International Journal of Economics, Management and Accounting 28, no. 2 (2020): 361-391

TOWARDS A MORE SOCIALLY INCLUSIVE AND SUSTAINABLE FRAMEWORK FOR ISLAMIC BANKING AND FINANCE

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ABSTRACT

Mainstream interest based financial system marginalized many Muslims as the system is in conflict with the principles of *sharīʿah* (Islamic law). *Islāmic* banking and finance (IBF) institutions aimed at promoting *Islāmic* norms of economic behavior, and ultimately to realize the *maqāṣid al-sharīʿah* have developed and offer *sharīʿah* compliant financial instruments. The growth of IBF institutions has been phenomenal since their introduction in the 1960s. The upsurge of IBF in the 1970s was driven by oil price rises, competition for regional power between Egypt and Saudi Arabia, and a general *Islāmic* resurgence. The second upsurge has involved similar drivers, but with the added benefit of standardized regulation and management, as well as improved overall business decision-making. The aftermath of 11 September 2001 reinforced the second surge in *Islāmic* finance. However, IBF institutions have tended to respond to prevailing forces of the international financial system by moving closer to conventional financial institutional practice. IBF is supposed to expand the Muslim financial base and reduce financial exclusion, but many institutions have been taken over by pragmatic bankers who shift the core operation away from the original religious and social ideals. The new generation of financial instruments are at odds with the foundational axioms of *Islāmic* economics. As such, the concept behind IBF has been reduced to the mere removal of *ribā'* and the conduct of financial activities according to *sharīʿah* derived contractual norms. IBF institutions are following the letter of the *sharīʿah*, but not its spirit, the *maqāṣid*. The simplistic 'pragmatism' may mean that the globalization and unprecedented growth of IBF would permeate the lives of many poorer disenfranchised Muslims. However, more recent developments in IBF such as *i*MFI and social impact *ṣukūk* (*Islāmic* bond) suggest that IBF is moving to a more socially inclusive and sustainable finance.

JEL Classification: G21, G23.

Key words: Islamic finance, Financial inclusion, Social finance

1. INTRODUCTION

Mainstream interest based transaction is in conflict with the principles of *sharīʿah* (Islamic law)[1], marginalizing many Muslims from global economic and financial systems. *Islāmic* banking and finance (IBF) institutions were introduced in the 1960s to serve marginalized Muslims with modern financial services, through *sharīʿah* compatible instruments. The ideal of IBF is to promote *Islāmic* norms of economic behavior, and ultimately to realize the *maqāṣid* (objectives) of *sharīʿah*[2]. In economic contexts, it is to create a just economic system. Al-Zuhayli, states that "the primary goal of Islamic financial institutions is not profit-making, but the endorsement of the goals of socio-economic development and the alleviation of poverty" (Al-Zuhayli, 2003).

The IBF institutions introduced attracted Muslims who shunned the mainstream interest based system. *Islāmic* deposits took off rapidly, suggesting there are unsupplied demands of Islamicly accepted products and services (Wilson, 2005). The industry grew at a phenomenal rate; over the last decade, *Islāmic* finance has grown 10 percent to 12 percent. *Islāmic* banking exists in more than 60 countries and the industry has become systemically important in 13 jurisdictions[3] (IMF, 2018). In 2018, *Islāmic* assets (banking, capital markets, and Takaful) reached USD2.19 trillion (IFSB, 2019), up from just USD150 billion in the 1990s. However, even with the phenomenal growth, IBF only represents a very small share of global financial assets, and only about 28 percent of the population in Muslim-majority countries use formal or semi-formal financial intermediaries. Furthermore, empirical studies on Muslim majority countries show that the proportion of Muslim population using financial intermediary services is less than that of their non-Muslim counterparts (Mohieldin, et. al., 2011; Demirguc-Kunt, Beck, and Honohan 2008; El-Hawary and Grais, 2005).[4]

In the early stages of development, IBF institutions were typically banks catering to Muslims and operating on *ribā'*-free basis. Broad changes in global political and economic environments led to more diverse and innovative IBF instruments, catering to both Muslim and non-Muslim customers. More complex financial instruments such as *sukūk* (*Islāmic* bond) and the Dow Jones Islamic Market Index were introduced and IBF institutions were increasingly integrated into the global economy with involvement in mega development projects. In addition, global financial players such as Citibank, Standard Chartered, and HSBC established Islamic "windows" and *Islāmic* banking subsidiaries such as Standard Chartered Saadiq and HSBC Amanah. At the country level, Pakistan, Iran and Sudan turned their financial system to be based entirely on *sharīʿah* principles, while countries such as Malaysia have a dual system where mainstream interest based and the IBF system co-exist.

The phenomenal growth of IBF raises the questions of why and how the industry has managed to achieve the growth alongside well established mainstream financial institutions, and how the industry has succeeded in becoming one of the players in the global financial system. However, more importantly how far has IBF, as practiced to date, provided greater inclusion and empowerment for Muslims as envisioned by the *maqāṣid al-sharī'ah*? This paper examines the factors responsible for the phenomenal growth of the IBF industry, and questions whether it has satisfied its ideal mission of inclusion and building a just economic system.

2. EVOLUTION OF IBF

A few pilot experiments precede the establishment of formal IBF institutions. In the Indian subcontinent, loan cooperatives, influenced by European mutual loan experiments infused with religious and ethical ideals were started in the 1940s (Heikal, 1983). At least one short-lived experiment took place in Pakistan during the late 1950s, when rural landlords created an interest free credit network (Warde, 2000).

Modern IBF institutions can be traced to the establishment of the MitGhamr Saving Bank by Dr. Ahmed al-Najjar in Egypt, and the Tabung Haji[5] (Pilgrimage Fund) proposed by Professor Ungku Aziz in Malaysia in 1963. The MitGhmar experiment was influenced by West German mutual saving scheme with capital funded by West German banks. Even though MitGhamr did not pay or charge interest, it did not make any reference to *sharīʿah* in its charter; this is unlike Tabung Haji which specifically caters for saving of Muslims for the purpose of making pilgrimage to Mecca. The two experiments caught the eyes of *Islāmic* scholars who had been seeking an *Islāmic* economic model since the early 20th century. Consequently, they began to promote the establishment of IBF institutions in academic circles and political figures started to use the concept as a tool to awaken the public as well as for their personal political mileage (Warde, 2000). In Pakistan for example, *Islāmic* banking is on the platform of every major political party, and any politician not endorsing it risks political suicide (Rivlin, 2008).

At its peak, MitGhmar had nine branches, 250,000 depositors and close to two million Egyptian pounds in deposits (Al-Omar and Abdel-Haq, 1996). The circumstances behind its closure are somewhat obscure. By some accounts it had encountered financial problems; others suggest that it was commercially successful but was politically forced to close because of infiltration by the Muslim brotherhood. With the closing of MitGhmar, in 1971, the Egyptian government created the Nasser Social Bank as part of its policy of co-opting *Islāmic* groups in its fight against leftist elements. The official goals of Nasser Social Bank were to "broaden the base of social solidarity among citizens" and "provide aid to needy citizens". Similar with MitGhmar, there was no direct reference to Islam, but the bank operated based on *muḍārabah* and the collection and distribution of *zakāt* (Rivlin, 2008).

Further East, Royal Professor Ungku Abdul Aziz who saw the need for Muslims to gradually accumulate savings before performing the *Haj* submitted to the government the proposal "A Plan to Improve the Economic Position of Future Pilgrims" in 1959. He recommended that future pilgrims should save in a financial institution untainted by *ribā'* but yielding profits. The concept paper on the organization and activities of Tabung Haji was presented to Sheikh Mahmoud Al-Shahltut, Rector of Al-Azhar University of Cairo who was fully convinced and believed that the recommendations were not contrary to *sharīʿah*. In August 1962, The Pilgrims Saving Corporation was incorporated, and it was subsequently launched on the 30th of September, 1963. In 1969, the Corporation was merged with the Pilgrims Affairs Office, which had been in operation since 1951 in the state of Penang, Malaysia. This gave birth to the Lembaga Urusan dan Tabung Haji (Pilgrims Management and Fund Board) (Tabung Haji, 1995). In 2011, Tabung Haji fund size was RM28 billion and it participated in short and long-term equity investment activities in different sectors including industrial, services, plantations and properties.

In 1975, a group of businessmen took the initiative of establishing the first *Islāmic* bank, Dubai Islamic Bank in Dubai, United Arab Emirates (UAE), with official support from the governments of the UAE and Kuwait that respectively contributed 20 percent and 10 percent of the capital. The most important development in the history of modern IBF is the establishment of the Islamic Development Bank (IDB) in 1975. It was established as an international financial institution in pursuance of the declaration of intent issued by the Conference of Finance Ministers of Islamic Countries held in Jeddah, Saudi Arabia, in December 1973. The declaration was signed by the representatives of 23 OIC member countries. The Second Conference of Finance Ministers, held in Jeddah in August 1974, adopted the Articles of Agreement establishing the IDB, and the inaugural meeting of the Board of Governors of IDB took place in Riyadh, Saudi Arabia, in July 1975 and the bank started functioning on 20th of October 1975.

The 1980s saw IBF maturing at a slower pace. However, during this period, more *sharīʿah* compliant financial instruments were developed and several multinational banks started offering IBF instruments; a recognition of the model viability and its acceptance by international players. The International Monetary Fund (IMF) and the World Bank also recognized *Islāmic* financial products as a genuine means of financial intermediation and produced studies to that effect (Iqbal and Mirakhor, 1987). During the period, attention was also given to non-bank Islamic financial institutions such as *takaful* (insurance) companies and investment funds. Unlike the *Islāmic* insurance sector which did not register sufficient growth, *Islāmic* investment funds witnessed significant progress.

The 1990s saw initiatives for the establishment of infrastructural institutions supporting the IBF industry. In the beginning, IBF institutions had to work within the mainstream financial institutional framework, hence leaving them at a disadvantageous position vis a vis the mainstream financial institutions (Iqbal and Molyneux, 2005). The initiatives started in the 1990 led to standardization and regulation that enhanced IBF growth in the 2000s.

3. IBF: IDEAL AND REALITY

Prohibiting the receipt and payment of *ribā'* has been seen as the central feature of IBF. However, the ideal philosophical foundation of IBF goes beyond the interaction of factors of production. The prohibition of *ribā'* is only a means to achieve the end; the *maqāṣid* of *sharīʿah,* Islāmic religio-socio-economic objectives, which include the ability for the poor to participate in the global economic order. This is visioned to be achieved through elimination of *ribā'* by moving to profit and loss sharing (PLS) instruments and transactions. The IBF system places equal emphasis on ethical, moral, social, and religious dimensions, to enhance equality and fairness for the good of society as a whole (Rosly and Bakar, 2003; Ahmad, 1992; Chapra, 1985; Siddiqi, 1985; Al-Sadr, 1982).

IBF addresses the issue of financial inclusion from two directions; the promotion of risk-sharing contracts, and through *Islāmic* wealth distribution instruments. In the case of poverty alleviation, the use of risk-sharing financing instruments can be offered through *sharīʿah*-compliant microfinance, financing for small and medium enterprises, and micro-insurance. *Islāmic* redistributive instruments such as *zakat* and *sadaqah* complement the risk-sharing instruments in targeting the poor sector of society.

Ideally, IBF should be responsible for community social welfare; however, Ismail (2002) stressed that IBF is a commercial entity and it should not be treated as a social welfare institution. "*Islāmic* banks are … not charitable organizations, and that they must turn a profit" (Warde, 2000). IBF institutions' main responsibility is to the shareholders and depositors; they should not be burdened with social welfare responsibilities which is the duty of the government. The use of shareholders' funds for social activities not required by the law may jeopardize IBF viability and competitiveness. Ismail (2002) suggested that profit maximization as the primary aim does not negate the importance of societal responsibility. Social objectives can be attained indirectly by being continuously profitable, viable and sustainable, as suggested by free marketers. In fact, the majority of *Islāmic* banks' stakeholders regard IBF institutions as entities with distinctive characteristics distinguishing them from their mainstream counterparts; they are equally perceived as organizations characterized by ethical norms and social commitments without undermining the commercial aspects of doing business (Dusuki and Dar, 2007).

3.1 IBF INSTRUMENTS[6]

El-Hawary et al. (2004) define the IBF system as a system that adheres to the following four principles:

a. Risk-sharing: the terms of financial transactions need to reflect a symmetrical risk/return distribution among each participant to the transaction.
b. Materiality: all financial transaction must have “material finality,” i.e., be directly linked to a real underlying economic transaction; thus options and most other derivatives are banned.
c. No exploitation: neither party to the transaction should be exploited.
d. No financing of *haram* (sinful) activities: transaction cannot be used to produce goods banned by the Quran (e.g., alcohol, pork products, gambling).

It is expected that IBF instruments are to depend on, and to grow in tandem with real economic activities. Financial transactions must be accompanied by underlying real activities, unlike the mainstream financial system, where it can be distinct from the real side of the economy. This is evidenced by the volume of financial transactions that dwarf real economic activity. For example, the value of world financial transactions, was 25 times world GDP in 1995, it rose to 70 times that value by 2007 (Matheson, 2011). Ideally, IBF will shift the mainstream interest debt-based financial intermediation to an equity-based and risk-sharing arrangement (Dusuki and Abdullah, 2007). However, both risk sharing and “debt-based” instruments are being offered by IBF.

3.1.2 MAIN FORMS OF PROFIT AND LOSS SHARING (PLS) INSTRUMENTS IN ISLAMIC FINANCE

Main forms of PLS instruments in IBF are:
a. *Muḍārabah*: ‘Trustee finance contract’ or passive partnership, where one party provides funds while the other provides the expertise. Profits accrued are shared on a pre-agreed basis but losses are borne only by capital provider.
b. *Mushārakah*: ‘Equity participation contract’ providing for profit/loss sharing in joint business. The financier provides a portion of the total funds and all partners may participate in management. Profits are distributed in pre-agreed ratios but losses are borne strictly in proportion to respective capital contributions.

c. *Ṣukūk*: *Islāmic* bonds, generally paying a 'LIBOR+X%' rate but may have a fixed rate if backed by *ijārah* or *murābaḥah* transactions. It must be asset-backed and *sharīʿah* compliant.

3.1.3 MAIN FORMS OF NON-PLS OR TRADE BASED ISLAMIC FINANCE

Main forms of non-PLS instruments in IBF are:

a. *Murābaḥah*: Mark up sale, i.e., a sale on mutually agreed profit, where client requests the bank to purchase an item and bank resells the item to the client for a predetermined marked up price usually paid in instalments.
b. *Ijārah*: Lease or lease-purchase agreement.
c. *Bai'-Salam*: deferred delivery purchase; only items that can be fully specified in terms of quantity, quality, attributes, etc., are eligible; monetary instruments are specifically excluded.
d. *Bai'-Muajjal*: Deferred payment/credit sale, where seller informs buyer of cost, selling price and the final payment date (may be instalment or lump sum); spot price may be lower than deferred payment price.
e. *Ji'ala*: Service charge, consultancy fee, placement fee, etc.

3.2 IDEAL VS REALITY

The debate over the practice of IBF has led to the distinction between *sharīʿah*-compliant and *sharīʿah*-based *Islāmic* products (Ahmed, 2011, 2014), where the latter are products that follow the *maqāsid*. Current practices of IBF are *sharīʿah*-compliant; however the majority are not *sharīʿah*-based. Only a negligible portion of IBF financing and products are following the ideal PLS mode (Dusuki and Abdullah, 2007; Khan, 2010). In the case of Malaysia in 2004, only 0.5 percent of *Islāmic* bank financing was based on the PLS mode of *muḍārabah* and *mushārakah* (Chong and Liu, 2009), which is consistent with *Islāmic* banking experiences in other countries such as Bangladesh, Egypt, Iran, Pakistan, Philippines, and Sudan (Mills and Presley, 1999). Yousef (2004) showed that the share of mark-up instrument in total financing in Middle East and North Africa was 85.6 percent, in East Asia it was 70.4 percent, in South Asia it was 92.2 percent, and Sub-Saharan Africa at 55.7 percent. Khan (2010) showed that among the biggest *Islāmic* banks, 78.4 percent of Kuwait Finance House financing was non-PLS, and it was 99.5 percent for Al-Rajhi.

These figures indicate that instead of moving closer to the ideal, IBF institutions have tended to respond to prevailing forces of the global financial system by moving closer to mainstream financial institution practice. IBF may have expanded the Muslim financial base, but many institutions have been taken over by pragmatic bankers who shift the core operation away from the original ideals. IBF institutions avoid PLS contracts such as *muḍārabah* and *mushārakah* as the central instruments. Instead, they operate largely on debt-based contracts, such as *murābaḥah*, *ijārah*, *salam*, or *istiṣnā'*. As such, the concept behind IBF has been reduced to the mere removal of interest. As suggested by Ismail (2002) however, the main responsibility of IBF institutions is to their shareholders; they should not be involved in too risky ventures hence jeopardizing bank sustainability and their stakeholder interests. If PLS contracts may be too risky a proposition for the IBF, and may not maximize its profit, why has IBF achieved this phenomenal growth? Will IBF achieve such growth by moving on the proper tangent?

4. THE GROWTH OF IBF

The phenomenal growth of IBF can be broken up into two periods: the early stage of development in the 1970s and the period characterized by increased multipolarity of the *Islāmic* world in the late 1990s, where emerging nations such as Malaysia played a key role, in addition to vast transformations in international finance, driven by technological change, innovation, deregulation and globalization (Warde, 2005). The factors determining, and their importance for, the growth of IBF in these two periods differ because of the changes in the global socio-political-economic environments. The intersection between *Islāmic* resurgence and petrodollar has been argued as the main factor responsible for the momentum of IBF institutions; however, not exclusively as those who patronize IBF institutions include both Muslim and non-Muslim. The factors that have been proposed in explaining IBF growth include:

a. *Islāmic* resurgence.
b. Petro-dollar: the oil price surge in the 1970s and the late 1990s.
c. September 11, 2001 incident.
d. Standardization of IBF Industry Regulatory Framework.
e. Government Support.

4.1 ISLAMIC RESURGENCE

Islāmic resurgence since the 1960s has driven the IBF industry (Chong and Liu, 2009; Asutay, 2007; Haniffa and Hudaib, 2007). The resurgence is one of the most important social movements of the 20th century, affecting every Muslim country from North Africa to South-east Asia. The surge in religious participation and values in Muslim societies lurks in the background of debate on the clash of civilizations, the so-called war on terror and the 'failure' of multiculturalism (Berger,1999). The resurgence intensifies discussions on the *Islāmic* economic system and *ribā'* free economy as an alternative to the interest based economic system. The success of MitGhmar and Tabung Haji invigorated Muslim scholars, showcasing the viability of IBF. Academic circles rode on the success and promoted IBF in academic seminars and conferences, while politicians used the concept to awaken the public as well as for their personal political mileage. The 1970s also saw the fight for regional power between Egyptian President Gamal Abdel Nasser's pan-Arab socialist ideology and Saudi King Faisal's pan-Islamism. Petro-dollars helped King Faisal to trump over pan-Arab socialist ideology, further fuelling *Islāmic* resurgence in the Arab world. However, Soliman (2005) argues that the MitGhamr Saving Bank is not an exclusively *Islāmic* institution.

> "Al-Najjar never made any reference to Islam in the process of founding the bank for fear the project will be rejected…[hence] we can conclude … neither the state nor the public was informed that the motive behind the creation of the bank was an *Islāmic* one" (Soliman, 2005).

Notwithstanding whether MitGhamr is truly an *Islāmic* Bank, it had provided an impetus for the development of the IBF industry and helped invigorate the discussions on an alternative financial system.

If *Islāmic* resurgence had helped in the early development of IBF institutions, they need to be viewed as "*Islāmic*" by their customers, and that the main reason for patronizing IBF institutions is religious observance. Critics of IBF pointed out that there is nothing *Islāmic* about current IBF practices. The financial instruments offered by the IBF institutions are technically *sharīʿah* compliant, yet, economically there are no differences between financial instruments used by mainstream banks and IBF institutions (El Gamal, 2006;

Nomani, 2006; Zaman, 2002). Khan (2010) shows that current IBF practices do not satisfy any of the four Islāmic banking principles as suggested by El-Hawary et al. (2004) and describe it as "weakly" *Islāmic* at best. Kuran (2004) called IBF fundamentalist, essentially political, and economically counterproductive. Ahmad (1992) states that:[7]

> "The sad reality is that though everyone concedes that Islam prohibits interest, there is not a single Muslim country which running its financial institutions without resorting to interest. The fact is that no one knows how to do it, and when political pressure mounts, they can only resort to some kind of subterfuge." (16)
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> "The worst part of the story is that *Islāmic* economists, as a body in their International Monetary and Fiscal Conference held in Islamabad in 1981, gave their unreserved approval to this arrangement. So far this is the best that *Islāmic* economics has to offer, viz., change the name of interest and you have abolished interest." (48)

Sympathizers argued that IBF institutions are still in their infancy, there is a need to replicate mainstream instruments, instead of coming up with risky new untried products. Nevertheless, debt based products that mimic conventional instruments are the more popular products, instead of the "strongly *Islāmic*" PLS instruments. It should also be stressed that in certain cases the IBF institutions are required to mimic conventional products in order to be able to legally operate within the mainstream financial system (El Gamal, 2006).

Studies on factors motivating customers to patronize IBF institutions show that religious observance is one of the considerations but it is not the only factor. Thus, *Islāmic* resurgence may help to explain a part of the momentum in IBF. Erol and El-Bdour (1989, 1990) show that factors such as fast and efficient service, bank reputation and image, and confidentiality are the primary criteria for the choice of *Islāmic* or mainstream bank,[8] suggesting that religious motivation in bank selection is not the only reason. Naser et al. (1999) extend the early work by Erol and El-Bdour (1989) and conclude that bank reputation and the religious beliefs were the two most important factors motivating the use of *Islāmic* banking services. Omer (1992) and Metwally (1996), however, conclude that religion was the primary factor in the choice of an *Islāmic* banking institution.[9]

A number of similar studies were subsequently undertaken in a variety of contexts. In Bahrain, Metawa and Almossawi (1998) conclude that the most important factor in determining the attitudes of *Islāmic* bank customers was religion, then profitability. In Egypt, Hegazy (1995) compares the demographic profiles of four hundred customers of two banks and suggests the choice of *Islāmic* bank is based partly on religious motivation, but customers still rank bank service speed and efficiency near the top of their selection criteria. These studies suggest that besides religious observance the explanation for IBF growth needs to take into account factors such as the efficiency of IBF institutions and the rate of return on investment. Religiosity may entice Muslim customers to IBF institutions; efficiency and rate of return, however, are important in keeping them.

4.2 PETRO-DOLLAR

Islāmic resurgence helped to establish IBF institutions of the smaller scale such as MitGhmar, however it was the massive support from oil wealth and the political economy conditions of the time that helped to institute the *Islāmic* banking system with the help of IDB. In 1973, the average crude oil price was USD3.29 per barrel; it quadrupled to USD11.58 per barrel in 1974. The surge provided opportunity for King Faisal to extend his power using petro-dollar to trump Nasser's pan-Arabism, and establish the Organisation of Islamic Conference (OIC) and Islamic Development Bank (IDB) that are instrumental in developing IBF (Castle, 2008; El Gamal, 2008; Warde, 2000). The importance of oil price in the IBF equation is further evidence by the slow momentum of IBF in the 1980s. IBF finance was thus often dismissed as a passing fad associated with the oil boom (Rivlin, 2008).

In the second growth period the use of petro-dollar to encourage IBF growth is markedly different. High oil price created a pool of financial liquidity among oil exporters in the Gulf Cooperation Council (GCC) states, similar to surpluses during the 1970s and early 1980s. However, in the 1970s, the GCC were unprepared for their sudden surpluses; generally, they outsourced the management of the surpluses to commercial, usually American bankers, and much of the surpluses were invested in U.S. T-bills or Eurodollar deposits in the West. The GCC states were not seeking to alter the global financial system; they simply followed the prevailing wealth management practices. Consequently, the U.S. remained the central player in the international financial system. During the second growth period, as IBF institutions strengthened, in addition to the September 11 incident, GCC members were more strategic about their petro-dollar investment. They adopt ambitious investment strategies and spent on institutional infrastructure locally, creating free-trade zones for manufacturing, developing services and facilities that would attract businesses, skilled knowledge workers, and tourists (Abdelal, Khan, and Khanna, 2008). The changes in investment strategy fuelled the growth of IBF in the second period as the surpluses from oil wealth were spent locally or invested in IBF institution in Muslim countries (Imam and Kpodar, 2016; Kpodarand Imam, 2010).

4.3 SEPTEMBER 11, 2001 INCIDENT

The Sept 11, 2001 incident affected *Islāmic* finance both positively and negatively. Many credible financial institutions of Muslim countries were accused of racketeering, wrongful death, negligence and conspiracy in a lawsuit dismissed later. But it inflicted damage to the reputation and operation of these institutions. American officials, ignorant about *Islāmic* finance, viewed all *Islāmic* banks with heightened suspicion (Islahi, 2006) and froze assets of prominent Saudis, harassing IBF institutions and *Islāmic* charities (Malik et al, 2011). The negative perception forced Muslims investors to seek more hospitable locations to deposit and invest their money. In the atmosphere of growing mistrust between the West and the Muslim world, IBF have been mobilized politically to promote a regional market for capital mobilization and investment nurtured by *Islāmic* solidarity (Smith, 2004).

In the beginning, because of diverging interpretation of the *sharīʿah*,[10] Muslim countries did not strategically coordinate IBF implementation. Sensing "that Islam was a religion under siege" (Warde, 2005), induced the rise in religiosity in Muslim countries and suspended earlier misgivings over diverging interpretations of *sharīʿah* in IBF and gave way to a quest for common ground. This eased the effort of standardizing the regulatory framework in the industry by IDB, AAOIFI and IFSB, which helped to enhance trust in the industry.

As for IBF, Malaysia which has a relatively sophisticated financial system, sensed opportunity from the surplus wealth from the Muslim oil exporting countries, and used clever marketing to attractthese investors into IBF. Malaysia issued the first sovereign *sukūk* in 2002, and made a point of appointing *sharīʿah* scholars from the GCC states to monitor compliance. It should be noted that Arab-Malaysian integration is part of the broader phenomenon of IBF regionalization.

4.4 STANDARDIZATION OF REGULATORY FRAMEWORK

Studies show that among the reasons a consumer will patronize an IBF institution are the bank's good reputation and image, which require standardized regulatory framework in the industry. Investors will invest only if they trust the consistency and stability of the institution. The newly standardized regulations prompted by reaction to the September 11, 2001 incident help to better monitor IBF operations, thus providing the needed confidence and encouraging fund movement especially after the incident.

With the help of IDB, IBF institutions stepped up their efforts in standardizing *Islāmic* banking industry regulation and supervision. IDB played the key role in developing internationally acceptable standards and procedures, strengthening the IBF industry architecture in different countries. Several other international institutions are also working to set *sharīʿah*-compliant standards and harmonize them across countries. These include the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the Islamic Finance Service Board (IFSB), the International Islamic Financial Market, the Liquidity Management Center, and the International Islamic Rating Agency (Solé, 2007; Iqbal and Molyneux, 2005). Indeed, a number of countries and institutions have adopted the accounting standards developed by the AAOIFI, which complement IFSB.

4.4.1 ISLAMIC DEVELOPMENT BANK

IDB is a multilateral development bank serving Muslim countries, with 55 member countries. Its purpose is to foster economic development and the social progress of member countries and Muslim communities in accordance with *sharīʿah* principles.IDB has established a number of institutions and funds with distinct administrative arrangements and operational rules, which enable IDB to mobilize supplementary financial resources in line with *sharīʿah*principles and to focus on those functions and activities which cannot be covered under its normal financing arrangements.

In order to promote IBF growth, IDB supports the establishment of Islamic financial institutions licensed in various jurisdictions by participating in their equity capital, and helps to introduce *Islāmic* windows in mainstream banks. IDB does not support its financial resources by borrowing funds from mainstream financial markets as this involves payment of interest. For this reason, the Bank developed *sharīʿah*-compliant financial schemes and instruments to support its ordinary financial resources.

4.4.2 THE ACCOUNTING AND AUDITING ORGANIZATION FOR ISLAMIC FINANCIAL INSTITUTIONS (AAOIFI)

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is an *Islāmic* international autonomous non-profit making corporate body that prepares accounting, auditing, governance, ethics and *sharīʿah* standards for Islamic financial institutions. It was established in accordance with the Agreement of Association which was signed by Islamic financial institutions on 26 February 1990 in Algiers. It was registered in the Kingdom of Bahrain on 27 March 1991. The AAOIFI standards were introduced for the first time in 1993 for Islamic financial institutions.

4.4.3 THE ISLAMIC FINANCIAL SERVICES BOARD (IFSB)

Proper regulation and supervision of banks and financial institutions is important for financial efficiency and stability. Some of the risks faced by the IBF industry are unique due to the *sharīʿah* compliance requirements. Bank supervisors utilizing the traditional standards cannot assess such risks. The need for special guidelines for regulating and supervising *Islāmic* banks has long been felt. Some regulatory authorities have already introduced guidelines for *Islāmic* banking supervision in their respective jurisdictions. With the active involvement of the IMF, the IDB and support from the Bahrain Monetary Agency, Bank Negara Malaysia and other central banks, IFSB was established in Malaysia in November 2002 and has been in operation since March 2003. The IFSB aims at promoting development of a prudent and transparent *Islāmic* financial services industry and provides guidance on the effective supervision and regulation of institutions offering *Islāmic* financial products. IFSB published exposure drafts of capital adequacy and risk management standards for Islamic financial institutions. This helped regulators both in countries that already have well-developed *Islāmic* financial systems and in Western countries to understand and supervise *Islāmic* finance. Its mandate is to serve as an international standard-setting body for the regulatory and supervisory agencies interested in ensuring the soundness and stability of the *Islāmic* financial services industry. It also strives to develop standards in accordance with the unique features of Islamic financial institutions in coordination with the existing standard setting bodies. IFSB has begun developing two prudential standards for the *Islāmic* financial services industry: The Capital Adequacy and Risk Management standards.

4.5 EFFICIENCY OF IBF

Inefficiencies have been found to account for about 20 percent or more of costs in the banking industry (Berger et al., 1993), thus, it is expected that industry growing rapidly is more efficient than those growing at a slower pace. However, comparative studies on bank efficiency showed that *Islāmic* banks efficiency are at best similar to those of non-*Islāmic* banks.

Srairi (2010) shows conventional banks are more efficient than *Islāmic* banks for 71 banks in the Gulf Cooperation Council countries over the period 1999 – 2007 in terms of both cost and profit efficiency. In the case of Pakistan, Sarker (1999) concludes *Islāmic* banks could not achieve maximum efficiency under the mainstream banking framework. Samad and Hassan (2006) and Batchelor and Wadud (2003) show that *Islāmic* banks in Malaysia are less efficient than conventional banks, where full-fledged *Islāmic* banks tend to have lower technical efficiency than commercial banks offering *Islāmic* banking products because of decreasing return to scale. Rosly, Ibrahim, and Abdullah (2003) conducted a study on *Islāmic* banks in Sudan and found that the *Islāmic* banks have low efficiency – both technical and allocative: they were not optimizing their input usage.

In comparing the performance of 15 conventional and 15 interest-free banks worldwide, Metwally (1997) concludes *Islāmic* banks faced more difficulties in attracting depositors compared to conventional banks, and that interest-free banks tend to be more traditional in utilizing funds, therefore they face many disadvantages in terms of investment opportunities. However, profitability and efficiency are similar for mainstream and *Islāmic* banks. Ismail, Abd

Majid, and Ab Rahim (2013) measured the cost efficiency of 34 commercial banks in Malaysia for the period 1993-2000 tocompare relative performance of *Islāmic* and conventional banks. They argue that *Islāmic* bank efficiency is not statistically different from that of conventional banks. Samad (1999) was among the first to investigate the Malaysian *Islāmic* banking sector efficiency. His paper investigates the relative performance of the full-fledged Malaysian *Islāmic* bank compared to its conventional bank peers for the period 1992 to 1996 and found that conventional bank managerial efficiency was higher than that of the full-fledged *Islāmic* bank. On the other hand, the measures of productive efficiency revealed mixed results. He suggested that the average utilization rate of the *Islāmic* banks is lower than that of the conventional banks. Similarly, he found that profits earned by the full-fledged *Islāmic* banks either through use of deposit or loanable funds, or used funds are also lower than that of the conventional banks, reflecting the weaker efficiency of the full-fledged *Islāmic* banks. In contrast, the productivity test by loan recovery criterion indicate that the efficiency of the full-fledged *Islāmic* banks seems to be higher and bad debts as a percentage of equity, loans, and deposits also show a clear superiority over the conventional bank peers.

These results suggest that bank efficiency does not play an important role in the growth of IBF as *Islāmic* bank efficiency is not better than for mainstream banks; instead some of them have lower efficiency than mainstream banks.

4.6 GOVERNMENT SUPPORT

The importance of government support is manifested in Pakistan, Iran and Sudan, where the entire financial system was “Islamized”. On the other hand, some countries such as Malaysia are taking a gradual approach; yet within Malaysia, Kelantan state which is governed by the Pan Malaysian Islamic Party (PAS) insistence on *Islāmic* pawn broking and the transferring of the state account from interest-based to Islamic bank in 1990s had affected the IBF industry there (Salleh, 1999).

State intervention is also manifested in the history of IBF in the U.K. Lord Eddie George during his tenure as the Governor of the Bank of England played a key role in laying the foundations for Islamic mortgages in the U.K. The senior backing he provided led to the success of the *Islāmic* mortgage initiative. Ahli United Bank[11], has been offering *Islāmic* mortgages in the UK since the late 1990s; it was the Finance Act 2003 supported by the Governor of the Bank of England that opened the door to *sharīʿah*-compliant mortgages providing impetus in this niche of financial markets by levelling the playing field for *Islāmic* mortgages regarding stamp duty. As a result, other players such as HSBC Amanah, Alburaq, Islamic Bank of Britain and Lloyds TSB entered the arena providing competition and increasing customer awareness. The efforts were not solely of importance to the UK, as press coverage for the initiative spread across the Muslim world. Many countries that were lagging behind or did not have the regulatory framework for IBF took the initiative to reframe their IBF structure. The Finance Act 2003 work assists changes elsewhere, influencing regulations in Malaysia and Brunei, among other countries.

In Egypt, the story of *Islāmic* finance cannot be separated from government policies: in the early seventies, the government promoted *Islāmic* banks as a component of *infitah* ('open-door') policies and as a counterweight to left-wing and Nasserite opposition. In recent years, just as the government's policy against *Islāmic* groups has toughened, the economic – and rhetorical – war between conventional and *Islāmic* institutions has heated up, each side accusing the other of being un-*Islāmic*.

Bank Negara Malaysia establishment of centers for higher learning in *Islāmic* finance, and grouping of experts at institutes such as INCEIF, have helped to train *Islāmic* bankers conversant in both conventional and *Islāmic* finance, and trained in the *sharīʿah*.

5. CAN IBF INCLUDE THE EXCLUDED MUSLIMS?

The rapid growth of IBF fuelled by *Islāmic* resurgence, petro-dollars and the 9/11 incident has not permeated the lives of many poorer Muslims disenfranchised by the economic system; thus, IBF institutions have not been successful in fulfilling the *maqāṣid* of *sharīʿah*. This begs the question of whether there is a need to restructure the IBF industry in alignment with the *maqāṣid* of *sharīʿah*, and if so, what steps and instruments are needed to include the excluded poor Muslim into the global financial system?

Asutay (2007) suggests current structure conforming to the legalistic *Islāmic* dimensions should remain, and should be accepted as the second-best solution; where the best is the theoretical position of *Islāmic* economics which stress the need to satisfy *maqāṣid* of *sharīʿah* as suggested by Chapra (1985) among others. Even though limitationsexist in current IBF structures, IBF has offered important services. The *maqāṣid* can be served and structured in a newly introduced specialized *Islāmic* institution that incorporates the *maqāṣid* directly into its operation. Such a project can be through the introduction of *sharīʿah*-compliant instruments in mainstream microfinance institutions (MFI) hence the need for *Islāmic* microfinance institutions (*i*MFI). Even if PLS contracts may not be the preferred option, *i*MFI will target "non-bankable" Muslims, hence assisting in satisfying the goal of a fair and just economic system. A sizeable substratum, the poorest of the poor, are not "bankable", and desperately need assistance. *i*MFI will have the poorest of the poor as the primary criterion of eligibility for funding, as some of their capital funding are from *zakāt*[12].

Meanwhile, Jouti (2019) proposed an integrated approach for building sustainable *Islāmic* social finance ecosystems. The approach includes the participation of traditional *Islāmic* institutions of *zakāt*, *sadaqah* and *awqāf* and commercial financing institutions. *Islāmic* capital markets can also help through socially responsible investments and to raise funds for social welfare projects through *sharīʿah*-compliant financing instruments such as *sukūk*. *Islāmic* banks can also provide appropriate *sharīʿah*-compliant instruments to social welfare initiators. Technologically, *sadaqah* in the form of crowd funding may also assist in achieving inclusiveness.

5.1 INCLUSION THROUGH ISLAMIC INSTRUMENTS OF WEALTH DISTRIBUTION

Access to capital is one of the issues in MFI. The capital can be sourced from the institution's own fund, from debt or from retail deposit; it can be sourced domestically or internationally.[13] As some of the sources such as interest based debt are disallowed by *sharīʿah*, *i*MFI are suggested to use *Islāmic* redistributive instruments such as *zakāt*, *sadaqah* and *awqāf* as their funding sources (Habib, 2002). Following the experience of the European Bank for Reconstruction and Development in issuing microfinance bonds socially responsible investment (SRI) *sukūk* has been suggested as a financing mechanism for *Islāmic* microfinance (Khouildi and Kassim, 2018; Zain and Sori, 2017). *Sukūk* are certificates of equal value representing undivided ownership of assets, usufructs and services or the assets of particular projects or special investment activity. In 2019, BMT Bina Ummah, a

Yogyakarta-based *Islāmic* microfinance cooperative, raised IDR710 million through a primary *sukūk* issuance on blockchain using Blossom Finance's Smart Sukuk platform. The issuance is the world's first primary *sukūk* issuance on public blockchain, as well as the first micro *sukūk*[14]. Funds raised from the issuance, which is structured under *muḍārabah*, are used to expand financing for local entrepreneurs.

Zakāt is an annual levy, obligatory on every Muslim who has reached the *nisab* (minimum wealth). It is strictly and explicitly earmarked in the *Qur'an* primarily for the poor and destitute, and secondarily for specific public needs. *Sharīʿah* is clear and elaborate in defining the nature of *zakāt* recipients and payers. While recipients of *zakat* funds are explicit, a greater degree of flexibility exists with respect to beneficiaries of *sadaqah* or voluntary charity. *Awqāf* is an endowment or a trust usually for charitable purpose. *Awqāf* have flourished in Muslim communities throughout history and provided important social services especially in the form of mosques, schools, hospitals, potable water sources, and support for the poor. Kahf (1998) defines *wqāf* as "diverting funds and other resources from consumption and investing them in productive assets that provide either usufruct or revenues for future consumption by individuals or groups of individuals."

Indeed, some *i*MFI, such as *Baitul Mal Wat Tamwil* (BMT) in Indonesia are using these *Islāmic* sources of funds and wealth distribution instruments.[15] BMT is a unique *i*MFI established by individual or group initiatives to help micro-entrepreneurs and eradicate rural poverty especially in villages or traditional markets by operating informally with minimum regulation and supervision (NurKholis, 2008). It is not a bank but operates like a bank. Some BMTs are registered with the Ministry of Cooperation and Small Enterprise as *sharīʿah* saving and loan cooperatives and some as the business units of *Islāmic* charity organizations (Wahyuni, 2008). BMT has dual functions– as a *BaitulMaal* and a *BaitulTamwil*. *BaitulMaal* collect and distribute *zakāt*, *sadaqah*, *awqāf*, and so forth, while *BaitulTamwil* function as financial intermediaries providing financial services to micro enterprises through the 'allowable' *BaitulMaal* fund, as some of the funds collected are earmarked for specific groups of recipients clearly defined in the *sharīʿah* (Hadisumarto and Ismail, 2010). *BaitulTamwil* financing can be in terms of PLS, mark-up or *qarḍul-ḥasan*.

The main issue with *zakat* and *sadaqah*-dependent institutions is sustainability of funds as they are rooted in voluntarism. Funds mobilized through charity are inconsistent and may not lend themselves to careful planning and implementation. Fund sustainability can be sustained through a self-generating funding mechanism. *BaitulTamwil* helps the *BaitulMaal* regenerate funds through the financing provided to the poor. One of the unique instruments from BMT and other *i*MFI is *qarḍul-ḥasan*[16], which is a loan entered into by the lender without expectation of any return on the principal. While the debtor is obliged to return the principal, the lender is urged, according to a number of the sayings of the Prophet *(ṣal-Allāhuʿalayhiwasallam)* not to press the debtor if he or she is unable to repay by the specified deadline. The importance of *qarḍul-ḥasan* is evidence as it is reported from the Prophet *(ṣal-Allāhuʿalayhiwasallam)* that the reward by Allah *(ʿazzawajalla)* for *sadaqah* is ten times and that of *qarḍul-ḥasan* is 18 times. Unlike in *zakat* and *sadaqah* there is an effort to recover the loan, hence it is more sustainable; furthermore it is also an incentive for the debtor to use the loan productively.

In the case of Iran, *qarḍul-ḥasan*h as enjoyed phenomenal growth since the Iranian Revolution, where *qardul-hasan* funds usually provide small consumer and producer loans and, in some cases, lenders engage in profit-sharing activities with small producers. These funds are usually associated with a masjid or other religious organization and sometimes with guilds or professional associations. These funds operate with reasonably low administrative costs since most are managed by voluntary fund managers (Mirakhor and Iqbal, 2007). Widiyanto, Mutamimah, and Hendar (2011) and Khan and Philips (2010) have shown how *qardul-hasan* financing through *i*MFI has been able to empower communities and help alleviate poverty in Central Java, Indonesia, Pakistan and Kosovo respectively. The largest microfinance scheme in Malaysia, Amanah Ikhtiar Malaysia (AIM), also claims that its loans are based on *qardul-hasan* principles; however, AIM imposes a 10 percent service charge on its loans.

Sustainability is also addressed in *awqāf* through creation of permanent and income-generating physical assets. *Awqāf* has historically been the major vehicle for creating community assets. On the other hand, restrictions on *wqāf asset* development and use for pre-specified purposes introduce rigidity into the system. Undoubtedly, it is important to preserve and develop assets under *wqāf* to add to productive capacity and create capabilities for wealth creation. *Awqāf* may also be created specifically to impart knowledge and skills in entrepreneurship development among the poor as microfinance alone cannot create wealth unless combined with entrepreneurial skills. Indeed, all technical assistance programs can be organized as *awqāf*. Recently, monetary *wqāf* instead of physical asset has been suggested to circumvent the rigidity of use. Zarka (2013) argues that monetary *wqāf* has been permitted by some early jurists; however it was usually deemed an exception with limited applicability because of misappropriation risk. IBF with the current regulations and standards can ease the monitoring process, hence making monetary *wqāf* feasible and more desirable. The monetary *wqāf* could be another source for *i*MFI funding.

6. CONCLUSION

Many Muslims are marginalized from the global economy because the mainstream interest based financial system is in conflict with the *sharīʿah* (Islamic law). To address the issue, IBF has developed *sharīʿah* compliant instruments. The ultimate objective of IBF is to promote *Islāmic* norms of economic behavior, and ultimately to realize the *maqāṣidal-sharīʿah* in creating a just economic system by eliminating *ribā'*. The PLS instruments employed by IBF institutions, such as *mudārabah*, are considered the ideal mode of *Islāmic* finance. In contrast to conventional interest-based finance, PLS instruments counter unequal income and wealth distributions, leading to optimal resource allocation. PLS instruments ensure justice in the relationships between the parties involved, as returns to the bank depend entrepreneur operational results.

IBF institutional growth has been phenomenal since its introduction in the 1960s. The expansion has been especially pronounced in the 1970s and since the late 1990s. The upsurge of IBF in the 1970s was driven by oil price rises, competition for regional power between Egypt and Saudi Arabia, and a general Islāmic resurgence. The second upsurge involved similar drivers, but with the added benefit of standardized regulation and management, as well as improved overall business decision-making. The aftermath of 11 September 2001 reinforced the second surge in *Islāmic* finance. The sense that Islam was under siege strengthened the quest for common ground in IBF institutions. Divergent interpretations of the *sharīʿah* had previously divided the industry. After 2001 initiatives to enhance standardization were led by the Islamic Development Bank (IDB) in

Jeddah, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) in Manama, and the Islamic Financial Services Board (IFSB) in Kuala Lumpur.

Today, the *Islāmic* banking industry has become systemically important in many countries; *Islāmic* assets have reached USD2.19 trillion, up from just USD150 billion in the 1990s. The sector includes many specifically *Islāmic* institutions, such as Al Rajhi Bank Saudi Arabia, Bank Islam Malaysia and Bank Melli Iran. In addition, many large global financial institutions such as Citibank and HSBC have added *Islāmic* banking alongside their conventional operations. It is now also possible to hold *Islāmic* accounts with these banks in Western countries, where some non-Muslims have become customers as well.

The early IBF institutions of the 1960s, such as MitGhamr Savings Bank in Egypt and TabungHaji in Malaysia, were socially oriented institutions, anchored in the *maqāṣidal-sharīʿah* and Islāmic economic vision. They provided credits and other financial services to peasants, small businesses, and workers, aiming at overcoming financial exclusion and expanding the ownership base of society. However, subsequently, IBF institutions have tended to respond to prevailing international financial system forces by moving closer to conventional financial institution operations. IBF continues to expand the Muslim financial base and reduce financial exclusion, but many institutions have been taken over by pragmatic bankers who shift the core operation away from the original religious and social ideals. Today, most IBF institutions avoid PLS as a central instrument. The use of more risky PLS contracts, such as *mudārabah* and *mushārakah,* has dramatically declined. Instead, IBF institutions operate largely on debt-based contracts, such as *murābaḥah*, *ijarah*, *salam*, or *istisnā*. These relatively safe credits are similar, in some respects, to lending on the basis of fixed interest.

The new generation of financial instruments are at odds with the foundational axioms of *Islāmic* economics. As such, the concept behind IBF has been reduced to the mere removal of *ribā'* and the conduct of financial activities according to *sharīʿah*derived contractual norms. IBF institutions are following the letter of the *sharīʿah*, but not its spirit, the *maqāṣid*. The marked-up contracts are only weakly *Islāmic*.

The simplistic 'pragmatism' has meant that globalization and unprecedented growth of IBF has not permeated the lives of many poorer Muslims disenfranchised by the current economic system.

These low-income groups are not interested in *sukūk*, capital protected funds, *Islāmic* hedge funds, AAOIFI standards or IFSB prudential regulations. They want access to *Islāmic* micro-credits, SME financing, venture capital and other related programs. 'Non-bankable' Muslims want the dignity to provide for their families financially, and IBF could do much more to this end. *i*MFI has been suggested as the driver for inclusiveness because of the 'failure' of IBF, and these *i*MFI have been using *Islāmic* wealth distribution instruments as their source of capital. Recent developments also saw *sharīʿah*-compliant financing instruments such as *sukūk* being developed to improve inclusiveness. However, unlike MFI, formal *i*MFI are very recent, similar to the IBF industry. They will need time to adjust to the fast moving global financial system before including the marginalized Muslims in the global financial system.

ACKNOWLEDGEMENT

A version of this paper was presented at the Empowering the Margins in Global Politics Project: Including the Excluded Workshop, Rio de Janeiro, 2011.

ENDNOTES

1. Shariah or Islāmic law is meant to regulate all aspects of a Muslim's way of life. It is broadly divided into two sets of rules: one relates to the obligatory worship of God (*ʿibādah*) and the other relates to daily life outside the context of obligatory worship (*muamalat*), including commercial and financial dealings.
2. "The 'ulama' classified masalih-cum-*maqāṣid* into three categories in a descending order of importance, beginning with the essential masalih, or *daruriyyat*, followed by the complementary benefits, or *hajiyyat*, and then the embellishments or *tahsiniyyat*. … The essential interests are enumerated at five, namely faith, life, lineage, intellect and property. … The second class of the interests, known as *hajiyyat*, or complementary interests are defined as benefits which seek to remove severity and hardship that do not pose a threat to the very survival of normal order. … The third class of masalih, known as *tahsiniyyat*, are in the nature of desirables as they seek to attain refinement and perfection in the customs and conduct of people at all levels of achievement" (Kamali, 1999).
3. IFSB's Financial Stability Report 2016, specified that an *Islāmic* banking system is classified as systemically important if it accounts for 15 percent or more of the domestic banking system assets.

4. Most of the Muslim majority countries are less developed, hence access to financial intermediaries, both mainstream and *Islāmic* are still lacking.
5. The IDB prize in *Islāmic* banking for the year 1410 Hijri (1990A.D) was awarded to Lembaga Urusan dan Tabung Haji (Pilgrimage Management and Fund Board) of Malaysia, considering the significance of Tabung Haji as an Islamic Financial Institution which has mobilized savings of individuals and successfully operated an investment fund in an *Islāmic* way in order to fulfil the lifelong desire of many individuals for the performance of the haj rituals. Tabung Haji has devised an innovative way to motivate Muslims to save in order to provide for their expenses for performing the pilgrimage. It has managed the resources mobilized from small savers in an efficient manner and invested them in industry, commerce, agriculture and real estate in conformity with *Islāmic* principles. In this way, it has not only provided *Islāmic* services to the individuals but has, at the same time, operated a huge investment fund using investment techniques conforming to *sharīʿah* (Tabung Haji, 1995).
6. Based on Khan (2010) Box 1, p. 809.
7. Quoted from El Gamal (2006).
8. The study surveyed Jordan customers.
9. Omer (1992) surveyed three hundred Muslims in the United Kingdom on their patronage factors and awareness of *Islāmic* financing methods. Metwally (1996) also used factor analysis to study the attitudes of Muslims in three Arabic dual-banking systems (Kuwait, Saudi Arabia and Egypt) towards *Islāmic* banking.
10. While *sharīʿah* is immutable and infallible, *fiqh* is changeable. *Fiqh* deals with the observance of rituals, morals and social legislation in Islam as well as political systems. There are four prominent schools of *fiqh* within Sunni.
11. Formerly known as United Bank of Kuwait.
12. Obaidullah, M. p. 10.
13. International sources of funding may come from the United Nations (UN) agencies, development finance institutions and private institutions or individual investors. Hsu (2007) shows that domestic sources of funding, including deposits account for 85 percent of MFI funding, while foreign sources account for 15 percent.
14. https://ifnfintech.com/islamic-microfinance-cooperative-issues-micro-smart-*sukūk*-in-worlds-first-primary-*sukūk*-offering-on-public-blockchain/
15. There are three levels of *Islāmic* banks in Indonesia, based on size: (i) General commercial banks, (ii) Rural banks and (ii) Sub-rural financial institutions. Bank Muamalat Indonesia represents the first kind. PT Bank Perkreditan Rakyat Syariah (PT BPRS) represents the second form. Rural banks must be located in the capital of Kecamatan

and prohibited to operate beyond the approved areas. The third form is BMT.The establishment of BMT is triggered by the limited opportunity to establish a formal *Islāmic* bank either in the form of General Bank, or Rural Bank.

16. *Qarḍ* is a noun signifying the act of tearing something apart with one's teeth, suggesting perhaps the act of tearing away a part of one's wealth in the form of a loan (suggesting a painful process). Hasan means splendid or beautiful. The two words together mean a 'beautiful loan' perhaps because, as the *Qur'ān* asserts, these loans are made to Allah *(ʿazza wajalla)*rather than to the borrower and this eases the pain of 'tearing away' part of one's wealth and lending it to someone in need.

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