professionals may delve into the Sharīʻah and the real business needs to find answers to the current Islamic banking issues and lead the industry on the right path of developing Sharīʻah based products to do *halāl* business and hedge business risk.

[5] An American institution, 'Global Exchange' has listed top 10 reasons why to oppose or avoid the IMF programs; the most important is that the IMF bailouts deepen, rather than solve, economic crisis http://www.globalexchange.org/resources/wbimf/oppose . (Nov 15 2015)