7 Some Muslim countries have recently introduced what are called 'Muqarada Bonds', the proceeds of which are to be used for income-yielding public utility projects such as the construction of bridges and roads. The bond holders will have a share in the collection of tolls and other receipts.

8 Qirad, sometimes also called muqarada, refers to a financial arrangement whereby the financier gets a share in the output, as in the case of Muqarada Bonds (see footnote 7). In the literature, the terms qirad and mudaraba are often used interchangeably.

9 The market shares of the Islamic banks are close to 20 per cent in Egypt, Kuwait and Sudan and roughly 10 per cent in Jordan and Qatar. By contrast, in Turkey, Islamic banks account for less than 1 per cent of the market (see Nienhaus 1988).

علم و فن میں حضرت امام احمد بن حنبل رحمۃ اللہ علیہ کا کوئی ثانی نہیں : (محدث ابو زرعہ)

____, 1983b. Issues in Islamic Banking, Islamic Foundation, Leicester.

____, 1985. Partnership and Profit-Sharing in Islamic Law, Islamic Foundation, Leicester.

____, 1988. 'Islamic banking: theory and practice', in M. Ariff (ed.), above.

Su'ud, M. Abu, n.d. 'The economic order within the general conception of the Islamic way of life', Islamic Review, London, 55 (2): 24-26 and (3): 11-14. Udovitch, Abraham L., 1970. Partnership and Profit in Medieval Islam, Princeton University Press, Princeton, N.J.

Uzair, Mohammad, 1955. An Outline of 'Interestless Banking', Raihan Publications, Karachi.

____, 1982. 'Central banking operations in an interest-free banking system'. in M. Ariff (ed.), above.

Zaidi, N.A., 1987. 'Profit rates policy for PLS depositors', Journal of Islamic Banking and Finance, 4 (4): 35-46.

1 Surah al-Rum (Chapter 30), verse 39; Surah al-Nisa (Chapter 39), verse 161; Surah al-Imran (Chapter 3), verses 130-2; Surah al-Baqarah (Chapter 2), verses 275-81. See Yusuf Ali's Translation of the Qur'an.

2 Hadith compiled by Muslims (Kitab al-Musaqat).

3 This refers to a Hadith compiled by Muslims (Kitab al-Musaqat).

4 Bank Islam Malaysia Berhad has been offering a 70:30 profit-sharing ratio in favour of depositors (Man 1988).

5 In 1984 the Islamic Bank of Bangladesh offered rates of return ranging from 4.95 per cent to 14.13 per cent. The Faisal Islamic Bank of Egypt, Cairo, gave a 9 per cent rate of return on deposits in the same year (Afkar Inquiry, December 1985).

6 According to Sharia, profits arising from a mudaraba arrangement can be divided in any proportion between the two contracting parties as agreed upon at the time of the contract, but losses, if any, will fall on the financier only.

Nienhaus, V., 1983. 'Profitability of Islamic PLS banks competing with interest banks: problems and prospects', Journal of Research in Islamic Economics, 1(1):37-47.

____, 1986. 'Islamic economics, finance and banking - theory and practice', Journal of Islamic Banking and Finance, 3(2):36-54.

____, 1988. 'The performance of Islamic banks - trends and cases', paper presented to the Conference on Islamic Law and Finance, convened in the University of London, 8 April.

Partadireja, Ace, 1974. 'Rural credit: the Ijon system', Bulletin of Indonesian Economic Studies, 10 (3): 54-71.

Qureshi, Anwar Iqbal, 1946. Islam and the Theory of Interest, Lahore.

Rahardjo, Dawam, 1988. 'Islamic banking in Indonesia?' in M. Ariff (ed.), above.

Rahman, Fazalur, n.d. 'Riba and interest', Islamic Studies, Karachi, 3(1):1-43.

Ready, R.K., 1981. 'The march toward self-determination', paper presented at the First Advanced Course on Islamic Banks, International Institute of Islamic Banking and Economics, Cairo, 28 August - 17 September.

Rosa, D.A., 1986. 'Islamic financial policies and domestic resource mobilisation', Savings and Development, 2:143-53.

Salama, Abidin Ahmad, 1986. 'Utilisation of financial instruments: a case study of Faisal Islamic Bank (Sudan)', paper submitted to the Seminar on Developing a System of Islamic Financial Instruments, organized by the Ministry of Finance Malaysia and the Islamic Development Bank, Kuala Lumpur.

Scharf, T.W., 1983. Arab and Islamic Banks, OECD, Paris.

Siddiqi, M.N., 1982. 'Islamic Approaches to Money, Banking and Monetary Policy: A Review', in M. Ariff (ed.), above.

____, 1983a. Banking Without Interest, The Islamic Foundation, Leicester.

• ____, and Mirakhor, A., 1986. 'The frame-work and practice of Islamic banking', Finance and Development, September.

____ and ____, 1987. Theoretical Studies in Islamic Banking and Finance (Book Distribution Centre, Houston.

____ and ____ forth-coming (1988). 'The financial system and monetary policy in an Islamic economy', Journal of Research in Islamic Economics.

Khan, Muhammad Akram, 1968. 'Theory of employment in Islam', Islamic Literature, Karachi, XIV (4): 5-16.

____ n.d. 'International monetary crisis, causes and cure', The Criterion, Karachi, 6 (2): 5-19.

Khan, W.M., 1985. Towards an Interest-Free Islamic Economic System, The Islamic Foundation, Leicester.

Man, Zakariya, 1988. 'Islamic banking: the Malaysian experience', in M. Ariff (ed.), above.

Mannan, M.A., 1970. Islamic Economics, Lahore.

Mastura, Michael O., 1988. 'Islamic banking: the Philippine experience', in M. Ariff (ed.), above.

Mirakhor, Abbas, 1986. 'Some theoretical aspects of an Islamic financial system', paper presented at a Conference on Islamic Banking sponsored by the Central Bank of the Islamic Republic of Iran, Tehran, 11-14 June.

Mohsin, M., 1982. 'Profile of riba-free banking', in M. Ariff (ed.), above. Naqvi, S.N.H., 1981. Ethics and Economics: An Islamic Synthesis, The Islamic Foundation, Leicester.

____, 1982. 'Interest rate and intertemporal allocative efficiency in an Islamic economy', in M. Ariff (ed.), above.

Naughton, S.A.J. and Tahir, M.A., 1988. 'Islamic banking and financial development', Journal of Islamic Banking and Finance, 5 (2).

Investment, Technology Transfer and Business Culture, University of Stockholm and Institute of South-east Asian Studies, Singapore.

Homoud, S.H., 1985. Islamic Banking, Arabian Information, London.
Huq, Azizul, 1986. 'Utilization of financial investments: a case study of Bangladesh', paper submitted to the Seminar on Developing a System of Islamic Financial Instruments, organized by the Ministry of Finance Malaysia and the Islamic Development Bank, Kuala Lumpur.

Iqbal, Zubair and Mirakhor, Abbas, 1987. Islamic Banking, International Monetary Fund Occasional Paper 49, Washington D.C.

Irshad, S.A., 1964. Interest-Free Banking, Orient Press of Pakistan, Karachi.

Kahf, Monzer, 1982a. 'Saving and investment functions in a two-sector Islamic economy', in M. Ariff (ed.) , above.

____ 1982b. 'Fiscal and monetary policies in an Islamic economy', in M. Ariff (ed.),above.

Karsten, I., 1982. 'Islam and financial intermediation', IMF Staff Papers, March, 29(1):108-42.

Khan, Abdul Jabbar, 1986. 'Non-interest banking in Pakistan: a case study', paper presented to the Seminar on Developing a System of Islamic Financial Instruments, organized by the Ministry of Finance Malaysia and the Islamic Development Bank, Kuala Lumpur.

Khan, M. Fahim, 1983. 'Islamic banking as practised now in the world' in Ziauddin, Ahmad et al. (eds.).

Khan, M. S.,1986.'Islamic interest-free banking', I M F Staff Papers, March, 33(1):1-27.

____. 1987 'Principles of monetary policy in an Islamic framework', paper presented to the International Institute of Islamic Economics, Islamabad, Pakistan, July.

____ (ed.) 1984. Papers on Islamic Banking, New Century Publishers, London.

Ariff, M. 1982. 'Monetary policy in an interest-free Islamic economy - nature and scope' in M. Ariff, (ed.), Monetary and Fiscal Economics of Islam, International Centre for Research in Islamic Economics, Jeddah.

____ 1988. Islamic Banking in South-east Asia, Institute of Southeast Asian Studies, Singapore.

Bruce, N.C., 1986. 'Islamic banking moves east', Euromoney, July: 142-5.

Chapra, M. Umer, 1982. 'Money and banking in an Islamic economy' in M Ariff (ed.), above.

____ 1985. Toward a Just Monetary System, The Islamic Foundation, Leicester.

Choudhury, Masul Alam, 1986. Contributions to Islamic Economic Theory: A Study in Social Economics, St Martin Press, New York.

Council of Islamic Ideology (CII), Pakistan, 1983. 'Elimination of interest from the economy', in Ziauddin, Ahmed et al. (eds.).

El-Asker, A.A.F., 1987. The Islamic Business Enterprise, Croom Helm, London.

El-Din, A.K., 1986. 'Ten years of Islamic banking', Journal of Islamic Banking and Finance, July-September, 3(3):49-66.

Halim, Abdul, 1986. 'Sources and uses of funds: a study of Bank Islam Malaysia Berhad,' paper presented to the Seminar on Developing a System of Islamic Financial Instruments, organized by the Ministry of Finance Malaysia and the Islamic Development Bank, Kuala Lumpur.

Hjarpe, Jan, 1986. 'Mudaraba banking and taka-ful insurance: the question of "Islamic Banks", their significance and possible impact', in Jan Selmer, and Loong Hoe Tan, Economic Relations between Scandinavia and ASEAN: Issues on Trade,

امام محمد بن ادریس شافعی رحمۃ اللہ علیہ کا سن ولادت ۱۵۰ ہجری اور سن وفات ۲۰۴ ہجری ہے ☆

hajj = pilgrimage
haram = unlawful
iman = faith
mudaraba = profit-sharing
muqarada = mudaraba
musharaka = equity participation (interest free)
qirad = mudaraba
riba = interest
shirka = musharaka
halal = lawful
ijara = leasing
mithl = like
mudarib = entrepreneur-borrower
murabaha = cost-plus or mark-up
qard hasan = benevolent loan
rabbul-mal = owner of capital
Shariah = Islamic law

References

*Abdallah, A., 1987. 'Islamic banking', Journal of Islamic Banking and Finance, January-March, 4(1): 31-56.
*Abdeen, A.M. and Shook, D.N., 1984. The Saudi Financial System, J. Wiley and Sons, Chichester.

*Abdel-Magib, M.F., 1981. 'Theory of Islamic banks: accounting implications', International Journal of Accounting, Fall: 78-102.

*Aftab, M., 1986. 'Pakistan moves to Islamic banking', The Banker, June: 57-60.

*Ahmad, Sheikh Mahmud, 1952. Economics of Islam, Lahore.

____, n.d. 'Interest and Unemployment', Islamic Studies, Islamabad, VIII (l): 9-46.

Al-Arabi, Mohammad Abdullah, 1966. 'Contemporary banking transactions and Islam's views thereon', Islamic Review. London, May 1966: 10-16.

Al-Jarhi, Ma'bid Ali, 1983. 'A monetary and financial tructure for an interest- free economy, institutions, mechanism and policy', in Ziauddin, Ahmad et al. (eds.), Money and Banking in Islam, International Centre for Research in Islamic Economics, Jeddah, and Institute of Policy Studies, Islamabad.

Ali, M. (ed.) 1982. Islamic Banks and Strategies of Economic Cooperation, New Century Publishers, London.

☆ امام مالک بن انس رحمۃ اللہ علیہ کی ولادت سن ۹۳ ہجری میں اور وفات ۱۷۹ ہجری میں ہوئی ☆

One of the main selling points of Islamic banking, at least in theory, is that, unlike conventional banking, it is concerned about the viability of the project and the profitability of the operation but not the size of the collateral. Good projects which might be turned down by conventional banks for lack of collateral would be financed by Islamic banks on a profit-sharing basis. It is especially in this sense that Islamic banks can play a catalytic role in stimulating economic development. In many developing countries, of course, development banks are supposed to perform this function. Islamic banks are expected to be more enterprising than their conventional counterparts. In practice, however, Islamic banks have been concentrating on short-term trade finance which is the least risky.

Part of the explanation is that long-term financing requires expertise which is not always available. Another reason is that there are no back-up institutional structures such as secondary capital markets for Islamic financial instruments. It is possible also that the tendency to concentrate on short-term financing reflects the early years of operation: it is easier to administer, less risky, and the returns are quicker. The banks may learn to pay more attention to equity financing as they grow older.

It is sometimes suggested that Islamic banks are rather complacent. They tend to behave as though they had a captive market in the Muslim masses who will come to them on religious grounds. This complacency seems more pronounced in countries with only one Islamic bank. Many Muslims find it more convenient to deal with conventional banks and have no qualms about shifting their deposits between Islamic banks and conventional ones depending on which bank offers a better return. This might suggest a case for more Islamic banks in those countries as it would force the banks to be more innovative and competitive. Another solution would be to allow the conventional banks to undertake equity financing and/or to operate Islamic 'counters' or 'windows', subject to strict compliance with the Shariah rules. It is perhaps not too wild a proposition to suggest that there is a need for specialized Islamic financial institutions such as mudaraba banks, murabaha banks and musharaka banks which would compete with one another to provide the best possible services.

Glossary

al-wadiah = safe keeping
bai'salam = pre-paid purchase
fiqh = jurisprudence
bai'muajjal = deferred-payment sale
baitul mal = treasury
Hadith = Prophet's commentary on Qur'an

☆ امام اعظم ابو حنیفہ رحمۃ اللہ علیہ کا سنِ ولادت ۸۰ ہجری اور سن وفات ۱۵۰ ہجری ہے ☆

Finally, in the most recent contribution to the growing Islamic banking literature, Nien-haus (1988) concludes that Islamic banking is viable at the microeconomic level but dismisses the proponents' ideological claims for superiority of Islamic banking as 'unfounded'. Nienhaus points out that there are some failure stories. Examples cited include the Kuwait Finance House which had its fingers burned by investing heavily in the Kuwaiti real estate and construction sector in 1984, and the Islamic Bank International of Denmark which suffered heavy losses in 1985 and 1986 to the tune of more than 30 per cent of its paid-up capital. But then, as Nienhaus himself has noted, the quoted troubles of individual banks had specific causes and it would be inappropriate to draw general conclusions from particular cases. Nienhaus notes that the high growth rates of the initial years have been falling off, but he rejects the thesis that the Islamic banks have reached their 'limits of growth' after filling a market gap. The falling growth rates might well be due to the bigger base values, and the growth performance of Islamic banks has been relatively better in most cases than that of conventional banks in recent years.

According to Nienhaus, the market shares of many Islamic banks have increased over time, notwithstanding the deceleration in the growth of deposits. The only exception was the Faisal Islamic Bank of Sudan (FIBS) whose market share had shrunk from 15 per cent in 1982 to 7 per cent in 1986, but Nien-haus claims that the market shares lost by FIBS were won not by conventional banks but by newer Islamic banks in Sudan. Short-term trade financing has clearly been dominant in most Islamic banks regardless of size. This is contrary to the expectation that the Islamic banks would be active mainly in the field of corporate financing on a participation basis. Nien-haus attributes this not only to insufficient supply by the banks but also to weak demand by entrepreneurs who may prefer fixed interest cost to sharing their profits with the banks.

Conclusion

The preceding discussion makes it clear that Islamic banking is not a negligible or merely temporary phenomenon. Islamic banks are here to stay and there are signs that they will continue to grow and expand. Even if one does not subscribe to the Islamic injunction against the institution of interest, one may find in Islamic banking some innovative ideas which could add more variety to the existing financial network.

☆ میں نے امام محمد سے بڑھ کر کوئی فصیح نہیں دیکھا (امام محمد بن ادریس شافعی) ☆

accounted for a very small proportion of the total investment portfolio. while bai'muajjal and ijara formed the bulk of the total. It is evident from Mastura's analysis that the Philippine Amanah Bank is, strictly speaking, not an Islamic bank, as interest-based operations continue to coexist with Islamic modes of financing. Thus, the PAB has been operating both interest and Islamic 'windows' for deposits. Mastura's study has produced evidence to show that the PAB has been concentrating on murabaha transactions, paying hardly any attention to the mudaraba and musharaka means of financing. The PAB has also been adopting unorthodox approaches in dealing with excess liquidity by making use of interest- bearing treasury bills. Nonetheless, the PAB has also been invoking some Islamic modes in several major investment activities. Mastura has made special references to the qirad principle adopted by the PAB in the Kilu-sang Kabuhayan at Kaunlaran (KKK) movement launched under Marcos and to the ijara financing for the acquisition of farm implements and supplies in the Quedon food production program undertaken by the present regime. So far no reference has been made to Indonesia, the largest Muslim country in the world, with Muslims accounting for 90 per cent of a population of some 165 million. The explanation is that a substantial proportion, especially in Java, are arguably nominal Muslims. Indonesians by and large subscribe to the Pancasila ideology which is essentially secular in character. The present regime seems to associate Islamic banking with Islamic fundamentalism to which the regime is not at all sympathetic. Besides, the intellectual tradition in Indonesia in modern times has not been conducive to the idea of interest-free banking. There were several well respected Indonesian intellectuals including Hatta (the former Vice President) who had argued that riba prohibited in Islam was not the same as interest charged or offered by modern commercial banks, although Islamic jurists in Indonesia hold the opposite view. The Muslim public seems somewhat indifferent to all this. This, however, does not mean that there are no interest-free financial institutions operating in Indonesia. One form of traditional interest-free borrowing is the still widely prevalent form of informal rural credit known as ijon (green) because the loan is secured on the standing crop as described by Partadireja (1974). Another is the arisan system practiced among consumers and small craftsmen and traders. In this system, each member contributes regularly a certain sum and obtains interest-free loans from the pool by drawing lots. The chances of an Islamic bank being established in Indonesia seem at present remote (cf. Rahardjo 1988).

by the Sudanese monetary authorities on investment deposits which in turn was influenced by limited investment opportunities in the domestic economy. There are also interesting variations in the pattern of resource utilization by the Islamic banks. For example, musharaka has been far more important than murabaha as an investment mode in Sudan, while the reverse has been the case in Malaysia. On the average, however, murabaha, bai'muajjal and ijara, rather than musharaka represent the most commonly used modes of financing. The case studies also show that the structure of the clientele has been skewed in favor of the more affluent segment of society, no doubt because the banks are located mainly in metropolitan centres with small branch networks.

The two main problems identified by the case studies are the absence of suitable non-interest-based financial instruments for money and capital market transactions and the high rate of borrower delinquency. The former problem has been partially redressed by Islamic banks resorting to mutual inter-bank arrangements and central bank cooperation, as mentioned earlier.
The Bank Islam Malaysia, for instance, has been placing its excess liquidity with the central bank which usually exercises its discretionary powers to give some returns. The delinquency problem appears to be real and serious. Murabaha payments have often been held up because late payments cannot be penalized, in contrast to the interest system in which delayed payments would automatically mean increased interest payments. To overcome this problem, the Pakistani banks have resorted to what is called 'mark-down' which is the opposite of 'mark-up' (i.e., the profit margin in the cost-plus approach of murabaha transactions). 'Mark-down' amounts to giving rebates as an incentive for early payments. But the legitimacy of this 'mark-down' practice is questionable on Shariah grounds, since it is time- based and therefore smacks of interest.

In the Southeast Asian context, two recent studies on the Bank Islam Malaysia by Man (1988) and the Philippine Amanah Bank by Mastura (1988) deserve special mention. The Malaysian experience in Islamic banking has been encouraging. Man's study shows that the average return to depositors has been quite competitive with that offered by conventional banks. By the end of 1986, after three years of operation, the bank had a network of fourteen branches. However, 90 per cent of its deposits had maturities of two years or less, and non-Muslim depositors accounted for only 2 per cent of the total. Man is particularly critical of the fact that the mudaraba and musharaka modes of operation, which are considered most meaningful by Islamic scholars, The IMF study, however, expressed considerable uneasiness about the concentration of bank assets on short-term trade credits rather than on long-term financing. This the authors found undesirable, not only because it is inconsistent with the intentions of the new system, but also because the heavy concentration on a few assets might increase risks and destabilize the asset portfolios. The study also drew attention to the difficulty experienced in both Iran and Pakistan in financing budget deficits under a non-interest system and underscored the urgent need to devise suitable interest-free instruments. Iran has, however, decreed that government borrowing on the basis of a fixed rate of return from the nationalized banking system would not amount to interest and would hence be permissible. The official rationalization is that, since all banks are nationalized, interest rates and payments among banks will cancel out in the consolidated accounts. (This, of course, abstracts from the banks' business with non-bank customers.) There are also some small case studies of Islamic banks operating in Bangladesh (Huq 1986), Egypt (Mohammad 1986), Malaysia (Halim 1988b), Pakistan (Khan 1986), and Sudan (Salama 1988b). These studies reveal interesting similarities and differences. The current accounts in all cases are operated on the principles of al-wadiah. Savings deposits, too, are accepted on the basis of al-wadiah, but 'gifts' to depositors are given entirely at the discretion of the Islamic banks on the minimum balance, so that the depositors also share in profits. Investment deposits are invariably based on the mudaraba principle, but there are considerable variations. Thus, for example, the Islamic Bank of Bangladesh has been offering PLS Deposit Accounts, PLS Special Notice Deposit Accounts, and PLS Term Deposit Accounts, while Bank Islam Malaysia has been operating two kinds of investment deposits, one for the general public and the other for institutional clients.

The studies also show that the profit-sharing ratios and the modes of payment vary from place to place and from time to time. Thus, for example, profits are provisionally declared on a monthly basis in Malaysia, on a quarterly basis in Egypt, on a half-yearly basis in Bangladesh and Pakistan, and on an annual basis in Sudan.

A striking common feature of all these banks is that even their investment deposits are mostly short-term, reflecting the depositors' preference for assets in as liquid a form as possible. Even in Malaysia, where investment deposits have accounted for a much larger proportion of the total, the bulk of them were made for a period of less than two years. By contrast, in Sudan most of the deposits have consisted of current and savings deposits, apparently because of the ceiling imposed

...eriod. The Iranian system allows banks to accept ...ngs deposits without having to pay any return. but it ...s to offer incentives such as variable prizes or bonuses ...on these deposits. Term deposits (both short-term and ... a rate of return based on the bank's profits and on the ...ty. No empirical evidence is as yet available on the ...uestion as to whether interest or a profit-share provides the ...ly ...ive incentive to depositors for the mobilization of private ...ic ...here Islamic and conventional banks exist side by side, ...abo ...ank control of bank interest rates is liable to be circumvented ...nse ... of funds to the Islamic banks. ...cent

...) resu... ...bal and Mirakhor have noted that the conversion to Islamic modes ar... has been much slower on the asset than on the deposit side. It appears that the Islamic banking system in Iran was able to use less than half of its resources for credit to the private sector, mostly in the form of short-term facilities, i.e., commercial and trade transactions. The slower pace of conversion on the asset side was attributed by the authors to the inadequate supply of personnel trained in long-term financing. The authors, however, found no evidence to show that the effectiveness of monetary policy in Iran, broadly speaking, was altered by the conversion.

The Pakistani experience differs from the Iranian one in that Pakistan had opted for a gradual islamization process which began in 1979. In the first phase, which ended on 1 January 1985, domestic banks operated both interest- free and interest-based 'windows'. In the second phase of the transformation process, the banking system was geared to operate all transactions on the basis of no interest, the only exceptions being foreign currency deposits, foreign loans and government debts. The Pakistani model took care to ensure that the new modes of financing did not upset the basic functioning and structure of the banking system. This and the gradual pace of transition, according to the authors, made it easier for the Pakistani banks to adapt to the new system. The rate of return on profit-and-loss sharing (PLS) deposits appears not only to have been in general higher than the interest rate before islamization but also to have varied between banks, the differential indicating the degree of competition in the banking industry. The authors noted that the PLS system and the new modes of financing had accorded considerable flexibility to banks and their clients. Once again the study concluded that the effectiveness of monetary policy in Pakistan was not impaired by the changeover.

these difficulties are not regarded as insurmountabl... Pakistan's Council of Islamic Ideology (CII 1983) has s... respective capital contributions of parties can be ... common denominator by multiplying the amounts pro... number of days during which each component, such as ... equity capital, its current cash surplus and suppliers' cred... deployed in the business, i.e., on a daily product basis. As ... profits (net of administrative expenses, taxes, and appro... reserves) would be divided between the shareholders of th... the holders of deposits, again on a daily product basis.

Literature: Practice

Recent years have brought an increasing flow of empirical studies ... Islamic banking. The earliest systematic empirical work was undertaken by Khan (1983). His observations covered Islamic banks operating in Sudan, United Arab Emirates, Kuwait, Bahrain, Jordan, and Egypt. Khan's study showed that these banks had little difficulty in devising practices in conformity with Shariah. He identified two types of investment accounts: one where the depositor authorized the banks to invest the money in any project and the other where the depositor had a say in the choice of project to be financed. On the asset side, the banks under investigation had been resorting to mudaraba, musharaka and murabaha modes. Khan's study reported profit rates ranging from 9 to 20 per cent which were competitive with conventional banks in the corresponding areas. The rates of return to depositors varied between 8 and 15 per cent, which were quite comparable with the rates of return offered by conventional banks.

Khan's study revealed that Islamic banks had a preference for trade finance and real estate investments. The study also revealed a strong preference for quick returns, which is understandable in view of the fact that these newly established institutions were anxious to report positive results even in the early years of operation. Nienhaus (1988) suggests that the relative profitability of Islamic banks, especially in the Middle East in recent years, was to a large extent due to the property (real estate) boom. He has cited cases of heavy losses which came with the crash of the property sector.

The IMF study referred to earlier by Iqbal and Mirakhor (1987) also contains extremely interesting empirical observations, although these are confined to the experience of Iran and Pakistan, both of which have attempted to islamize the entire banking system on a comprehensive basis. Iran switched to Islamic banking in August 1983 with a three-

...mic Banking

...med Ariff, University of Malaya

...ontd........ from the last issue)

... this that Islamic banking has three distinguishing ... interest-free, (b) it is multi-purpose and not purely ...d (c) it is strongly equity-oriented. The literature ...ly any serious criticism of the interest-free character of the ...ice this is taken for granted, although concerns have been ...about the lack of adequate interest-free instruments. There is ...nsensus that Islamic banks can function well without interest. ...cent International Monetary Fund study by Iqbal and Mirakhor ...) has found Islamic banking to be a viable proposition that can result in efficient resource allocation. The study suggests that banks in an Islamic system face fewer solvency and liquidity risks than theirv conventional counterparts. The multi-purpose and extra-commercial nature of the Islamic banking operation does not seem to pose intractable problems. The abolition of interest makes it imperative for Islamic banks to look for other instruments, which renders operations outside the periphery of commercial banking unavoidable. Such operations may yield economies of scope.

But it is undeniable that the multipurpose character of Islamic banking poses serious practical problems, especially in relation to the skills needed to handle such diverse and complex transactions (Iqbal and Mirakhor 1987).

The stress on equity-oriented transactions in Islamic banking, especially the mudaraba mode, has been criticized. It has been argued that the replacement of pre-determined interest by uncertain profits is not enough to render a transaction Islamic, since profit can be just as exploitative as interest is, if it is 'excessive' (Naqvi 1981). Naqvi has also pointed out that there is nothing sacrosanct about the institution of mudaraba in Islam. Naqvi maintains that mudaraba is not based on the Qur'an or the Hadith but was a custom of the pre-Islamic Arabs. Historically, mudaraba, he contends, enabled the aged, women, and children with capital to engage in trade through merchants for a share in the profit, all losses being borne by the owners of capital, and therefore it cannot claim any sanctity. The fact remains that the Prophet raised no objection to mudaraba, so that it was at least not considered un-Islamic.

The distribution of profit in mudaraba transactions presents practical difficulties, especially where there are multiple providers of capital, but