Journal of Management and Social Sciences
Vol. 3, No. 1, (Spring 2007) 01-10

Islamic Banking: Present and Future Challenges

Noor Ahmed Memon *
Department of Economics, Institute of Business & Technology (BIZTEK)

ABSTRACT

Islamic finance was practiced predominantly in the Muslim world throughout the middle-ages, fostering trade and business activities with the development of credit. In Spain and the Mediterranean and Baltic states, Islamic merchants became indispensable middlemen for trading activities. In fact, many concepts, techniques, and instruments of Islamic finance were later adopted by European financiers and businessmen. In contrast, the term "Islamic financial system" is relatively new, appearing only in the mid-1980s. In fact, all the earlier references to commercial or mercantile activities conforming to Islamic principles were made under the umbrella of either "interest-free" or "Islamic" banking. The paper emphasizes the role of Islamic banks as financial intermediaries and the importance of financial intermediation for society. It argues that Islamic Banks entering directly into trade, industry and agriculture etc is not beneficial because it means leaving the role of financial intermediation for others. The basic principle of Islamic banking is the prohibition of Riba or interest, which has seldom been recognized as applicable beyond the Islamic world, but many of its guiding principles have, consciously or unconsciously, been accepted. The majority of these principles are based on simple morality and common sense, which formed the basis of many religions, including Islam.

Islamic Banking an alternate to interest-based banking is not banking in the traditional sense of the word. It derives its inspiration and guidance from the religious edicts of Islam and has to conduct its operations strictly in accordance with the directives of Shariah. Islamic financial system employed the concept of participation in the enterprise, utilizing the funds at risk on a profit-and-loss-sharing basis. At present, there are more than 300 Islamic Banks and other financial institutions managing funds to the tune of $300 billion, with deposits exceeding $ 120 billion and operating in 48 countries. To avoid interest, Islamic Banks have developed profit-sharing schemes in tapping and mobilisation their resources. Both Islamic Banks lending policy and lending principles are excellent tools for creating and developing entrepreneurs. In relation to entrepreneurs, the status of the Islamic Bank is either of partner or investor, whereas, for conventional banks the relationship is more of creditor-debtor. Entrepreneurs who maintain a relationship with Islamic Banks are expected to be more ethical and not be involved in businesses that are prohibited by the Islamic laws.

* The material presented by the author does not necessarily portray the viewpoint of the editors and the management of the Institute of Business & Technology (BIZTEK).

* Dr. Noor Ahmed Memon :drnoor@biztek.edu.pk

A 10-year master plan has been made to promote Islamic banking globally and increase its size to make it an agent for the change so as to save people from the curse of inflation, which is an integral part of capitalism.

JEL Classification : E4; N2

Keywords : Banking, Riba, Islam, Interest free

1. INTRODUCTION

Islam is not simply one of the greatest monotheistic religions, signifying submission to the will of Allah, but as system of life in entirety. It prescribes a complete code of conduct for every day human life in all its spheres and manifestations. It does not confine itself to a spiritual relationship between man and Allah or describes the Almighty only with a transcendental reference but also regulates, in right proportions, an interactive relationship between man and man, and between man and society with moral, political and economic genesis. As a result, it is a religion lived in every day life and no Muslim is in any doubt as to exactly how he should carry on the events of his day.

On the other hand, capitalism has not been able to narrow down the gap between the "haves and "have-nots". Material affluence, wherever it exists, is marked by a conspicuous absence of a broad based sharing of fortunes and thus real happiness to a large number of people is seriously missing. Likewise, socialism advocating collective ownership of the means of production and control of distribution has failed to provide the necessary motivation for collective development and personal self-actualisation, and thus retarded the process and rate of economic growth.

Similarly, communism, stressing ownership of property and control of production, distribution and supply by the whole of classless society, could not get along with the human potential, dynamism and aspirations, and fell too short to bring about economic satisfaction or progress, in individual and collective life.

Kotz (1978) says that the conventional banks and few families who control them have "access to other peoples' capital". He points out that "the wealthiest and most powerful capitalists operate through banks" and that these banks are also the major stockholders in and creditors of the largest non-financial corporations. Mishan (1971:205) observes "… it would be irrational for the lender to be willing to lend as much to the impecunious as to the richer members of the society, or to lend the same amounts on the same terms to each".

Galbraith (1975:297) rightly points out that "those who least need to borrow and those who are most favoured are in the planning system. Those who most rely on borrowed funds, or least favoured are in the market system".

Schmidt (1974) while expressing his views about the economic problems of that time said that "The world economy has entered into a phase of extraordinary instability and its future course is absolutely uncertain". The Holy Qur'an says that "Mischief has appeared in the land and the sea, on account of men's own doing." (30:41). What the Holy Qur'an declared 1400 years ago, is equally true even today.

Looking at the inadequacies of the prevailing economic system, in promoting real economic well-being of the masses, Muslims all over the world stared to re-discover the wisdom and balance of Islamic economic system. This led to a renaissance, during the last few decades of economic thought and system as enunciated by Islam. The upsurge gained momentum with the discovery of oil and resultant ballooning up of the national income of many Middle Eastern countries. In the process, attention was focused on Islamic Economic System, Islamic banking and elimination of interest (riba) in conformity with the injunctions contained in the Holy Qur'an and sayings of the Holy Prophet (Peace be upon him).

The revival of Islamic Economic System has now become a point of central attention in Islamic world, which covers about one-sixth of the land surface of the global. The Muslim population by the year 2050 A.D. is expected to be over 2.6 billion or over 26% of the projected world population of 10 billion. Thus one out of every four people by the middle of 21st century would be Muslim, aspiring to lead an economic life as envisaged in Islam. Under the Islamic tenets, interest is prohibited in all forms and manifestations. This prohibition is strict, absolute and unambiguous. The Holy Qu'ran has clearly warned that those who do not forego interest which has already accrued and do not desist from taking it any further, then they are at war path with Allah and his Prophet (2:278-279).

2. WHAT IS RIBA?

The word "Riba" means excess, increase or addition, which correctly interpreted according to Shariah terminology, implies any excess compensation without due consideration (consideration does not include time value of money).

This definition of Riba is derived from the Quran and is unanimously accepted by all the Islamic scholars. There are two types of Riba, identified to date by these scholars namely 'Riba An-Nasiyah' and 'Riba Al Fadl'. 'Riba An-Nasiyah' is defined as excess, which results from predetermined interest (sood) which a lender receives over and above the principle (Ras ul Maal). 'Riba Al Fadl' is defined as the excess compensation without any consideration resulting from a sale of goods. The Islamic system order based on a set of principles constituting the concept and philosophy as enunciated explicitly in the Quran. This philosophy provides what can be understood as the Islamic system of social justice.

Plato and Aristotle had also opposed the concept of interest in the era of before Christ. Interest was also prohibited in the preliminary teachings of Jews and Christians, and is also prohibited in the First Testament of the Holy Bible.

Modern economists have also opposed the interest. The famous English economics expert Lord Keynes, who is globally recognized as an expert of modern economics, has first time expressed his views on the point that unless the interest is abolished in some un-vexatious way, unemployment could not be eradicated from the world, rather, he insisted that the world would not bear the long-run idleness which is connected with the capitalism.

Lord Keynes writes in a book that the rate of interest will have to be diminished in order to eradicate unemployment. Lord Keynes said that for a developed economy, interest rate should be zero. It means according to Lord Keynes there should be no interest in a model economy. The interest is an instrument of exploitation for a common person and nations, and for this purpose the detailed study under the title "The protocols of the learned elders of Zions," can be perused.

While defining the relationship between interest and unemployment, Lord Keynes writes in his above-quoted book that "The Onus of interest badly affects capacity of capital and the vulnerability adversely affects the constructively, which give rise to unemployment. In the 20th century, Karl Marx, who introduced the surplus theory in his book "Das Capta", and Mao Zedung, and other socialist scholars and economists had also dissented with interest termed as "Organ of fiscal exploitation".

Lord Keynes has extremely opposed the prevailing system of "batai" on cultivation of agricultural land he has defined "batai" to be the earliest and preliminary shape of interest.

It is a matter of great concern that the earliest shape of “batai” has no place in Islamic Shariat is prevailing in our country, despite of so-called agricultural reforms no body tends to abolish the “batai” system. In Islam, interest is vehemently opposed. According to Shariah Appellate Bench (SAB) of the Supreme Court of Pakistan, Riba is involved in such cases as under:

i) All prevailing forms of interest, either in banking or private transactions, fall within the definition of Riba.

ii) Any interest stipulated in government borrowings acquired from domestic or foreign sources is Riba and clearly is prohibited by the Holy Qur’an.

iii) The present financial system, based on interest, is against the injunctions of Islam as laid down in the Holy Qur’an and Sunnah. In order to bring it in conformity with the Shariah it has to be subjected to radical changes.

Federal Shariat Court Says:

Riba Al-Nasia includes all kinds of interest irrespective of the fact whether the interest is, or is not added to principal sum after fixed periods and whether the sum lent is for production or consumption purposes.

Islam accepts basic concomitants of market economy like the right of innate ownership, freedom of enterprise and competitive environment of business and industry. The Holy Prophet (Peace be upon him) is reported to have allowed competitive price mechanism to balance the demand and supply of goods for dispensation of economic justice, ultimate best benefit of society and efficient allocation of resources. The limitations only take care of some moral, religious and cultural perceptions as well as to suit the aspirations that emphasize the significant role of the state in inculcation of the desired norms. These limitations are necessary for fulfilment of overall objectives of Islamic Shariah..

3. HISTORY

Islamic Banking in Pakistan is growing at an excellent pace. Efforts are being made since 1979 to islamise the financial system for which the SBP initially introduced 12 Islamic modes of financing to replace interest-based instruments. The Council of Islamic Ideology (CII) in a separate report in 1980 advised the SBP to replace the money market discount rate with the arrangement whereby the SBP would be empowered to finance the banks on profit and loss sharing basis. Among other recommendations one was to set up interest-free ‘common pool of funds’ on cooperative basis to replace the existing interest bearing government securities.

The SBP initially took drastic steps towards the development (and implementation) of financial instruments based on Islamic principles. Later the whole process came to a standstill. No effort had been made towards the elimination of interest from inter bank transactions; inter-government transactions and foreign currency accounts.

Pakistan has witnessed the second wave of Islamisation of financial system since 1999. This time the Supreme Court of Pakistan asked the government to take steps towards the elimination of interest from the economy. A meeting held under the chairmanship of the president of Pakistan decided to allow Islamic Banks to operate parallel to conventional banks. In addition, conventional banks were also allowed to offer Islamic banking services through dedicated Islamic windows. Now, six Islamic Banks and 13 conventional banks with a total network of 200 branches offer Islamic Banking products and services. In addition, non-bank financial institutions such as Islamic Mutual Funds, Takaful Companies, Mudaraba Companies, House Building Finance Corporation etc. are also the active participants. Efforts are also been made for the development of Islamic Sukuk (bond) market. Islamic Banking is targeting to capture 10 per cent of the total financial sector in the years to come.

Interest-free liquidity management is the major concern for Islamic Banks. The State Bank of Pakistan (SBP) requires Islamic banks and conventional banks to maintain the same Cash Reserve Requirement (CRR) of five per cent and Statutory Liquidity Requirement (SLR) of eight per cent.

Islamic Banks can hold their required reserve in special current accounts with SBP or with the National Bank of Pakistan. Any return on these accounts is the absolute discretion of the SBP. Recently, the SBP has introduced new SLR policy for the Islamic Banks allowing them to invest in Wapda Sukuk but not exceeding five per cent of their investment portfolio. The growth of Islamic Banking as 'rapid pace of growth', but the details showed that neither the pace of growth matched with the growth in conventional banking, nor its share was improving to capture a bigger piece of cake. The total banking assets of the Islamic Banking increased from Rs.118 billion in December 2006 to Rs.136 billion in March 2007. However, its shares in terms of asset percentage of banking industry were just 3.2% while comparing conventional banking assets.

The size of the conventional banking is increasing rapidly since the last four years which left the Islamic Banking far behind in the race for banking market. In terms of deposits, Islamic Banking share was 3% of total banking deposits, though the size of deposits increased substantially during the last 15 months. The deposit rose to Rs.83 billion in December 2006 from Rs50 billion in December 2005. It further rose to Rs.93 billion in the first quarter of 2007 till end of March 2007.

Murabaha financing is almost 40% of the total financing by the Islamic Banking institutions till the quarter ending March 2007. Second most widely used mode of finance is Ijarah financing accounting for about 30% of the total financing. Growing interest in diminishing Musharakah is depicted representing 17% of the total financing. This was not encouraging for the growth of the Islamic Banking. However, financial position of the Islamic Banking industry is strong and earning and profitability ratios have improved.

State Bank of Pakistan has established Islamic Banking Department to give focussed attention to the area. The Central Bank is pursuing three-pronged strategy to promote Islamic Banking in Pakistan _ to establish full-fledged Islamic banks in the private sector; setting up of subsidiaries by the existing commercial banks; and separate branches for Islamic Banking by the existing commercial banks. A Shariah Board is also in place at the State Bank of Pakistan, having experts to guide the Islamic Banking industry.

4. ISLAMIC BANKING MOVEMENT IN THE WORLD

Islamic Banking, based on the Islamic economic system, is not restricted to Muslims only. The objective of Islam injunction is welfare of the whole humanity. Islamic Banking is no longer confined to concepts and ideas only. Until the first half of the 20th century, it was more or less an abstract concept. Islamic Banking and finance started in 1963 when Mit Ghambr Savings Bank began offering interest free banking in Egypt. This bank and its branches were forced to close down in 1971 due to perceived threat by the administration. The Islamic Summit of Lahore, Pakistan held in 1974 recommended the creation of Islamic Banks and Islamic Development Bank.

Starting from 1980s various Islamic Banks and Islamic financial institutions have begun their operations in different Islamic countries. While the countries of Iran and Pakistan have implemented Islamic Banking in the whole banking sector, other countries have permitted Islamic Banking institutions operate with the other traditional banks.

Malaysia is the first country to issue bonds on Islamic basis. Malaysian government allowed conventional banks to offer Islamic instruments as well if they want. Examination of the progress of these institutions in Iran and Pakistan reveals that in Pakistan this process is a gradual one. On the other hand in Iran the process of conversion of traditional banks and financial institutions into Islamic ones was very rapid.

The government of Iran has nationalized all the banks during the period of 1979-1982 after the Islamic revolution. In August 1983, the Iranian government had passed the law for riba free banking and asked all banks to convert their deposits and finish Islamisation of all their operations within three years.

After this period government has started to exert control on the banks so that the banks provide interest free loans to public for housing and for small-scale projects. The banks have also provided funds for government projects. The six commercial banks and three specialized banks are mainly engaged in short term projects and profit sharing agreements are only small percentage of their activities. Since then Islamic Banks have steadily been growing.

There are thirty-one Islamic Financial Institutions and "interest-free mode of financing" which are practical and more than 48 countries as well as more than 300 Islamic Banks are working on these non-interest modes and interest-free methods all over the globe.

The international Islamic Financial Institutions are providing a wide range of services in accordance with the basic principles of Shariah. The products are Mudaraba, Murabaha, Musharaka, Ijarah, Istisna and Salam.

Conventional banks operate under the concept of lender-borrower relationship where interest is considered as the rental income on capital. The depositors are assumed to be capital providers. Profits of the banks are distributed at the discretion of the bank managements.

But the Islamic Banks follow the concept of Mudaraba (profit sharing) based on investor-entrepreneur relationship. Here Islamic Banks consider depositors as entrepreneurs. The profits generated through this relationship are divided between the two parties as per agreed ratio.

Further, researchers divide Islamic Bank customers into three broader categories (a) religiously motivated customers (b) high profit motivated customers (c) customers who are religiously motivated but also expect returns at least similar to conventional banks. Customers of second and third categories generally dominate in terms of numbers in any Islamic bank. They expect returns on deposits similar to conventional banks.

In the money market, the main objective is to meet short-term liquidity requirements. The market facilitates banks with deficit in cash to borrow from the banks having surplus money. Islamic money market conducts a similar function of meeting the short-term liquidity needs. Instead of interest, it allows Islamic Banks to share surplus capital on profit-sharing basis.

Islamic and conventional money markets can be assumed to offer similar returns on investments. Low returns in Islamic money markets may badly affect the overall profitability of Islamic Banks in the initial stages of their development. Even if, Islamic money market offers returns higher than conventional market, the Islamic Banks may still not enjoy an advantageous position.

According to the Institute of Islamic Banking and Insurance, there are more than 300 Islamic Financial Institutions in the world. These institutions are working in the following countries: Albania, Algeria, Australia, Bahamas, Bahrain, Bangladesh, British Virgin

Islands, Brunei, Canada, Cayman Islands, Cyprus, Djibouti, Egypt, France, Gambia, Germany, Guinea, India, Indonesia, Iran, Iraq, Italy, Ivory Coast, Jordan, Kazakhstan, Kuwait, Lebanon, Luxembourg, Malaysia, Mauritania, Morocco, The Netherlands, Niger, Nigeria , Oman, Pakistan, Palestine, Philippines, Qatar, Russia, Saudi Arabia, Senegal, South Africa, Sri Lanka, Sudan, Switzerland, Tunisia, Turkey, Trinidad and Tobago, United Arab Emirates, United Kingdom, United States, Yemen.

The positive realization of the Umah's responsibility towards creating an Islamic framework of economic and financial system at state level owes itself to the late King Faisal bin Abdul Aziz Al Saoud of Saudi Arabia on whose initiative the organization of Islamic Conference was established. Concrete steps were taken to initiative collective efforts towards uniting the Muslims for common objectives.

Malaysia, Bahrain and a few other countries of the Gulf no doubt are an exception because they are running a parallel system of Islamic Banking and finance and money market on a comprehensive scale. A number of other Islamic countries have taken legislative measures to facilitate functioning of Islamic financial institutions. Sudan, Bahrain, Saudi Arabia, Jordan, Turkey and some other countries are typical examples. In recent years, Bahrain satisfactorily emerged as the hub of Islamic Banking activities.

Bahrain with the largest concentration of Islamic Financial Institutions in the Middle East region, is hosting 26 Islamic Financial Institutions dealing in diversified activities including commercial banking, investment banking, offshore banking and funds management. It pursues a dual banking system, where Islamic Banks operate in the environment in which Bahrain Monetary Agency (BMA) affords equal opportunities and treatment for Islamic Banks as for conventional banks. Bahrain also hosts the newly created Liquidity Management Centre (LMC) and the International Islamic Financial Market (ITEM) to coordinate the operations of Islamic Banks in the world. To provide appropriate regulatory set up, the BMA has introduced a comprehensive prudential and reporting framework that is industry-specific to the concept of Islamic banking and finance. Further, the BMA has pioneered a range of innovations designed to broaden the depth of Islamic financial markets and to provide Islamic institutions with wider opportunities to manage their liquidity.

In USA, UK and a number of other European countries, various Islamic funds were lying idle for a number of years. Some conventional financial institutions of international standing in an endeavour to utilize them, established Islamic banking subsidies and windows. Many banks, both in the Muslim world and outside, are offering Islamic financial products and taking active part in capital market transactions. Liquid instruments from these products like equity mutual funds are emerging. Dow Jones Islamic Market Index is also there.

Now more than 300 Islamic Financial Institutions were operating in the world from China to the USA managing funds to the tune of $300 billion, while the growth of Islamic Banking across the world was 20% that of conventional banking was much less. The system has the added advantage of curbing speculative activity as all its financing is linked with commercial transactions. The largest Islamic institutions are located in Bahrain, Kuwait, Saudi Arabia and Iran. Western banks through their Islamic units in the UK, Germany, Switzerland, Luxembourg etc. also practiced Islamic Banking. The Islamic Banking will be increased to 10 percent from 2.5 per cent in Pakistan, from 13 to 20 percent in Malaysia, 3 per cent to 10 percent in Indonesia and 60 per cent in the Gulf Cooperation Council (GCC) countries.

The objective of Islam's injunction is the welfare and betterment of human beings. This betterment meant not only for the individual but also for the whole of humanity. Al-Adle and Al-Ihasan are two very important norms, which Islamic economics urges to observe in the dealings with others. Al-Adle requires man to observe justice and fair play in all his/her dealings with other people. Al-Ihsan requires individuals to go beyond their minimum obligations, kindness and sacrifice for others to achieve the highest standards of benevolence to build a caring society. These two very important factors, justice and benevolence, however, are prerequisite fundamental principles for society to survive and flourish.

5. INFLATION

Under the Islamic Banking system, commercial banks have to take equity shares of companies seeking funds. Western economists hold the view that the system has become fantastically complicated and for its operation an army of accountants and specialists will be required. In international transactions, a zero rate of interest may mean a negative rate of return on loans if inflation is taken into account.

Since interest-bearing loans have no specific relation with actual production, and the financier, after securing a strong collateral normally has no concern how the funds are used by the borrower, the money supply effected through banks and financial institutions has no nexus with the goods and services actually produced on the ground. It creates a serious mismatch between the supply of money and the production of goods and services. This is obviously one of the basic factors that create of feed inflation. Since Islamic Finance is provided on the basis of real production and economy, it has rather curtailed inflation.

This phenomenon is aggravated to a horrible extent by the well-known characteristics of the modern banks normally termed as “money creation.”

This apparently miraculous function of the banks is sometimes taken to be one of the factors that boost production and bring prosperity. But the champions of modern banking and numerous theories developed to support the concept of money-creation by the private banks seldom unveil the illusion underlying this concept. But the net result is that the modern banks are creating money out of nothing.

They are allowed to advance loans in the amounts ten times more than their deposits. The coins and notes issued by the government as genuine and debt-free money have now a very insignificant proportion in the total money in circulation.

Islamic economics is a system, which not only fulfils our moral, ethical and religious obligations but also demonstrates to be economically feasible and financially rewarding. Islamic banking is based on asset-based transactions for the purpose of income generation, and prohibits financing in all forms of economic activities, which are normally and/or socially injurious to the society.

The field of Islamic Banking operations is unlimited. It is under continuous process of evolving and Islamic financial modes instruments have been developed to cover nearly all kinds of businesses including consumer financing, project financing, house financing, working capital financing, import and export financing, venture capital, etc.

The perception of Islamic Banking is not generally clear to many people particularly in the west. It is important to appreciate that Islamic Banking implies zero rate of interest but not zero rate of return as Islamic Banks do not deal in money but deal with money. Theoretically, there is no concept of loans and credits in Islam for financing of trade, industry and agriculture except Qard-Hasan. Islamic Banks, therefore, involve themselves in financing (short, medium and long term) for working capital requirements and also contribute to the capital of an enterprise by participating in its equity. These financing are on profit and loss sharing basis. It is interesting to note that the equity participation by interest-based banks and financial institutions in Europe, America and elsewhere is greatly in line with the financing under profit and loss sharing system of Islamic Banking.

Interestingly, the result of a survey conducted in USA has indicated that the bankers in that country perceived at least 10 out of 20 Islamic Banking practices as acceptable. These

10 practices are investment accounts, transfer of funds, cost plus finance, profit and loss sharing, trust financing, leasing, lease purchase, letters of guarantee, flexible investment of deposit and role as trustees. This clearly indicates the areas of possible operation, understanding and exchange of business between conventional banks and Islamic Banks with their existing modes of financing and investment.

Western banking system now in vogue almost all over the world developed in centuries and in its perfection great deal of hard work based on very sound theoretical framework was involved. No such framework or background exists for creating an entirely different system, because Muslim society has so far not been able to produce scholars of exceptional qualities who could devise an alternative banking theory for giving a practical shape to a Riba-free system. Islamic Banking continues to depend mainly on mark-up, not substantially different from modern day interest. Islamic mode of banking is expected to grow in Pakistan as commercial banks are interested in providing facilities based on Islamic principles.

The present parallel banking set-up allows conventional banks to transact in the Islamic money market through their separate Islamic branches and earn returns equal to Islamic banks. Existing Islamic Banking arrangement thus puts Islamic Banks in a disadvantageous position as they would transact only in the Islamic money market. But at the same time, other banks through their Islamic and conventional branches can deal in both Islamic and the conventional money markets. The scenario leaves the SBP with no option but to manage the Islamic and conventional money markets returns at the same level.

Special attention should also be paid for developing Islamic money market instruments to meet the liquidity requirements plus to match the current market financing rates on constant basis. Current available Islamic Financial Instruments are either long-term or fixed in nature which create funding mismatch problem.

At present, Islamic Banks use short- term deposits on variable rates to finance medium and long-term projects. The situation leads Islamic Banks either to maintain high liquid ratios or to avoid long-term financing that can affect the overall profitability. Various Islamic countries have developed Islamic money market instruments under the concepts of Wakala (agent), short-term Sukuk (bonds), and securitisation of assets etc. There are many others short- term instruments which are acceptable in one Muslim country but are subjected to some restrictions in other Muslim countries - especially those issued under the concept of buy-back agreements and Bai Al-Inah (sale of debt).

Likewise, Islamic money market is also facing serious research deficiencies in the area of oversight of financial instruments. Innovations are needed to facilitate Islamic Banks to manage their liquidity gap as efficiently as the conventional banks.

6. CONCLUSION

Starting from the core of Islamic finance up to the implementation of Islamic finance in Banks and financial institutions I conclude that it is an alternative paradigm for believers and non-believers because it is quite necessary for the development and happiness.

The Islamic financial system employs the concept of participating in Halal business opportunities, utilizing the funds at risk on a profit-and-loss-sharing basis. This does not mean that investments with financial institutions are necessarily speculative. This is excluded by careful investment policy diversification of risk and prudent management by Islamic Financial Institutions. The investment in Islamic Financial Institutions provides potential opportunity for profit in proportion to the risk assumed to satisfy the different demands of participants in the contemporary environment and within the guidelines of the Shariah.

The concept of interest can be replaced with the concept of equalizer profit, profit-sharing, rental sharing, profit and loss sharing, commission, service charges, etc. as it has been termed as Shariah complaint return by the Supreme Court of Pakistan in the Riba judgement which has been remanded.

The profit earned through the method/products/instrument of non-interest modes/ instrument/product for example through rental sharing, commission, purchase, commission, profit and loss sharing, Modaraba, service charges may be termed as equalizer instead of mark-up of Shariah Complaint Return.

Islamic Banking industry has shown tremendous growth and its advances have increased six fold, which clearly sends a message that the Islamic Banking is right on the growth path. Those who refused to acknowledge the phenomenon in the early days now are active participants and mobilizing their efforts to tap into this fast-growing Islamic financial market. The West has also recognized the potential of this industry and a large number of Western banks have either established subsidiaries and/or opened Islamic Banking window operations.

REFERENCES

AHMAD, MAMUD SHAIKH (1989). Towards Interest Free Banking Institute of Islamic Culture. Lahore, pp 171-196.

ANSARI, SAALIM SALAM (2005). Interest-based Conventional and Non-Interest Modern Banking Investment and Marketing. Karachi Issue No. 08 pp6-9.

FAZLUR-REHMAN (1969). Riba and Interest. Islamic Studies, March 1969.pp1-43.

FEDERAL SHARIAT COURT (FSC), GOVERNMENT OF PAKISTAN (1991). Judgment on Laws Involving Interest (14-12-1991) by P.L.D. Publishers, Lahore.

GIERATHS, CHRISTINE (1991). Islamising the Financial Sector in Pakistan. Main Participants and Final Product in “Islam, Politics and Society in South Asia” Ed. By Andre Wink, Manohar.

HASSAN, TARIQ (January-March, 1986). Interest Free System of Banking and Finance in Pakistan. Journal of Islamic Banking & Finance (JIB&F), Karachi.

IQBAL, MUNAWAR (April 2001). Islamic and Conventional Banking in the Nineties: A Comparative Study’ in Islamic Economic Studies. Vol.8 No.2 pp.1-27.

KHAN, M. AKRAM (1992). Islamic Banking in Pakistan: The Future Path. All Pakistan Islamic Education Congress, Lahore.

OMAR, AL FAUD & ABDEL HAQ, MOHAMMAD (1996). Islamic Banking: Theory Practice and Challenges. Oxford University Press, Karachi.

SHAIAH APPELLATE BENCH (SAB), SUPREME COURT OF PAKISTAN (2000). Judgement on Riba. Shriat Law Reports, Lahore, February.

THE COUNCIL OF ISLAMIC IDEOLOGY, GOVERNMENT OF PAKISTAN (1980). Report of Elimination of Interest from the Economy, June.

UZAIR, MUHAMMAD (1978-2001). Interest Free Banking. Royal Book Company, Karachi.

ZIAUDDIN, AHMAD (1993). Probation of Interest in Islam’ in Banking & Finance Islamic Concept, (March 1993). edited by Mukhtar Zaman, IAIB, Karachi.