Islamic banking essay

Finance, Banks

Money and Banking TERM REPORT The Islamic Banking System Imperial College of Business Studies Lahore Submitted to: Syed Masroor Hussain Submitted by: Faisal Mazher BaiG Introduction: I slamic banking has been defined as banking in consonance with the ethos and value system of Islam and governed, in addition to the conventional good governance and risk management rules, by the principles laid down by Islamic Shariah. Interest free banking is a narrow concept denoting a number of banking instruments or operations, which avoid interest. Islamic banking, the more general term is expected not only to avoid interest-based transactions, prohibited in the Islamic Shariah, but also to avoid unethical practices and participate actively in achieving the goals and objectives of an Islamic economy. Modern banking system was introduced into the Muslim countries at a time when they were politically and economically at a low ebb, in the late 19th century. The main banks in the home countries of the imperial powers established local branches in the capitals of the subject countries and they catered mainly to the import export requirements of the foreign businesses.

The banks were generally confined to the capital cities and the local population remained largely untouched by the banking system. The local trading community avoided the “ foreign” banks both for nationalistic as well as religious reasons. However, as time went on it became difficult to engage in trade and other activities without making use of commercial banks. Even then many confined their involvement to transaction activities such as current accounts and money transfers. Borrowing from the banks and depositing their savings with the bank were strictly avoided in order to keep away from dealing in interest which is prohibited by religion. With the passage of time, however, and other socio-economic forces demanding more involvement in national economic and financial activities, avoiding the interaction with the banks became impossible.

Local banks were established on the same lines as the interest-based foreign banks for want of another system and they began to expand within the country bringing the banking system to more local people. As countries became independent the need to engage in banking activities became unavoidable and urgent. Governments, businesses and individuals began to transact business with the banks, with or without liking it. This state of affairs drew the attention and concern of Muslim intellectuals. The story of interest-free or Islamic banking begins here. In the following paragraphs we will trace this story to date and examine how far and how successfully their concerns have been addressed.

Historical Development: The history of interest-free banking could be divided into two parts. First, when it still remained an idea; second, when it became a reality – by private initiative in some countries and by law in others. We will discuss the two periods separately. The last decade has seen a marked decline in the establishment of new Islamic banks and the established banks seem to have failed to live up to the expectations.

The literature of the period begins with evaluations and ends with attempts at finding ways and means of correcting and overcoming the problems encountered by the existing banks. Interest-free Banking as an Idea: Interest-free banking seems to be of very recent origin. The earliest references to the reorganisation of banking on the basis of profit sharing rather than interest are found in Anwar Qureshi (1946), Naiem Siddiqi (1948) and Mahmud Ahmad (1952) in the late forties, followed by a more elaborate exposition by Mawdudi in 1950 (1961). Muhammad Hamidullah's 1944, 1955, 1957 and 1962 writings too should be included in this category.

They have all recognised the need for commercial banks and the evil of interest in that enterprise, and have proposed a banking system based on the concept of Mudarabha – profit and loss sharing. In the next two decades interest-free banking attracted more attention, partly because of the political interest it created in Pakistan and partly because of the emergence of young Muslim economists. Works specifically devoted to this subject began to appear in this period. The first such work is that of Muhammad Uzair (1955).

Another set of works emerged in the late sixties and early seventies. Abdullah al-Araby (1967), Nejatullah Siddiqi (1961, 1969), al-Najjar (1971) and Baqir al-Sadr (1961, 1974) were the main contributors. Early seventies saw the institutional involvement. Conference of the Finance Ministers of the Islamic Countries held in Karachi in 1970, the Egyptian study in 1972, First International Conference on Islamic Economics in Mecca in 1976, International Economic Conference in London in 1977 were the result of such involvement. The involvement of institutions and governments led to the application of theory to practice and resulted in the establishment of the first interest-free banks. The Islamic Development Bank, an inter-governmental bank established in 1975, was born of this process.

The coming into being of interest-free banks: The first private interest-free bank, the Dubai Islamic Bank, was also set up in 1975 by a group of Muslim businessmen from several countries. Two more private banks were founded in 1977 under the name of Faisal Islamic Bank in Egypt and the Sudan. In the same year the Kuwaiti government set up the Kuwait Finance House. However, small scale limited scope interest-free banks have been tried before.

One in Malaysia in the mid-forties and another in Pakistan in the late-fifties. Neither survived. In 1962 the Malaysian government set up the " Pilgrim's Management Fund" to help prospective pilgrims to save and profit. The savings bank established in 1963 at Mit-Ghamr in Egypt was very popular and prospered initially and then closed down for various reasons. However this experiment led to the creation of the Nasser Social Bank in 1972.

Though the bank is still active, its objectives are more social than commercial. In the ten years since the establishment of the first private commercial bank in Dubai, more than 50 interest-free banks have come into being. Though nearly all of them are in Muslim countries, there are some in Western Europe as well: in Denmark, Luxembourg , Switzerland and the UK. Many banks were established in 1983 and 1984. The numbers have declined considerably in the following years.

In most countries the establishment of interest-free banking had been by private initiative and were confined to that bank. In Iran and Pakistan, however, it was by government initiative and covered all banks in the country. The governments in both these countries took steps in 1981 to introduce interest-free banking. In Pakistan, effective 1 January 1981 all domestic commercial banks were permitted to accept deposits on the basis of profit-and-loss sharing (PLS). New steps were introduced on 1 January 1985 to formally transform the banking system over the next six months to one based on no interest.

From 1 July 1985 no banks could accept any interest bearing deposits, and all existing deposits became subject to PLS rules. Yet some operations were still allowed to continue on the old basis. In Iran, certain administrative steps were taken in February 1981 to eliminate interest from banking operations. Interest on all assets was replaced by a 4 percent maximum service charge and by a 4 to 8 percent ‘ profit’ rate depending on the type of economic activity. Interest on deposits was also converted into a ‘ guaranteed minimum profit.

’ In August 1983 the Usury-free Banking Law was introduced and a fourteen-month change over period began in January 1984. The whole system was converted to an interest-free one in March 1985. The subject matter of writings and conferences in the eighties changed from the concepts and possibilities of interest-free banking to the evaluation of their performance and their impact on the rest of the economy and the world. Their very titles bear testimony to this and the places indicate the world-wide interest in the subject. Conference on Islamic Banking: Its impact on world financial and commercial practices held in London in September 1984, Workshop on Industrial Financing Activities of Islamic Banks held in Vienna in June 1986, International Conference on Islamic Banking held in Tehran in June 1986, International Conference on Islamic Banking and Finance: Current issues and future prospects held in Washington, D.

C. in September 1986, Islamic Banking Conference held in Geneva in October 1986, and Conference ‘ Into the 1990’s with Islamic Banking’ held in London in 1988 belong to this category. The most recent one is the Workshop on the Elimination of Riba from the Economy held in Islamabad in April 1992. Several articles, books and PhD theses have been written on Islamic Banking during this period. Special mention must be made of the work by M. Akram Khan in preparing annotated bibliographies of all published (and some unpublished) works on Islamic Economics (including Islamic Banking) from 1940 and before.

It is very useful to students of Islamic Economics and Banking, especially since both English and Urdu works are included (1983, 1991, 1992). M. N. Siddiqi’s bibliographies include early works in Arabic, English and Urdu (1980, 1988). Turkish literature is found in Sabahuddin Zaim (1980). Current Practices: Generally speaking, all interest-free banks agree on the basic principles.

However, individual banks differ in their application. These differences are due to several reasons including the laws of the country, objectives of the different banks, individual bank’s circumstances and experiences, the need to interact with other interest-based banks, etc. In the following paragraphs, I will describe the salient features common to all banks. Deposit Accounts: All the Islamic banks have three kinds of deposit accounts: current, savings and investment. Current Accounts: Current or demand deposit accounts are virtually the same as in all conventional banks. Deposit is guaranteed.

Savings Accounts: Savings deposit accounts operate in different ways. In some banks, the depositors allow the banks to use their money but they obtain a guarantee of getting the full amount back from the bank. Banks adopt several methods of inducing their clients to deposit with them, but no profit is promised. In others, savings accounts are treated as investment accounts but with less stringent conditions as to withdrawals and minimum balance. Capital is not guaranteed but the banks take care to invest money from such accounts in relatively risk-free short-term projects. As such lower profit rates are expected and that too only on a portion of the average minimum balance on the ground that a high level of reserves needs to be kept at all times to meet withdrawal demands.

Investment Account: Investment deposits are accepted for a fixed or unlimited period of time and the investors agree in advance to share the profit (or loss) in a given proportion with the bank. Capital is not guaranteed. Modes of Financing: Banks adopt several modes of acquiring assets or financing projects. But they can be broadly categorised into three areas: investment, trade and lending. Investment Financing: This is done in three main ways: a) Musharaka where a bank may join another entity to set up a joint venture, both parties participating in the various aspects of the project in varying degrees. Profit and loss are shared in a pre-arranged fashion.

This is not very different from the joint venture concept. The venture is an independent legal entity and the bank may withdraw gradually after an initial period. b) Mudarabha where the bank contributes the finance and the client provides the expertise, management and labour. Profits are shared by both the partners in a pre-arranged proportion, but when a loss occurs the total loss is borne by the bank.

c) Financing on the basis of an estimated rate of return. Under his scheme, the bank estimates the expected rate of return on the specific project it is asked to finance and provides financing on the understanding that at least that rate is payable to the bank. (Perhaps this rate is negotiable.) If the project ends up in a profit more than the estimated rate the excess goes to the client. If the profit is less than the estimate the bank will accept the lower rate.

In case a loss is suffered the bank will take a share in it. Trade Financing: This is also done in several ways. The main ones are: a) Mark-up where the bank buys an item for a client and the client agrees to repay the bank the price and an agreed profit later on. b) Leasing where the bank buys an item for a client and leases it to him for an agreed period and at the end of that period the lessee pays the balance on the price agreed at the beginning an becomes the owner of the item. c) Hire-purchase where the bank buys an item for the client and hires it to him for an agreed rent and period, and at the end of that period the client automatically becomes the owner of the item.

) Sell-and-buy-back where a client sells one of his properties to the bank for an agreed price payable now on condition that he will buy the property back after certain time for an agreed price. e) Letters of credit where the bank guarantees the import of an item using its own funds for a client, on the basis of sharing the profit from the sale of this item or on a mark-up basis.

Lending: Main forms of Lending are: a) Loans with a service charge where the bank lends money without interest but they cover their expenses by levying a service charge. This charge may be subject to a maximum set by the authorities.

b) No-cost loans where each bank is expected to set aside a part of their funds to grant no-cost loans to needy persons such as small farmers, entrepreneurs, producers, etc. and to needy consumers. c) Overdrafts also are to be provided, subject to a certain maximum, free of charge. Services: Other banking services such as money transfers, bill collections, trade in foreign currencies at spot rate etc. where the bank’s own money is not involved are provided on a commission or charges basis. Financing: There are four main areas where the Islamic banks find it difficult to finance under the PLS scheme: a) participating in long-term low-yield projects, b) financing the small businessman, c) granting non-participating loans to running businesses, and d) financing government borrowing.

Long-term projects: Table 1 shows the term structure of investment by 20 Islamic Banks in 1988. It is clear that less than 10 percent of the total assets goes into medium- and long-term investment. Admittedly, the banks are unable or unwilling to participate in long-term projects. This is a very unsatisfactory situation.

Term Structure of Investment by 20 Islamic Banks, 1988 Type of Investment Amount* % of Total Short-term 4, 909. 8 68. 4 Social lending 64. 2 0. 9 Real-estate investment 1, 498.

2 20. 9 Medium- and long-term investment 707. 7 9. 8 Source: Aggregate balance sheets prepared by the International Association of Islamic Banks, Bahrain, 1988. Quoted in: Ausaf Ahmed (1994).

* Unit of currency not given. Government Borrowing: In all countries the Government accounts for a major component of the demand for credit — both short-term and long-term. Unlike business loans these borrowings are not always for investment purposes, nor for investment in productive enterprises. Even when invested in productive enterprises they are generally of a longer-term type and of low yield. This latter only multiplies the difficulties in estimating a rate of return on these loans if they are granted under the PLS scheme.

In Iran, ……

t has been decreed that financial transactions between and among the elements of the public sector, including Bank Markazi [the central bank] and commercial banks that are wholly nationalised, can take place on the basis of a fixed rate of return; such a fixed rate is not viewed as interest. Therefore the Government can borrow from the nationalised banking system without violating the Law. While the last claim may be subject to question, there is another serious consequence: Continued borrowing on a fixed rate basis by the Government would inevitably index bank charges to this rate than to the actual profits of borrowing entities. Legislation: Existing banking laws do not permit banks to engage directly in business enterprises using depositors' funds. But this is the basic asset acquiring method of Islamic banks.

Therefore new legislation and/or government authorisation are necessary to establish such banks. In Iran a comprehensive legislation was passed to establish Islamic banks. In Pakistan the Central Bank was authorised to take the necessary steps. In other countries either the banks found ways of using existing regulations or were given special accommodation. In all cases government intervention or active support was necessary to establish Islamic banks working under the PLS scheme.

In spite of this, there is still need for further auxiliary legislation in order to fully realise the goals of Islamic banking. For example, in Pakistan. ..

. the new law has been introduced without fundamental changes in the existing laws governing contracts, mortgages, and pledges. Similarly no law has been introduced to define modes of participatory financing, i. e.

Musharakah19 and PTCs. It is presumed that whenever there is a conflict between the Islamic banking framework and the existing law, the latter will prevail. In essence, therefore, the relationship between the bank and the client, that of creditor and debtor is left unchanged as specified by the existing law. The existing banking law was developed to protect mainly the credit transactions; its application to other modes of financing results in the treatment of those modes as credit transactions also.

Banks doubt whether some contracts, though consistent with the Islamic banking framework, would be acceptable in the courts. Hence, incentives exist for default and abuse. In Iran, although the law establishing interest-free banking ..

. is comprehensive, the lack of proper definitions of property rights may have constrained bank lending. Thus far there has been no precise legislative and legal expression of what is viewed as “ lawful and conditional” private property rights. This may also have militated against investment lending in agricultural and industrial sectors and thus encouraged increased concentration of assets in short-term trade financing instruments. Iran and Pakistan are countries committed to ridding their economies of riba and have made immense strides in towards achieving it.

Yet there are many legal difficulties still to be solved as we have seen above. In other Muslim countries the authorities actively or passively participate in the establishment of Islamic banks on account of their religious persuasion. Such is not the case in non-Muslim countries. Here establishing Islamic banks involves conformation to the existing laws of the concerned country which generally are not conducive to PLS type of financing in the banking sector.

We will see some of these problems below in section 4. 4. Involvement in Specialised Non-bank Activities: Dr Hasanuz-Zaman, lists the traditional tasks of the bank and then questions its ability to take on the additional functions it is called upon to perform under the PLS scheme: 21 It is due to historical reasons that banks have evolved purely as a financial institution. They are suited to attract money, keep it in safe custody, lend it under safety, invest it profitably and enjoy the capacity to create the means of payment. A bank has to maintain a balance between income, liquidity and flexibility.

While allocating its funds it has to be meticulously sensitive about the factors like capital position and rate of profitability of various types of loans, stability of deposit, economic conditions, influence of monetary and fiscal policy, ability and experience of bank's personnel and credit needs of the area. So far these banks thrive on a fixed rate of return a portion of which is passed on by them to the depositor. Thus the entire effort of a bank is irected towards money management and it is not geared to act as an entrepreneur, trader, industrialist, contractor or caterer. The question arises: with all these limitations can a bank claim any competence in trading or entrepreneurship which is necessary for musharakah or mudarba22 contract, or can it act as an owner of a large variety of heavy machinery, transport vehicles or real estate to take the position of a lessor or, can it act as a stockist to buy and resell the entire stock of imports and exports that are needed by genuine traders? Then he raises the even more serious question: In case the bank is historically and practically not competent to do all these jobs its claim to share a portion of profits as a working partner, trader or lessor becomes questionable. Traditional banks do perform a certain amount of project evaluation when granting large medium- and long-term loans. But doing such detailed evaluation as would be required to embark on a PLS scheme, such as determining the rates of return and their time schedule, is beyond the scope of conventional banks.

So is the detailed accounting and monitoring necessary to determine the actual performance. Under Islamic banking these exercises are not limited to relatively few large loans but need to be carried out on nearly all the advances made by the bank. Yet, widely acceptable and reliable techniques are yet to be devised. This is confounded by the fact that no consensus has yet been reached on the principles.

Both the unprecedented nature of the task as well as the huge amount of work that need be done and the trained and experienced personnel needed to carry them out seems a daunting prospect. To sum up, in Dr Hasanuz Zaman’s words: …

any techniques that the interest-free banks are practising are not either in full conformity with the spirit of Shari’ah or practicable in the case of large banks or the entire banking system. Moreover, they have failed to do away with undesirable aspects of interest. Thus, they have retained what an Islamic bank should eliminate. Islamic Banking in non-Muslim Countries: The modern commercial banking system in nearly all countries of the world is mainly evolved from and modelled on the practices in Europe, especially that in the United Kingdom.

The philosophical roots of this system revolves around the basic principles of capital certainty for depositors and certainty as to the rate of return on deposits. In order to enforce these principles for the sake of the depositors and to ensure the smooth functioning of the banking system Central Banks have been vested with powers of supervision and control. All banks have to submit to the Central Bank rules. Islamic banks which wish to operate in non-Muslim countries have some difficulties in complying with these rules.

We will examine below the salient features. Islamic Banks in Pakistan Following are some of the Islamic Banks operating in Pakistan. Al Faysal

Investment Bank Ltd, Islamabad Al Towfeek Investment Bank Ltd (Dallah Al Baraka Group), Lahore Faysal Bank Ltd, Pakistan National Investment Trust Ltd. , Karachi Shamil Bank Meezan Bank Limited Recently, National Bank of Pakistan had also started Islamic Banking in Pakistan. NBP Islamic Banking – OTHER SERVICES In addition to Shariah acceptable standard general banking services, following services are also being offered at the Islamic Banking Branch : • Letter of Credit Facility Handling of Remittances • Issuance of Bank Drafts and Pay Orders. • Collection of Export Bills.

• Collection of Local Bills. • Government Collections • Utility Bills Collection 1. The Islamic financial portfolios sectors The responsibilities of this sector are investing the cash waqf efficiency and effectively. The gathered cash waqf will be then invested by Nazir, a fund manager, in Islamic financial portfolios. The structure of Islamic banking and finance is firmly rooted in the Qur'an and the teachings of Prophet Muhammad (P.

B. U. H) which is called a Islamic Law3. Islamic Law has derived from revealed text a web of interrelated norms prohibiting interest-taking and undue speculative practices. Generally, these portfolios are divided into four kinds i. e a).

Islamic mutual funds, b). Islamic Capital Market Indices, c). Islamic Banking Products (Mudharaba Deposits), d) Islamic Bond. All of them are issued by Specific financial institutions. The gained profits will be distributed to meet the poor's basic needs and increase the quality of the poor's life.

Meanwhile, the principal keep being invested in potential investment opportunities. Is Riba ISLAMIC OR NOT ? The prohibition of Riba is no difference. First, comes building moral resentment against taking Riba, Riba that you practice hoping to increase your wealth does not really increase in God' consideration. The Verse 30: 39 reads: ????? ??????? ??? ???????? ????? ?????? ????? ??????? ????? ??????? ?? ??????? ??? ?????????? ????? ??? ???????? ?????????? ???????????? ?????? ???? ?? ???? ?????????????? And whatever ye lay out as Riba, so that it may increase in the property of (other) people, it shall not increase with Allah; and whatever you give in charity, desiring Allah's pleasure– it is these (persons) that shall get manifold. Interestingly, this Verse is Makkan, it came several years before the prohibition of Riba. Second, comes the condemnation of Riba as a facet of Disobedience that is a reason to earn the anger of God.

Talking about people before you Verses 4: 160-161 read: ??? ?????? ???? ??????????? ? ?????? ???????? ????????? ????????? ????? ???? ???????? ????????? ???? ????????? ? ???????? ???????????? ????? ??????? ?????? ??????? . . . Because of oppression the Jews inflicted We made unlawful for them certain good and wholesome (foods) which had been lawful for them, and because of their hindering many (people) from the way of God, And of their taking Riba though indeed they were forbidden it .

. . Surah al Nisa' chapter 4 of the Qur'an is a Madani Surah, these Verses came in the Early Medina period that marked the beginning of the conflict with the jewish tribes there. Actually, the prohibition of Riba was only revealed in the third Year of Hijra, after the defeat in the battle of Uhud. The circumstances went as follows: Defeated in the battle, there was a talk in Madina that the Makkans raised a lot of money through their Riba practices to finance the revengeful battle.

The Verse that contains the prohibition of Riba is number 3: 13o It came in the context of uplifting the spirit of the defeated and putting their lives back together, offering them alternative means to raise funds for future preparation. Verse 3: 130
reads: ??? ?????? ?????????? ??????????? ????????? ??????? ??????????? ?? ??? ????? ???????? ??????? ?????????? ?????? ???? . O ye who believe! Devour not Riba, doubled and multiplied, and be careful of (your duty to) Allah that ye may prosper. Those who know the styles of Arabic rhetoric can tell that “ doubled and multiplied” is a description of Riba, not a selection of one kind or rate of it for the prohibition.

After the total and complete prohibition comes the last stage that declares Riba as one of the gravest sins in this Religion of Islam and defines in clear terms what it means to abolish Riba practices from the society. Apparently in this stage and along with several Verses, comes most of the Sayings of the Prophet, pbuh. Many commentators call Riba “ Eating other people’s property in vanity and argue that the two Verses 4: 29 and 2: 188 that refer to “ eating funds of others in vanity” are about Riba. They
read: ??? ?????????? ????????????? ??????????? ?? ???????? ???????? ??????? ? ??????????? ???? ??? ??????? ??? ????????? ?????? ??????? .

) 29 : 4 (???? ????????? ???????????? ??????????? ???????????? .) 188 : 2 (O ye who believe! Eat not up your property among ourselves in vanity, except it be a trade by mutual consent And, And eat not up your property among yourselves in vanity. However, the Verses that strongly condemn Riba are those of Surah 2, number 275 through 280. To take only the relevant sections of these Verses, they

read: ???????? ???? ?????????? ?? ??????? ??????????? ?????? ???? ?????????? ? ???????????? ?????? ??????? ????? ? ? ? ???? ???????? ?????????? : ??????? ?? ???? ????????? ??????? ? ???????? ??????? ???????? ????????? ???? ? ? . Those who devour Riba will not stand except as stands one whom the Evil one by his touch Hath riven to madness; That is because they say: “ Sale is just like Riba;” But Allah hath permitted sale and forbidden Riba.

And, ???????? ??????????? ????????? ???????? ???? ? ? .

Allah will destroy (demolish) Riba, but will give increase for acts of charity.

And, ??? ??????????? ?????? ??? ??????? ???? ?????? ??? ????????? ?????? ???? ???? ???????? ???????? ??????? . O ye who believe! Be careful of (your duty to) Allah, and quit what remains of your practice of Riba, if ye are indeed believers.

And, ?????????? ???? ????? ? ??????????? ??????????? ?????? ???? ????????

And if ye do it not, take notice of war from Allah and His Messenger.

And, ????? ?????? ???? ???? ??????????? ?? ????????????? ??????? ???????? ??? ????? .

????? ????? ?? ? ????????? ????? ?????????? ???????? ? . . . ? But if ye repent, ye shall have your principals; neither shall you make (the debtor) suffer injustice (loss), nor shall you be made to suffer injustice (loss). And if the debtor is in a difficulty, then (let there be) postponement to (the time of ease).

Finally, the Verse 282 refers an alternative (deferredpayment sale that creates
indebtedness): ??? ???????? ?????? ???? ???????? ??????????? ????? ???????? ? ??????? ??????? ???????????? . . . O ye who believe, if you deal with each other in transactions involving debt . .

. Points these verses make: • Unyielding resolve on the prohibition of Riba; • Condemnation and absolute denunciation of Riba practices, and tagging them as oppressive or unjust; • Gravity of the sinfulness of Riba, especially that this is the only mention in the Qur'an of ' a notice of war from God and His Messenger; • Clear definition that any excess over principal is Riba; • Uncompromising position against rescheduling for an ncrement; and lastly; • Hinting that deferred-payment sale is an acceptable alternative. Throughout the history of Islamic Jurisprudence Muslim scholars have always understood Riba, that is prohibited in the Qu'an, as any increment in a lending contract, regardless of its size or rate. I attribute that unanimity to the clarity of Verse 2: 279, whose meaning is also repeated in several Sayings of the Prophet Muhammad, pbuh. There are several Sayings, about 55 of acceptable level of authenticity, on the issue of Riba most of them reflect the meanings given in the Qur'an.

While I avoid the lengthy discussion on Riba al Fadl, i. e. , Riba in sales, because it is a side issue, I select only a few Sayings on the Riba of debts, the “ Riba of the Qur’an”: The most popular and most authentically reported is the Hadith of the Farewell Speech given to the largest gathering ever in the life of the Prophet, pbuh, during Hajj, the only and farewell pilgrimage the Prophet

made: ?????? ???? ?? ?? ?????? ??? : ? ?? ?? ? ?? ? ???????? ??? ?? ? ?????? ??? ???? ??? ??? ? ?????? ???????? ???? ? ???? ??? ????? ??? ????? ???? ??????? ??? ?? . ???? ????? The Prophet, pbuh, said in the Farewell Speech: “ Vo, every thing of the affair of Jahiliyyah is let fall under my feet, the Riba of Jahiliyyah is let fall, and the first Riba I abolish is the Riba of al Abbas son of Abd al Muttalib, it is discarded, all.

” (principal and increase). Muslim reported. A version of the Hadith narrated by Abu dawud and Tirmidhi

reads: ???????? ???? ??? ????? ??? : . . . ????? ???????? ?? ??? ?? ??? ?? ? ????? ?? ???? ??? ? ?????? ? ?????? ?? ? ??? ????? ???? ?????? ??? ?? ?????? ??? ??? .

. . . And every Riba of Jahiliyyah is abolished. Neither shall you make (the debtor) suffer injustice (loss), nor shall you be made to suffer injustice, But the Riba of al Abbas son of Abd al Muttalib, it is discarded, all.

The next three Sayings emphasize the gravity of the sin of dealing in Riba: ? ??????? ??? ????????? ????? ???? ?? : ??? ????? ????? ???? ? ? . . . ????? ???? . .

. ??????? ????? ??????? ????) ? ???????? ??????? 3 ? 1 (In the Saying of “ the seven most devastating Sins”, the Prophet, pbuh, counted: “ believing in partnership with God, murder, ...

and Eating Riba… ” reported by Bukhari, Muslim nd others, [al Targhib wa al Tarhib, V 3, p 1].

And, ? ??? ???? ??? : ????? ??? ???? ? ????? ? ??? ?? ??? ? ???? ?? ? ???? . ????? ???? ???? ????) ? ???????? ??????? 3 ? 7 (The Messenger of God said: A Dirham of Riba, one knowingly eats, is more grave than thirty-six adulteries.

reported by Ahmad and al Tabarani, [al Targhib wa al Tarhib v 3 p 7].

And, ? ?????? ??? : ????? ?????? ? ?? ?? ??? ?? ???? . . ????? ???? . .

?????? ????) ? ???????? ??????? 3 ? 5(The Prophet, pbuh, said: Four (persons) very truly God will not make them enter Heaven … nd the Eater of Riba ..

. ” Al Hakim reported [Al Targhib wa al Tarhib, v 3, p 5]. In the last two Sayings certain additional punishment is mentioned by the Prophet, pbuh, for those who practice Riba. This may have some relation to the destruction mentioned in Verse 2: 276: ????? ? ????? ??? ? ? ??? ???? ??? . ??? : ??? : ??? ? ????? ? ?????? ? : ????? ??? ???? ???? . ???????? ???? ???? The Prophet, pbuh, put wrath on (cursed) the eater of Riba and its payer.

Narrator said: and its two witnesses and its writer? Narrator said: We only report what we heard. Reported by Bukhari and Muslim.

And, ?????? ??? ? ? : ? ????? ?? ?????? ????? ??? ?? ??? ?? ? ????? ?? ???? . ??? ? ??? ????) ? ???????? ??????? 3 ? 8 (The Messenger, pbuh, said: No people among whom adultery and Riba become openly practiced unless they have earned the punishment of God. Abu Ya’la reported, [al Targhib wa al Tarhib, v 3, p 8]. Conclusion: Islamic banking is a very young concept.

Yet it has already been implemented as the only system in two Muslim countries; there are Islamic banks in many Muslim countries, and a few in non-Muslim countries as well. Despite the successful acceptance there are problems. These problems are mainly in the area of financing. With only minor changes in their practices, Islamic banks can get rid of all their cumbersome, burdensome and sometimes doubtful forms of financing and offer a clean and efficient interest-free banking. All the necessary ingredients are already there.

The modified system will make use of only two forms of financing — loans with a service charge and Mudaraba participatory financing — both of which are fully accepted by all Muslim writers on the subject. Such a system will offer an effective banking system where Islamic banking is obligatory and a powerful alternative to conventional banking where both co-exist. Additionally, such a system will have no problem in obtaining authorisation to operate in non-Muslim countries. Participatory financing is a unique feature of Islamic banking, and can offer responsible financing to socially and economically relevant development projects.

This is an additional service Islamic banks offer over and above the traditional services provided by conventional commercial banks.

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