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INCONVERTIBILITY LOSS AND MURABAHA: A RECOVERY OPTION FOR ISLAMIC POLITICAL RISK INSURERS

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ABSTRACT

This paper attempts to illustrate the primacy of the Shari'a-compliant *murabaha* transaction as a means of inconvertibility loss recovery by Islamic political risk insurers. In practical terms, the risk most likely to occur in an underdeveloped Muslim country is the risk of the local currency becoming inconvertible because of a certain action or inaction by the authorities of the host country which is the destination of an export trade transaction, or a foreign direct investment covered under a political risk insurance policy. The political risk insurance (PRI) operator most concerned with the subject of this paper is the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC), a member of the Islamic Development Bank (IsDB) Group. Where the PRI operator is established within the auspices of a lending agency which lends in local currency, and provided that the necessary legal arrangements are in place, the PRI's local currency holdings could be passed on to the lending agency in the host country and the foreign currency equivalent thereof paid over to the PRI operator at its head office. In countries where a lender is not extending local currency financing and a speedy economic recovery is not expected, an attractive alternative for a PRI operator, as the authors argue, is the utilization of the local currency in *murabaha* transactions. PRI operators' apprehension about the risk of inconvertibility finds expression in denial of the inconvertibility coverage altogether. Where this is not the case, a PRI operator may impose recovery ceilings, demand the expiry of extended waiting periods, as well as compliance with a variety of other conditions prior to recovery. This paper argues that such measures are self-defeating. A Shari'a-compliant PRI operator is necessarily established to provide coverage against commercial and non-commercial risks in poor Muslim countries. To deny or restrict inconvertibility risk coverage in such countries is unacceptable. *Murabaha* is a panacea for currency inconvertibility: it is the most popular form of Islamic financing in the world, it is easy to structure, and its profits are almost certainly rewarding. While the risk of non-payment of the price by overseas buyers of Muslim country exports is minimal, risks associated with *murabaha* could be further minimized by means of export credit insurance coverage by local export promotion agencies.

Keywords: *Murabaha Transaction, Political Risk Insurance, Currency Inconvertibility, Export Credit Insurance*

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Introduction

The purpose of this article is to illustrate the primacy of the Sharia-compatible form of *murabaha* financing as a means of recovery by political risk insurers where an inconvertibility loss occurs under a policy. As examined herein, *murabaha* is easily a preferable recovery method in view of its structure's simplicity, its almost assured success, and hence, its unrivalled popularity in all developing Muslim country markets where political risk insurers operate.

The paper consists of five parts. The first part provides a general description of political risk insurance (PRI) as a means of providing coverage both for export trade transactions as well as for foreign direct investment (FRI) in developing countries. The second part of the paper examines recovery of the loss occurring when a local currency becomes inconvertible for one reason or another and describes the usual recovery procedures as well as the arrangements available to PRI operators to reduce their losses in a host country. Unlike trade transactions, forms of FDI compatible with Shari'a are not necessarily widely known. Therefore, part three of the paper explores current examples adhered to by Islamic financial institutions as well as examines the political risks associated therewith and for which Islamic PRI operators extend coverage. The primacy of *murabaha* as a means for inconvertibility loss recovery in both trade and FDI transactions is considered in part four, which also describes the mechanism of *murabaha* as currently practiced. Concluding remarks then follow in part five.

For most serious scholars and policymakers, international trade and foreign direct investment are indispensable handmaidens to rapid economic development (Takatoshi Ito & Anne O. Krueger, 2000). An overwhelming majority of developing countries and countries in transition have come increasingly to view foreign direct investment in particular as a source of economic development, modernisation and income growth and employment. Indeed, except in marginal cases, foreign direct investment has had a splendid track record of supplementing host country resources, triggering technology spillovers, assisting human capital formation, contributing to international trade integration, and assisting substantially in the alleviation of extreme forms of poverty (Harbhajan S. Kehal., 2004). No paradigm in this respect is more revealing than China's meteoric rise from rags to riches in a little over four decades. The country's open-door policy, for both international trade and direct investment, initiated in 1978, has since brought the country tens of billions of dollars in overseas investments, sparking an annual growth rate of over 9% for several years, thereby lifting approximately 800 million Chinese out of poverty.

Developing countries, particularly those with balance of payment difficulties, find it exceedingly difficult to borrow 'new money' and are therefore eager for increased international trade and foreign investment both of which bring in much-needed resources other than by borrowing. This appetite for foreign capital and resources is nearly always matched by foreign investors' desire to invest in capital-starved countries. Incentives are worth the venture: attractive new markets and much higher profit margins than in countries with abundant capital resources.

Exporters of goods and investors are however exposed to a wide range of commercial and non-commercial risks and the life of each is also 'a web of mingled yarn, good and ill together'. Thus, only a mechanism for reducing export and investment risks in the host country could encourage risk-averse exporters of goods as well as direct investors to proceed with the proposed sale or investment venture. This mechanism is political risk insurance or, PRI, which exporters of goods as well as foreign direct investors utilize extensively in worldwide business transactions.

PRI for Trade and Investment

PRI is the branch of the insurance business which provides financial protection to investors, financial institutions, and businesses that face the possibility of losing money in respect of their respective investments abroad because of political events in the host countries of investment. It protects against the possibility that a government will take some action that causes the insured to experience a large financial loss. One of the most common risks facing investments abroad is the risk of currency inconvertibility; the risk that investors' earnings in the local currency of the host country cannot be converted into foreign currency for transfer abroad. Inconvertibility occurs because of the action or inaction of the host country. It may occur because the host country disallows the conversion of its currency into foreign currency or because the host country simply fails to secure sufficient foreign currency to allow for the conversion of its local currency to occur.

Currently, eighty-six export credit and investment insurance agencies from sixty-seven countries provide PRI: all of which agencies are members of the Berne Union. In addition, four prominent multilateral PRI operators also provide the service to an increasing clientele base. In 2021 alone, Union members collectively provided payment risk protection to banks, exporters, and investors in the tune of US$2.7 trillion, amounting approximately to 13% of total world cross-border trade for goods and services. Export credit agencies provide insurance coverage against commercial risks associated with foreign receivables, notably non-payment by foreign buyers as a result of such risks as the insolvency of the buyer, bankruptcy or protracted delays or slow payments (Salcic, 2014). And—mostly for FDI in both of its forms--these agencies also provide coverage for non-commercial risks, generally known as political risks. The two forms of FDI are the direct investment form and the portfolio form; the latter referring to ownership of stocks, bonds, or other financial assets (United Nations Conference on Trade and Development (UNCTAD), 2007). As FDI tends to be long-term, it is exposed to risks traditionally classified as political risks. This class of risks may be defined as economic changes arising from events either directly or tangentially related to the political process such as the host government's breach of contract or its failure to honour significant obligations, resulting *inter alia* in sovereign debt defaults. PRI protects direct investments in either form from losses stemming from the government's nationalization or expropriation of invested assets, such as real estate, bank accounts and equity securities. In addition to inconvertibility and transfer risks, coverage extends also to a myriad of other risks such as political violence, including war, revolutions, insurrections, civil unrest, and terrorism (Ibrahim Shihata, 1988).

As this paper will explain, an exporter is often in a slightly better position than an investor in terms of inconvertibility loss recovery. Although an investor will also be indemnified by a PRI operator—where a cover had been taken out recovery by both insurer and insured is likely to experience idiosyncratic challenges.

It is however in relation to international trade that PRI is most relevant. The primary risk in these transactions, i.e., non-payment by the buyer, is the risk most covered by export credit agencies. As for non-trade investments, it is by no means certain that the availability of political risk coverage is a decisive factor in a decision to invest abroad. There is indeed evidence that only a relatively small share of inward foreign direct investment in Africa and other developing regions is covered by political risk operatives; the greater share of incoming investments remains uninsured (IsDB and ICIEC, 2020). The unexpected events, such as the COVID-19 coronavirus pandemic, proved to have a more devastating effect on the flow of foreign investment than the habitual apprehension about political risks. Just in Latin America, for instance, the pandemic caused foreign investment flows to the region to plummet by 45% in just one year (World Investment Report, 2022).

Naturally, it is unwelcome news for an exporter of goods when the buyer is unable, or refuses, to pay the agreed price. No less disastrous for an exporter or a direct investor is receiving the price of goods, or investment returns, in a currency that is inconvertible into a freely usable currency for transfer abroad. It is thus trite to assert that an exporter of goods or a foreign investor protected by PRI stands far above a non-protected exporter and/or investor. A prudent cross-border exporter of goods will therefore seek PRI coverage to guard against buyers' non-payment. Likewise, PRI coverage is plainly a judicious measure for an investor to take. While commercial losses of direct investments lie where they fall, those resulting from political risks are indemnified by the political risk insurer. And when a covered loss occurs, whether in respect of a trade transaction or a direct investment, the insured will claim under the policy. On condition of assigning and transferring its right to payment to the insurer, as will be explained in greater detail below, the insured policyholder will be compensated for a considerable part of the loss. Once a policyholder's right to payment is assigned and transferred to the insurer, the debt obligation is owed to the insurer. Little wonder that on average, approximately 80 per cent of developing country debt is owed to export credit agencies.

Inconvertibility Coverage, Procedure, and Recovery Methods

The absence of risk is impossible to contemplate in any dynamic situation. Risks do materialise, sometimes not single spies but in battalions. FDI is not all sunshine and rainbows. Some investments are not beyond espousing disastrous practices in host countries but the risks afflicting investors, caused by individuals or official authorities at the host country's end, are far greater than the occasional harms resulting from FDI (Caycedo, 2018). The prime risk to investors is the commercial risk of non-payment of goods by host country buyers. However, the scope of political risks is much wider, and their consequences are just as lethal: governments of host countries may disregard agreed commitments, confiscate property illegally, impede local currency conversion, prevent the transfer of foreign currency, and engage in a myriad of corrupt practices to the detriment of foreign investors (Sottilotta, 2013). From the point of view of the exporter of goods as well as the foreign direct investor, a particularly dreaded risk (often resulting in acrimonious disputes) is the failure of the host government, either by action or inaction, to facilitate the conversion of the local currency (whether the price of goods or direct investment returns) into a freely usable currency that may be transferred abroad. Rather than subsiding, disputes between investors and host countries, including disputes relating to inconvertibility and transfer, are on the rise. In 2022 alone, ICSID, the World Bank's International Centre for Settlement of Investment Disputes -which arbitrates investment disputes between foreign investors and host countries-- administered 346 disputes, making the largest number of cases ever administered in one fiscal year (ICSID, 2022).

There are differences, sometimes substantial, between the recovery of an inconvertibility loss by an exporter and the recovery by a foreign direct investor. Under an export credit transaction that goes awry, for instance, the risk occurs when the entire price due from, and payable by, the buyer has been deposited in a bank or other financial institution for the benefit of the exporter but remained inconvertible. Once this amount is assigned and transferred to the insurer, the exporter will be paid, in the contract currency, the agreed amount under the policy. The exporter could then move on with his or her life. But things are not so easy for an investor. Where an investment had taken the form of equity, leasing, *istisna'*, or any other form of investment compatible with Shari'a, as discussed later, the returns from the investment are usually made on an annual or semi-annual basis for many years. The risk of returns being made in local currency and remaining inconvertible could last an exceedingly long time indeed. The recovery, both by the insurer and the policyholder, is therefore likely to be a protracted and arduous process.

Recovery Procedure

A detailed examination of recovery processes by PRI operators is beyond the scope of this paper. The focus here is on recovery of an inconvertibility loss by Islamic PRI operators, such as the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC), a member of the Islamic Development Bank (IsDB) Group. Established in 1994, the primary purpose of ICIEC is to provide credit insurance, non-honouring of sovereign financial obligations as well as a wide range of investment insurance products to investors, mostly in the least developed of its 49 member countries.

What is remarkable here is the similarity between policy inconvertibility clauses among Berne Union members, Islamic and non-Islamic alike. Under the MIGA convention, for instance, the risk is defined in these terms:

> "Any introduction attributable to the host government of restrictions on the transfer outside the host country of its currency into a freely usable currency or another currency acceptable to the holder of the guarantee, including a failure of the host government to act within a reasonable period of time on an application by such holder for such transfer".

A range of ICIEC's policies currently in use also cover the risk in nearly identical terms. Thus, the essential components of the inconvertibility risk are: (a) a payment is due from a non-sovereign entity, i.e., an individual or a private business organization (b) the entity is able and willing to make the payment, (c) the entity cannot obtain or transfer the contract currency to the beneficiary, and (d) the obligee entity's failure is caused by restrictions imposed by the government or by its failure to make the required currency available. Coverage does not extend to monetary risks such as inflation or currency depreciation.

Once an investor ascertains that its receivables in local currency cannot be transferred abroad, the risk will in principle be deemed to have occurred, albeit not materialized. The lack of foreign currency reserves in the host country may be temporary or transient due to certain events or circumstances. It is not unusual for a Muslim-majority country, for instance, to experience foreign currency shortages just prior to the Hajj season but to return to normal levels of foreign currency reserves thereafter. However, the risk will be deemed to have materialized after the expiry of the standard waiting period in PRI policies. This period, in ICIEC's standard investment insurance policies, is calculated by reference to the number of days expiring between the date on which the loss has occurred and the date on which the loss is deemed payable under the policy.

As alluded to, it is the standard practice by every Berne Union member to make payment under the policy conditional on the policyholder assigning and transferring, or agreeing to assign and transfer, all its rights to payment under the policy to the insurer. The insurer's right to be the assignee and/or transferee of the policyholder's right is based on the doctrine of subrogation, often substantiated by the celebrated case of *Castellian v. Preston* (1883), and believed to have developed in equity as well as in common law (John Birds, 1997). In a legendary passage in that case, Brett L. J. expressed the *locus classicus* of the doctrine thus:

> "…as between the underwriter and the assured, the underwriter is entitled to the advantage of every right of the assured, whether such right consists of contract, fulfilled or unfulfilled, or in remedy for tort capable of being insisted on or already insisted on, or in any other right, etc..".

The essence of the doctrine is the same in Shari'a law: Sunni Schools of Thought categorically sanction the right of an indemnifier of a loss to step into the shoes of the recipient of indemnity to make itself whole, but not beyond redeeming itself for the exact indemnity made.

Both in Shari'a as well as under English law, subrogation arises only when the insured has been indemnified: subrogation is about stepping into the shoes of a payee; no payment, no shoes to step into. Again, both in Shari'a as well as in English common law, not any payment by the insurer will do. It must be full indemnity (*Globe and Rutgers Fire Insurance Company v. Truedell*, 1927). These rules make sense where the insurer is domiciled in the place where the loss has occurred. But where the locus of the risk is a developing country, as often is the case in inconvertibility losses, while the PRI is domiciled elsewhere, it is prudent for the PRI operator to demand to be the subrogee of the loss prior to compensation. In any case, it is no comfort for a policyholder to be in possession of an inconvertible currency, however substantial, and its assignment and transfer to the insurer should be a pleasant indicator of the commencement of the process of recovery.

As this paper exclusively examines recovery options of a PRI operator that has sustained an inconvertibility loss, let us assume that an exporter of goods had taken out a PRI policy issued, for instance, by ICIEC covering, principally, losses resulting from the buyer's inability to pay the price. Let us assume further that the buyer in question was able and willing to make the payment, and did, in fact, make the payment, but, in view of the dire economic situation in the buyer's country, the authorities could not make the necessary foreign currency available for conversion and subsequent transfer.

Once an inconvertibility loss has been ascertained by ICIEC, the corporation will forthwith notify the host country that a certain amount in local currency is now the property of ICIEC. Once such notice is furnished, the currency held in the name of the corporation will enjoy a wide range of immunities and privileges in the host country and will also be free from applicable foreign exchange restrictions, regulations, and control in the territory of the host country. It is unlikely however that privileges, immunities or any preferential treatment of the corporation regarding its holdings in local currency will mean much in practical terms. It is like booking a first-class cabin on a marooned cruise ship;

inconvertibility is very rarely if at all, a consequence of anything other than a lack of foreign currency reserves.

Inter-Agency Recovery Arrangements

After the expiry of the waiting period, and provided that the insured exporter (investors will discussed later) did not contribute to the inconvertibility loss in any manner, ICIEC will pay the exporter the recoverable amount in accordance with the policy terms. ICICE will then proceed to seek conversion of the local currency into a freely usable currency to be transferred abroad.

For PRI operators established within the auspices of international lending agencies, the inconvertibility risk does not usually pose any fundamental problem. MIGA, for instance, is a member of the World Bank Group, being the PRI arm of the Group. The World Bank itself, the Group leader (IBRD) lends staggering amounts in local currency in connection with its lending activities. The Bank can convert disbursed amounts to local currency and loan repayments by borrower countries will then be the amounts that they will repay under loan instruments. Likewise, the International Finance Corporation (IFC), the private sector financier in the Group, provides long-term local currency lending in connection with IFC's investments in poorer member countries of the Group (IFC, 2022). Thus, provided that legal arrangements to that effect are in place, an inconvertible local currency that becomes MIGA's property in its capacity as subrogee, could easily be paid over to IBRD or to IFC in a particular host country where either entity has local currency commitments. In accordance with such legal arrangements, the equivalent of the local currency paid by MIGA to either of its sisters in the Group will then be paid to MIGA in a freely usable currency. The same is also true of the African Trade Insurance Agency which could avail itself of a similar recovery avenue if the necessary legal arrangements are in place with the African Development Bank, a major financier of local currency in Africa.

As a member of the IsDB Group, there is no doubt that ICIEC's holdings in local currency, in the capacity of subrogee, could be transferred to the IsDB which finances local currency in dozens of development projects in its poorer member countries. Once so transferred in accordance with an agreement facilitating currency swaps between the two organizations, ICIEC would then receive at its head office the equivalent of the local currency in Islamic Dinars, the unit of account of both IsDB and ICIEC. In the unlikely situation where ICIEC could not pass on its local currency holding to an IsDB Group member, and there are no prospects for a speedy economic recovery in the particular host country, the remedy for ICIEC, as discussed later, could be the utilization of the local currency in Shari'a-compatible transactions. Entry into these transactions, it is submitted, is the only reasonable course of action for ICIEC to take, particularly in host countries where local currency traditionally only depreciates against international currencies, such as the US dollar and never appreciates.

Select Types of ICIEC's Covered Investments

In view of the risk-sharing advantages that equity investments offer to host countries, in addition to indisputable effects on resource mobilization and allocation, this form of investment (Claessens, 1995), recently rebounding from its historic low, is an exceedingly popular form of FDI. Its appeal to Islamic institutional investors finds expression in an equally healthy recovery after the crisis of the pandemic year. In view of this significance, all Berne Union members provide PRI for equity investments. Likewise, under its standard equity investment policy, ICIEC also protects equity investments against the usual political risks that afflict equity investments in both forms.

As for leasing, or *ijara*, as in Islamic finance parlance, there are hardly any differences worth mentioning between Islamic and non-Islamic leasing instruments, except for the prohibition by Shari'a of the charging of interest even on unpaid or delayed lease rentals. Indeed, in the event of a payment default, the lessee is enjoined to pay a past-due payment charge in accordance with a specified formula, but all sums of money earned by the Islamic institution by way of delinquent payment charges are disbursed for charitable purposes; never used in ordinary operations. In addition, there are of course restrictions on what forms of lease investments are acceptable to Shari'a as well as prohibitions pertaining to legal form, for instance, to avoid consolidation of more than one transaction in a single deal. Otherwise, Islamic, and non-Islamic PRI operators are on equal footing as far as leasing is concerned: the political risks associated with an Islamic as well as a non-Islamic lease investment are virtually identical.

Regarding *istisna'* ICIEC is undoubtedly the most familiar of the product among all PRI operators. There is indeed no record that the Berne Union has even heard of the product prior to ICIEC joining the Union in 2007. As a member of the IDB Group, ICIEC's position as a pioneer provider of *istisna'*-related political risks is not surprising. *Istisna'* is a medium-term financing arrangement by which a party (a producer, manufacturer, or a bank) undertakes to manufacture, construct, or build a specified asset for another party (a customer) with the obligation to deliver the asset to the customer upon completion. Thus, the asset in question is non-existent at the commencement of the transaction; the purpose of the agreement being to bring it into existence. Once completed, the financier will sell the asset to the customer at an agreed price. Examples of such arrangements include the construction of power plants, factories, roads, schools, hospitals, and residential developments (Financial Accounting Standard 11, 2015).

Istisna is, at least, a two-step procedure (Sa'ad *et al*., 2016). A project sponsor desirous of establishing a project, typically involving construction, seeks financing from an Islamic institution. The chance of the financing being extended is much greater when the project sponsor has secured coverage for the proposed project by ICIEC or another PRI operator. Once financing is secured, the *istisna*' agreement will be entered into between the project sponsor and the financier. Conditions precedent for financing include *inter alia*, the establishment of a first-rank mortgage on the project land as well as the establishment of an escrow account at a commercial bank in the host country of the proposed project (Muhammad al-Amine, 2006). Almost certainly, a financier will additionally be required to be named the primary beneficiary of ICIEC's policy. In addition to the financing agreement, the parties will also conclude an agency agreement under which the project sponsor undertakes to act as an agent for the financier for nearly all purposes pertaining to the establishment of the project. In many cases, the party undertaking the construction and completion of the project is not the customer, but a professional builder or contractor whose services are procured under a back-to-back or parallel *istisna'* agreement with the financial institution. On completion and upon the expiry of an agreed gestation period, the project is then sold by the financier to the customer who will pay the purchase price in annual or semi-annual instalments over an agreed period, often several years (Maghrebi *et al*., 2020). It is the receipt of these payments by the foreign direct investor, the financier, that is covered by ICIEC's investment insurance policy.

It follows from the above that equity investments, investment by means of *ijara* as well as *istisna*', share a basic feature: payment of annual or semi-annual instalments, in the form of dividends, in equity investments, lease rentals in *ijara*, or purchase price payments in *istisna*'. In all three investments, an obligee will make payments in local currency into an account at an agreed financial institution for transfer abroad. In all scenarios, therefore, the local currency intended to be converted into a freely usable currency may remain inconvertible, thereby causing a loss to the intended beneficiary. Where the beneficiary of such payments has covered the receipt thereof under a PRI policy, the policyholder would be compensated by the PRI operator upon assignment and transfer of the local currency to the operator. Now saddled with inconvertible local currency, which will only continue to pile up, it is the PRI operator's turn to reduce its losses by utilizing its local currency holdings in Shari'a-compatible transactions in the host country. Such utilization will continue until such time as the country builds sufficient foreign currency reserves for the transfer to finally occur.

Primacy of Murabaha

Investment of local currency holdings in local sovereign or corporate Sukuk bonds is unquestionably an efficient and prompt means of recycling local currency holdings. Not much work is required: bonds and Sukuk can be procured electronically minutes after issuance. Investments in other Sharia-compatible investments, such *murabaha*, *mudaraba* and *musharaka* will almost certainly involve considerable preparatory work such as feasibility studies, negotiations and documentation. A PRI operator such as ICIEC will obviously have no Shari'a concerns regarding investment in Sukuk bonds. Sukuk are financial products whose terms and structures comply with Shari'a, for unlike in conventional bonds, the Sukuk bondholder does not receive interest. What he or she receives is a share in profits derived from the revenues generated by the asset acquired with the proceeds of the Sukuk bond issuance (J. Godlewski, 2013). So popular are Sukuk nowadays that in 2022 alone more than $100 billion worth of Sukuk bonds were issued by many, even non-Muslim countries, and were traded in the United States, West European and Japanese markets. Thus, where Sukuk bonds are issued in local currency a Shari'a-compliant PRI operator could readily invest its holdings in such Sukuk much to the benefit of local SMEs, service, industrial and trade sectors (Abdelrahman, 2019).

It might appear paradoxical to sing the praises of Sukuk in a section stressing the primacy of *murabaha* as an investment avenue. However, Sukuk on the one hand and *murabaha* transactions carried out specifically for reducing inconvertibility losses, are very rarely mutually exclusive investment avenues, even in countries where the local currency historically depreciates against international currencies. This is so because developing Muslim countries with stock markets where Sukuk are attractive investments, very rarely experience currency inconvertibility. Thus, although it is theoretically possible that a middle-income Muslim country might experience currency inconvertibility, it is an extreme rarity that an appealing stock exchange could exist in a business environment where the local currency's inconvertibility is a real risk. Indeed, in historically high-inflation Muslim countries the Sukuk yield—however high-rarely, if at all, compensates the loss of value of the local currency and Sukuk as investment vehicles are therefore either non-existent or altogether ignored. It is in this sense that the primacy of *murabaha* as a means of reducing inconvertibility losses must be understood. Although some alternative Shari'a-compatible investment opportunities (other than a lucrative Sukuk market) may be available in such countries (Mansuri, 2005), the authors are of the opinion that *murabaha* transactions should be an immediate choice for an Islamic PRI operator eager to explore the opportunities that inconvertible local currency holdings may offer.

In its simplest form, *murabaha* is a financing structure in which a seller agrees to sell, and a buyer agrees to buy, a specified commodity at a certain price in accordance with agreed conditions such as time and place of delivery and time and manner of payment (Tlemsani *et al.*, 2020). Invariably, the price is the cost of the goods plus a markup representing the seller's profit. A *murabaha* transaction may be structured in a variety of ways conforming to Shari'a. In whatever form agreed, a financier, mostly an Islamic bank, will procure for and on behalf of a beneficiary, the agreed goods, subject to conditions as to price, quantity, and quality and an agreed markup. As in English statutory law, so in Shari'a, the primary obligation of the seller is to deliver the goods and of the buyer to accept delivery of, and pay for, the goods. However, unlike in any other legal system, the parties to a contract of sale in accordance with Shari'a are enjoined to observe specified moral standards which, in the case of a financier of a *murabaha* transaction, include the obligation to disclose terms applicable to the procurement of goods from an original supplier such as, for instance, if the goods are being procured from the original supplier on credit terms, as well the obligation to disclose any error or mistake even after the goods had been purchased by the buyer. The buyer's standing under a *murabaha* transaction is also unequalled in other legal systems for if the financier had failed to disclose the cost or capital outlay of the transaction or failed to make both or either of the disclosures specified above, the buyer has the option to have recourse to the financier for non-disclosure or the right to cancel the contract. It is of paramount importance here to accentuate the fact that the high moral standards required of the contracting parties to a *murabaha* transaction, do not render coverage of the transaction by a PRI operator any more risker or perilous than coverage of a non-Islamic export trade transaction.

A detailed description of the usual conditions of a *murabaha* transaction is unnecessary here, suffice it to reiterate the earlier proposition that *murabaha* should come in handy as an appropriate path for the utilization of an inconvertible local currency. Shari'a-compatible investment avenues may or may not exist in the host country, but no country exists without trade for, every man' lives by exchanging, or becomes in some measure a merchant. Thus, amounts accruing to a policyholder, whether as annual dividends (under an equity investment) or rentals (under *ijara*) or purchase price (under *istisna*') could be utilized by a PRI in *murabaha* transactions. Of course, there is no guarantee that the PRI's holdings in local currency will always be sufficient to make the PRI operator a sole trade financier: dividends, rental or purchase price payments in any policy period may not meet the needs of local traders seeking *murabaha* financing. In such cases the PRI could contribute whatever local currency funds in its possession in a syndicated *murabaha* led by a local bank or other financial institution. The PRI operator's share in the mark-up will be proportionate to its contribution to the syndicate.

There is no risk at all that *murabaha* transactions will diminish in significance or run out of fashion in any local market. They remain the best-known and most popular of all modes of financing by Islamic banks and trading entities alike and are likely to continue increasing steadily. Indeed, it is estimated that 90 percent of short-term financing by Islamic institutions worldwide is in the form of *murabaha* transactions (Miah & Suzuki 2020). In 2020, for instance, the Islamic Trade Finance Corporation, a member of the IsDB Group, approved a total of US$6.5 billion in *murabaha* trade finance, of which it disbursed US$5.1 billion, while approving US$763 million in new *murabaha* transactions in the first quarter of 2021.

It is indeed pedestrian to emphasise the significance of export trade to countries starved of foreign reserves. In Africa in particular, in the decade ending in 2020, trade revenues accounted for more than three times the values of overseas remittances, FDI inflows and official development assistance taken together (Luke, 2020). Compared to overseas development assistance, such as international aid, export earnings during the same decade were 17 times as much. Thus, in addition to being readily available opportunities for utilizing inconvertible local currency holdings, *mudaraba* transactions would seem to be the panacea for inconvertibility. A PRI agency's share of foreign currency earnings could be directly transferred from the overseas buyer of commodities to the agency's account at its head office.

Once the parties to a *murabaha* trade transaction become comfortable with one another, the transaction could be repeated as often as the parties wish by means of a revolving *murabaha* financing facility, particularly for essential commodities such as coffee, cotton, iron core, textiles, and hides (Harber, 1997). Such arrangements would seem most appropriate for a smart use of an inconvertible local currency to tackle the very reason that caused inconvertibility in the first place: lack of sufficient foreign currency in the host country.

In these turbulent times however, neither *murabaha* nor any Shari'a-compliant transaction is guaranteed fair winds and following seas. Trade risks are as frequent as they are ruinous and exports are oftentimes prey for recession, inflation and demand contraction, supply chain constraints, shooting wars and corporate defaults. Sanitary and phytosanitary measures often represent hurdles for African exports to Europe. Thus, investing local currency holdings in trade transactions may, in some exceptional circumstances, not achieve the required results and the PRI operator may end up losing its entire holding of the local currency; inconvertible as it is.

However, like fire insurers that deny coverage to flammable properties (wooden dwellings that need fire coverage the most) (Dudley, 2003), it would be self-defeating for an Islamic PRI operator, set up to protect market operators from commercial and non-commercial risks, to stay safe and dry at the shore; refusing to initiate *murabaha* transactions for its own benefit and that of the host country. Equally objectionable are underwriting techniques by an Islamic PRI operator that render currency inconvertibility a risk not worth covering. Where coverage is not denied altogether, policies may sometimes reduce the quantum of loss to a minimum by prescribing recovery ceilings much below the policyholder's projected local currency earnings. Underwriters may and often do prescribe extended waiting periods while requiring policyholders to comply with multiple conditions including exhausting all local recovery remedies as a condition for recovery.

As this paper has argued, holdings in local currency may not be as undesirable as they seem and need not therefore be evaded by coverage denial or diluted by underwriting curbs. By providing local currency financing to local exporters by means of *murabaha*, a PRI operator will not only earn a share in the transaction's profits in foreign currency but in doing so will contribute positively to business development and trade promotion in the host country. And although it is not possible to circumvent every conceivable risk associated with a business transaction, risks relating to developing country exports are regarded as low trade risks in terms of non-payment by overseas importers. At any rate, export promotion agencies exist in a very large number of developing countries and are recognized for their significant impact on exports. A PRI operator with significant holdings in local currency could easily finance host country exports by means of *murabaha* transactions while protecting itself by taking out an export trade insurance policy with the local export promotion agency. Even in countries with chronic foreign currency shortages the local export promotion agency may have in place adequate reinsurance or retrocession arrangements with overseas reinsurers or retrocession pools which will indemnify the local exporter and the PRI operator in the policy currency.

Of course, it is by no means certain that investment of an inconvertible local currency in *murabaha* will in all scenarios, in all countries always be the exclusive panacea for minimizing loss. There is however little doubt that it is an immensely prudent risk-minimization measure to contemplate.

Conclusion

The ideological animosity to international trade with, and foreign investment in, developing countries—once expressed in popular catchphrases--is now thoroughly outdated. No serious scholar today doubts the significance of trade and foreign direct investment as means of rapid economic growth and development in developing countries. The staggering economic and social successes achieved in several developing countries today, attest to the importance of globalization by means both of trade and direct foreign investment.

Neither trade nor DFI will ever be free of attendant commercial and political risks, for there is no zero risk in any dynamic situation. But as many illnesses can be cured, investment and trade risks can also be significantly minimized by measures such as PRI. Berne Union members as well as multilateral PRI operators are exceedingly successful in reducing PRI risks to traders and investors alike. A PRI operator intending to use its local currency holdings in *murabaha* transactions could reduce its risks further by taking out export credit insurance with a local export promotion agency.

A troubling risk to both exporters of goods and foreign investors is the risk of the local currency becoming inconvertible through the action or inaction of the authorities of the host country. For PRI operators established within the auspices of international lending agencies, the loss of inconvertibility does not pose a fundamental problem. Provided that legal arrangements to that effect are in place, the PRI operator could easily assign its local currency to a lending agency or to a member of its group in exchange for receiving the equivalent foreign currency abroad.

A host country where the local currency frequently or even occasionally becomes inconvertible is an unlikely setting for an appealing Sukuk bonds market. The next best investment outlet in such a country is likely to the *murabaha* business. *Murabaha* is exceedingly popular, is easy to structure and, other things being equal, its profit margins are exceptionally rewarding. The capital invested and the returns earned are, in principle, transferable abroad once the host country builds up enough foreign reserves.

A policyholder in a trade transaction stands in a better position *vis-a-vis* a foreign direct investor. The insured trader will highly likely receive the entire amount due under the policy in one single payment once the waiting period has expired and other conditions successfully complied with. For the foreign direct investor whose returns on the investment are due on half-yearly or yearly payments, recovery is likely to be difficult and protracted for both policyholder and PRI operator. For the policyholder, each half-yearly or annual amount due (whether dividends, *ijara* rentals or *istisna*' payments) is subject to a waiting period before the PRI operator is obligated to pay. And for the latter, disposing of the local currency could also prove cumbersome. The half-yearly or yearly payment may not be large enough to render the operator a sole financier of a *murabaha* transaction. At best, the operator could join a syndicated *murabaha* to earn a share of the profit proportionate to its stake in the syndication.

However, notwithstanding volatile political circumstances, unstable trade markets and countless other obstacles, it is no strain to imagination to reprocess one's local currency holdings in *murabaha* transactions. But to emphatically regard a local currency as a curse rather than an opportunity is suggestive of imagination atrophy.

Conflict of Interest

Authors have no conflict of interest to declare.

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