Theory of Islamic Financial System and Economic growth

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Abstract
Recently, there has been a rise of academic interest in the restructuring of financial systems. Economists have centered their discussions on the theoretical insights into comparative advantage of bank-base or market-base systems in promoting long-run economic growth. No matter if it is different or not, actually Shariah compliant or not, it is a fact that Islamic finance is gaining clout and influence every passing day. It is the fastest mode of finance in Pakistan and the world with assets and deposits growing faster than its conventional counterpart. It has now become a trillion-dollar industry worldwide and is expected to continue this growth as more and more Muslim countries have inclination to climb the development ladder with rising incomes.
So this gives rise to another question. Is Islamic finance – considering its increasing clout – really a practical substitute of financial system and solution? The Islamic financial system has been advancing without exception. However, the areas of research on this subject are very limited as mainly their focus is on permissible scope of activities for Islamic banks and other Islamic depository financial intermediaries only. These activities are mainly determined by the policies and set of law wherein it is found dictating the abolishment of interest rate in the financial system. (Kurshid Ahmad (2000), Chapra (1985) and Siddiqi (1982). Promoters of the bank-base systems lay emphasis on, that the systems are improved at activating savings, recognizing good investments and applying sound and stable corporate control, mainly during the early phases of economic expansion and in

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weak institutional surroundings (Steinherr and Huveneers, 1993; Titman and Wessels, 1988). However, other stake holder stresses the advantages of markets in allocating assets and resources, as long as risk management tools and justifying the harms related with greatly influential banks (Levine and Zervos, 1998; Bartholdyet al., 1997). This paper evaluates the pragmatic relation between the level of financial intermediary development and economic growth in the light of Islamic financial system.

The study aims to consider the pragmatic works on Islamic financial system in the light of room for economic advancement and the development. The approach in this regard is to look at the many aspects of the Islamic financial system and suggests some prudent and sound regulatory frameworks which are deemed necessary. The findings of the study suggest the more services that can be offered by the financial intermediaries, the greater the chances of producing more specialized financial services and diversification of financial institutions which can paves the way for future scholars to examine the systems from the angle of efficiency, effectiveness, rules and regulations, and the present lack of a recognized legal and accounting system.

**Keywords:** Islam, Finance, Banking, Economics, theory, wealth, interest

**INTRODUCTION**

Islam occupies an intermediate position between the doctrines of capitalism and communism, as a matter of fact, the world has always been divided into two diametrically opposite groups, i.e. “the haves” and “the have notes”.

Islam devises to minimize the conflict between these two groups, through an equitable distribution of wealth. By striking a middle line, it protected the interests of the society as well as individuals. For socio-economic uplift of society Islam has introduced numerous instruments which may be broadly categorized as compulsory and optional. Compulsory instruments are Zakat (prescribed poor due on hoarded wealth), Usher (a determined proportion of agricultural produce), Fitr (alms bestowed upon the poor on Eid ul fitr).

Beside the above compulsory instruments there are optional instruments such as Khairat charity, Infaq suspending benevolently in the way of Allah, Sadqat-charitable deeds. Economic inequality is fact of life. Islam doesn’t turn it back against to it. However those are lagging behind in economic race, are assumed of basic needs of life under Islamic system.
There are many traditions encouraging spending of money to relieve others of their poverty and preparing all other Muslims to come forward for mutual assistance and sympathy and extend financial cooperation to their needy brothers, we should spend money for freeing our captives and debtors and helping for wayfarers.

There is no room for exploitation, deception, injustice of any form in business transaction in the economic system of Islam. Economic system of Islam ensures social welfare and security, dignity of mankind and elimination of all sorts of vices. Islam purges Muslim of all kind of malpractices found in world. It is the only way out of all un-Islamic prejudices unsocial discriminations.

Adulteration, black marketing, deception and fraud, and using foul means in trade commerce and all business transaction is against Islamic teachings.

In short Quran and the Sunnah disallow all practices in trade and commerce and dealing which may lead to the loss of humanity at large.

DISTRIBUTION OF WEALTH
The Wealth should be kept in circulation and must not be allowed to be concentrated in the hands of few. Just as the water remains fresh if it is flowing, but becomes stagnant if its flow is stopped. Similarly the wealth becomes a cause of curse if its circulation is stopped. Islam approves of the economic progress provided lawful and righteous livelihood is adopted.

The distribution of wealth is one of the most of the important subjects which has given birth to global revolutions in this world of today and has affected every sphere of human activity from international politics down to the private life of individual.

The study of Holy Quran and the Sunnah clarifies fundamentals which have an essential and basic importance with regard to almost every aspect of Islamic economics.

According to the Quranic view, all means of livelihood are no more than just stages in man’s journey, and his destination is the sublimity of character and conduct, and consequently, the felicity of the world-hereafter.

OBJECTS OF DISTRIBUTION OF WEALTH ACCORDING TO ISLAM
In accordance with the injunction of Holy Quran as interpreted of Sunnah, the objects of distribution of wealth are as follows:
a) Establishing the practicable system of economy: “We have distributed their livelihood among them in worldly life, and raised some above others in matter of social status, so that some of them may utilize the services of others in their work.” (43-32)

b) Islamic system of distribution of wealth is to enable everyone to get what is rightfully due to him. “In their wealth there is known right for those who ask for it and those who have need for it.” (70-24)

c) The wealth, instead of becoming concentrated in a few hands, should be allowed to circulate in the society, as widely as possible, so that the distraction between the poor and rich be narrowed.

d) Islamic law of inheritance must be implemented very strictly. Payment of Zakat, Usher, fitra are compulsory duties and must be complied with. Earning wealth through lottery gambling, charging interest, fraud and corruption, cheating, using exploitive measure, inducting in intoxicative business, black-marketing, profiteering, short weighting, short measuring and undue and unlawful and foul means in commercial dealings, depriving the right of others by hooks or crooks is against the teachings of Islam.

ISLAM AND CAPITALISM

It is a need of an hour to determine and understand fully the disparity that exists between the Islamic view of the distribution and circulation of wealth and the Capitalist point of view. This difference being rather subtle and complicated and requires detail discussion.

Through evaluating and comparing the concise outlines of both the Islamic and the Capitalist systems regarding the distribution of wealth, following differences between the two have been drawn:

1. The industrialist or in other words entrepreneur, as a regular feature, has been excluded from the list of the means and the factors of production, but this does not entail that the very existence of the entrepreneur has been denied. What it does imply is just that the industrialist is not an autonomous actor, but is incorporated in any one of the three factors.

2. For Capital profit has been considered “reward” rather than “interest.”

3. Similarly the factors of production have been considered in a different mode. Capitalism defines ‘Capital’ as “the produced means of production.” Hence, Capital is supposed to include
machinery etc. as well, beside provisions of money and foodstuff. But the definition of “Capital” that we have presented while discussing the Islamic view of the distribution of wealth, includes only those things which cannot be utilized without their being wholly consumed, or, in other words, which cannot be let or leased – for example, money. Machinery is to be excluded from “Capital”, according to this definition.

4. In the same way, “land” has been defined in a more general way. That is to say, all those things have been brought under this head, which do not have to be wholly consumed in order to be used. Hence, machinery too falls under this category.

5. The definition of Labor too has been generalized so as to include mental labor and planning.

Let us see the details of the discussion. According to the Capitalist system, the vital feature of the entrepreneur (which enables him to “profit”) is believed to be that he perceives the risk of profit and loss in his business. Hence from the Capitalist point of view, “profit” is a kind of reward for his courage to enter into a commercial business enterprise where he alone will have to bear the burden of a possible loss, while the other three factors of production will remain protected from loss, for Capital would get the predetermined interest, Land the fixed rent and Labor the specific wages.

The Islamic point of view on the other hand persists that the capability to take the risk of a loss should, inherent with Capital itself, and that no other factor should be made to bear the burden of this risk. Consequently, the Capitalist, in so far as he takes the risk, is an entrepreneur too, and the man who is an entrepreneur is a Capitalist as well.

Currently, there are three ways in which Capital can be invested in a business enterprise:

1. **Private business:** The man who invests Capital may himself run the business without the help of any partners or shareholders. In this case the return which he gets may be called “profit” from the legal or popular point of view; but, in economic terms, this “reward” would be made up of (1) “profit”, in as much as Capital has been invested, and (2) “wages”, as earnings of management.

2. **Partnership:** The second form of investment is that several persons may jointly invest capital, jointly manage the business and jointly bear the risk of profit and loss. In
the terminology of the Fiqh, such a venture is called “Shirkat-ul-Aqd” or Partnership in contract. According to the terminology of economics, in this case too all the partners will be entitled to “profit” in so far as they have invested capital and also entitled to “wages” in so far as they have taken part in the management of the business. Islam has sanctioned this form of business organization too. This form was quite common before the time of the Holy Prophet (S.A.W) until he permitted people to retain it, and since then there has been a consensus of opinion on its permissibility.

3. CO-OPERATION OF CAPITAL AND ORGANIZATION (MUDARABAH):

4. The third form of investment is that one person may invest Capital while another may manage the business, and each may have a share in the profit. In the terminology of Fiqh, it is called “Mudarabah”. According to the terminology of economics, in this case, the person who invests his capital (“Rabb-ul-Mal”) will get his share in the form of “profit”, while the person who has actually managed the business will get it in the form of “wages”. But if the person who has been managing the business (“Mudarib”) eventually suffers a loss in the business, his labor will go wasted just as the capital of the investor would go wasted.

This form of business organization too is permissible in Islam. The Holy Prophet (S.A.W) himself has made such an agreement with Hazrat Khadijah before their marriage. Since then there has been a complete consensus of opinion on this too among the jurists of Islam.

MONEY LENDING BUSINESS

The fourth form of investing Capital, which has ever since been practiced in non-Islamic societies, is the money-lending business. That is to say, one person lends out capital in the form of a debt, and a second person puts in his labor; if there is a loss it has to be borne by labor, but, profit or loss, interest does accrue to Capital in any case. Islam has prohibited this form of investment.

The Holy Quran also says:

“O, believers, fear Allah, and give up what is still due to you from the interest (usury), if you are true believers. (2:278)

“If you do not do so, then take notice of war from Allah and His Messenger. But, if you repent, you can have your principal.
Neither should you commit injustice nor should you be subjected to it.” (2:279)

In these two verses, the phrases “what is still due to you from the interest” and “You shall have the principal” makes it quite clear that Allah does not ignore the least quantity of interest, that “giving up the interest” implies that the creditor should get back only the principal. Thus, it is evident that Islam considers every rate of interest (except zero %) to be totally prohibited. In the pre-Islamic period, certain Arab tribes used to carry on their trade with the help of money borrowed on the basis of interest from other tribes. Islam puts an end to such transactions altogether. Ibn Juraij says:

“In the pre-Islamic period, the tribe of Banu Amr bin Auf used to take interest from the tribe of Banu-al-Mughira, and the Banu-al-Mughira used to pay this interest. When Islam came, the later owed a considerable amount of money to the former”. And further on: “The Banu-al-Mughira used to pay interest to the Banu Thaqif”

Let it be understood that the position of every Arab tribe was like that of a joint company, carrying on trade with the joint Capital of its individual members. So, when a tribe would borrow collectively from another tribe, it would usually be for the purposes of trade. The Holy Quran prohibited even this practice. Thus, under the Islamic system of economy, if a man wants to lend his money to a businessman for being invested in business, he will have first to decide clearly whether he wishes to lend this money in order to have a share in the profit, or simply to help the businessman with his money. If he means to earn the right to a share in the profit by lending his money, he will have to adopt the mode of “partnership” or that of “Co-operation” (Mudarabah). That is to say, he too will have to bear the responsibility of profit or loss – if there is eventually a profit in the enterprise, he shall have a share in the profit; but if there is a loss, he shall have to share the loss too.

On the other hand, if he is lending this money to another person by way of help, then he must necessarily regard this help as no more than help and must forgo. All demand for a “profit”. He will be entitled to get back only as much money as he has lent out. Islam considers it not only unjust but also meaningless that he should fix a rate of “interest” and thus place all the burden of a possible loss on the debtor.

This discussion makes it clear that Islam places the responsibility of “taking the risk of loss” on Capital. The man
who invests capital in a risk-bearing business enterprise shall have to take this risk.

**THE TALE OF THIS WORLD**

Mawlana Rumi has elucidated this viewpoint with an excellent parable. He said:

"The similitude of this world is that of water, and the similitude of man is that of a boat. Just like a boat cannot move on without water, man cannot stay alive without this world and its provisions."  
(Miftahul Uloom, Sharh Mathnavi Maulana Rumi 2/37)

Well, as far as the water and the boat are concerned the water benefits the boat only as long as it surrounds the boat, as long as it supports the boat. But once water enters the boat it will be on longer of benefit. It will rather destroy the boat, causing to sink. The case of man and worldly provisions is not much different. Worldly provisions are extremely beneficial for man. One could not stay alive without them. But this holds true only as long as the water of worldly provision is a means to keep the boat of one’s heart afloat. Once the water of worldly provision enters one’s heart, it causes one to sink and it becomes a means of one’s ruin. This is the Islamic viewpoint regarding economics. But this does not mean that Islam considers these matters a superfluous frivolity. Islam does not teach celibacy. Worldly provisions and matters pertaining to economics are extremely useful, provided one utilizes the same within certain limits, and provided one does not consider them to be the ultimate objective of one’s existence.

Once explaining these two basic points, we need to know what are the basic problems of any economy, and how were they solved in the present economic systems, namely capitalism and socialism.

**THE SIGNIFICANCE AND CONNOTATION OF ‘ECONOMIC’**

As far as the first question namely ‘What are the basic problems of economy?’ is concerned, well, even a person who has just begun to study economics knows that there are four basic problems of economy, but before we try to understand these found problems, we need to keep in mind what economics means. The Arabic equivalent of economics is “Iqtisad”. Now if we look up this word in a dictionary, then we find that it actually implies a person’s fulfilling his need in a sufficient, prudent manner. This idea is conveyed by both the Arabic word “Iqtisad” and the English word ‘economics’. Hence the foremost problem of economics is that man’s needs or rather desires are unlimited, whereas the means and resources to fulfill those desires are limited. If means and resources were of such quantity so as to
match man’s needs and desires, then there would be no need for the subject economics. Economics however is needed because man’s needs and desires are far more than the available means and resources to fulfill these desires. Now one needs to overcome this discrepancy, and bring about conformity between these two, so that one can fulfill one’s needs and desires in a sufficient and prudent manner. This exactly is the subject-matter of economics.

ISLAMIC ECONOMIC SYSTEM

DOCTRINE

Islamic Finance is based on an economy that is in close connection with its Islamic teachings. Core principles find their formal and informal rules in the Quran and are adapted to local and new situations by ijtihad (individual interpretation by Islamic jurists). Whereas in western jurisdictions Muslims are bound by contracts and know the right of property. Muslims are bound by their stipulations with the exception that third, non Islamic parties are titled as non believers. Self interest is protected if it is in conclusion with the principles of the Quran, trustworthiness and justice. Work is ranked very high, higher than in the western world and idleness is frowned upon and judged as a lack of faith, even as a sign of faithlessness. As a result of proper and legitimate work, wealth is considered a blessing, but hoarding is prohibited. An important legal maxim is the system of risk sharing: profit comes with liability (and not of interest). Although lawful competition is Shariah compliant, cooperation, solidarity and cooperation are the main goals of individual economical behavior. Economic justice means equality of liberty and opportunity, justice in exchange and distribution. A just price is viewed as a result of interaction of economic forces in a market where all Shariah rules are observed. A bazaar is a typical Islamic market where inspectors (called Muhtasib) control the compliance to the Shariah. Waste, abuse of wealth and extravagance are condemned as unjust. Each member of society has the right of a certain standard of life, not as a matter of beneficence.

THEORY

ISLAMIC FINANCE

The Islam as a religion influences social, economical, cultural, basically all aspects of human life. Compared to the western culture, the differences might seem more profound than they actually are in reality. The western standard most likely has more
background on Christian religions then admitted and realized in everyday life. Follower of Islam often criticize « our » way of life when they start comparing our behavior with their theory of proper behavior and vice versa. The Islam is based on a single source, the Divine Law, a unique understanding of how society, politics and economics should be organized and in combination with each other executed. No differences are allowed between the sacred and the profane. Like in any developed society, there are rules that have to be followed and there is a need for enforcement mechanisms to empower these rules that have to be known by and addressed to the people.

FINANCIAL CONTRACTING AND INTEREST (riba)

INTEREST BASED SYSTEM
The theory of interest is based on the fact that the gain of one party is guaranteed. While the gain of the other party is not if a man borrows money from someone on interest then the money-lender is sure to get the amount of interest that accrued on the money lent. As for as the borrower is concerned, he has to pay the amount of interest to the money-lender at an agreed rate every year regardless of whether the business carried out with take money resulted in profit or loss. So the debtor’s gain is quite uncertain, and at times he suffers a great loss.

At other times it so happens that the debtor makes a huge profit with his loan. Let us assume a person starts business with a capital amount of ten crores Rupees, borrowed from a bank on interest. He then makes of profit of 50%. Out of this profit he pays the bank only 15% and the remaining 35% go into his own pocket. Now consider, with whose money did he conduct the business? It was public money (the investors’ money, to be more exact) and 35% of that profit earned on that money went into the pocket of one single person, i.e. the business-man. The remaining 15% went to the bank. After deducting its own share, the bank distributed a small portion of the profit; let’s say 10% percent among its depositors. The result was that out of 50% profit which had been earned through public money, only 10% are actually distributed among the public while 35% thereof go into the pocket of one man. The public is quite satisfied, for their deposit of one hundred Rupees becomes one hundred and ten Rupees at the end of the year. However, they do not know that even this meager profit of 10% reverts to the capitalist business-man. This is so become the 15% interest which he had to pay to the bank will be included in the cost of the product, which will in turn be reflected in the price of the same.
Thus the business man will recover this amount from the consumers. As a result of this vicious circle, the business man ultimately reaps the profit in every respect, and he remains safe and secure from the risk of loss. Even if he every happens to suffer a loss, the insurance companies are there to cover his loss and they also pay this compensation out of the money of the premiums charged from the policy-holders in periodical installments. Thus the capitalistic system thrives in the public money. I have tried to in a few words to give you a faint idea how an interest-based system words, how it breeds injustice, inequity, and unfairness in the distribution of wealth, which is strictly forbidden in the Islamic Shariah.

Contracts and financial transactions – as a certain form of a contract – must comply with the principles of Shariah and are only valid if they don’t contain Riba (interest), Gharar (lack of information disclosure), Qimar (gambling) and Myisur (games of chance involving deception). The concept of Riba is more than just the prohibition of charging financial interest, it is also forbidden, to make more than what it is given…. An excess or an addition… (Lane Lexican). Money was not created for its own sake but only as a medium of exchange. Riba al-Nasiah is the typical interest rate in modern financial transactions, where a positive return on a loan is fixed in advance and therefore not permitted. Indexation – e.g. linked to a consumer price index – is allowed in the eyes of the Shariah for wages, salaries and pensions but not for financial assets. Some Shariah scholars argue that financial stability is the aim of an Islamic State and not part of a contractual agreement.

DEFINITION OF RIBA
“Focusing on Riba in financial transaction, now we can construct a more formal definition of the term. According to the Shariah, Riba technically refers to the “premium” that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or for an extension in the duration of loan. At least four characteristics define the prohibited interest rate: (1) it is positive and fixed ex-ante; (2) it is tried to the time period and the amount of the loan; (3) its payment is guaranteed regardless of the outcome or the purposes for which the principal was borrowed; and (4) the state apparatus sanctions and enforces its collection.” [2]

The prohibition of Riba is based on its background of the Islamic justice that condemns all forms of exploitation, especially without sharing the risk, which would consequently leave all risks to the
borrower. Therefore it is typical that in an Islamic transaction the risk and the profit are shared. Islamic Finance supports the shareholder and not the creditor, the latter of which only takes the risk of the solvency of the borrower and not the risk of the success or failure of the enterprise. The prohibition of Riba can also be seen as a philanthropic element of the Sharia. To lend money for business purposes should have a business background (share the risk and profit), lending it for personal reasons (shortage of liquidity) should only occur as an act of charity and never out of profitable admissions.

SOCIAL AND ECONOMIC JUSTIFICATION OF PROHIBITION OF RIBA IN ISLAM

1. Riba Militates against the nature of man’s life on earth creates conflict and destroys cooperation. Interest is not humane.
2. Riba militates against the nature of the environment of production characterized by uncertainty of returns i.e. Interest is unjust.
3. Interest as an allocator of investible resources is inefficient as it allocates not according to productivity but according to credit worthiness of the borrowers.
4. Interest, by introducing rigidities in the system causes instability and increases fluctuation thereby reducing the production of wealth.
5. Replacement of interest by profit-sharing as the basis of financial intermediation may raise the return on savings, causing its supply to increase the demand for savings thereby increasing volume of investment and promoting growth, because entrepreneurs can take more risk under profit-sharing system.
6. Institution of interest contributes to decline in fiscal discipline, as government borrowing replaces additional taxations, making future generations pay for the comfort of the present one.
7. Interest has been the hallmark of the economics of the dominant western civilization whereas Islamic civilization in its glorious period functioned on the basis or profit sharing and trade credit. Rejection of interest is a necessary step towards economic resurgence of Muslim people.

GHARAR
Gharar stays for the lack of information or control in a contract and makes the contract invalid and void. In Roman law it would
be described as a general misapprehension. Sharia audits any uncertainty to the quantity, quality or existence of the subjected-matter as an element of Gharar. The trading of Gharar (the risk) is prohibited, which is a typical element of modern financial products, as derivatives. Still some issues are under review, like life insurances, where an uncertainty is insured.

**CONTRACTS**

The Islamic economic system has developed a set of standard contracts to serve for more sophisticated contracts and financial instruments. The categories of these standard contracts are:  
- Transactions (economic transactions, such as sale and trade of good and services)  
- Financing (create and extend credit, financing, provide capital)  
- Intermediation (execution of transactional or financial contracts)  
- Social Welfare (between individuals and the society)

**TRANSACTIONS**

The Islam supports trade and trading forms of business, no matter if physical assets or rights are the objective of the contract. Important categories are:  
- Bay’ al-Juajil (deferred payment sale)  
- Bay’ al-Salam (deferred delivery sale)  
- Ijarah (lease)  
- Istisna (partnership in manufacturing)

**FINANCING**

Typical financing contracts are Murabahah and Musharakah.  

**MURABAHAH (COST-PLUS SALES)**

A financier purchases a product (often commodities) to supply an entrepreneur, with a lack of capital, and receives payment with a certain delay (until final product is sold) and a profit. A modern mudarabaha consists of several steps:

A banks client asks the bank to purchase a product from a vendor.  
The Bank agrees to do so, purchases the product and resells it to the client for a fixed price.  

Often the client acts as the banks agent, so the product will be delivered directly from the vendor to the client. The Client pays the price for the product and a profit margin to the bank. This transaction for the financier (the bank) is often done with the product itself or another asset which the client can provide.
b. MUSHARAKAH (PARTNERSHIP)
When two or more people combine capital and/or labor to share profits and losses with similar rights and liabilities.

INTERMEDIATION
The nature of financial intermediation defines the basis of a financial system. Primary functions of intermediations are asset transformation, payments, and brokerage and risk transformation. Three groups of intermediation contracts are usually described: partnership, trust and security. A typical intermediation contract is a Mudarabah, where a partnership between an investor (principal) and the entrepreneur as his agent is created, so that the agent can use the money in the most suitable way to his judgment and the profit is shared. Typical elements of this contract are:

CONTROL
The investor has no management control over the agent, who is free in his decisions within the limitations of the contract. Profit and loss sharing while profit is usually shared, loss is only the risk of the investor, as long as the agent acts in good faith. Parties are free to negotiate the ratio of the profit share.

FLEXIBLE STRUCTURE
There can be several parties involved on both contractual sides with different goals. Also, the reduction of risk through personal surety or an asset (pledge) is common and an example of an intermediation contract.

RAHN (PLEDGE)
When an investor or lender reduces the risk of non-payment he either chooses personal or asset surety. When the lender takes an asset as collateral to secure the financial transactions is called rahn and is – in other words – a pledge. But only with a court decision the pledge can be liquidated to cover the lender’s investment. When a second obligation covers the risk of failure of the first obligation, it is called Kifala.

ISLAMIC BANKING
Using the above mentioned legal instruments, Islamic banks can provide their customers with a wide range of financial support. In a two tier-model a mudarabah contract between the depositor and the bank is closed. In the balance sheet no liabilities towards depositors are mentioned but only an equity position. In another conception the depositor has a choice of « two windows », where his funds are either placed as liabilities or investments in the balance sheet of the bank. In both schemes risks should be reduced to a minimum, but an investment always involves certain foreseen and unforeseen risks. While western banks focus on the
return on investment (interest rate), an Islamic bank will concentrate on the return of investment. This leads Islamic banks to long term thinking and long term relationships with their customers. An important background of Islamic banking and financing is the principle and agent model, also criticized as one reason managers (agents) take more risk than necessary, because they only share profits, not losses. Shariah Boards have to control and approve each financial product of Islamic banks. Because of a lack of Shariah scholars many of them sit on several boards, which can have influences on corporate government principles.

A typical balance sheet of an Islamic bank shows the mixture between a commercial and an investment bank, focused on long term and risk reduced strategies. Often islamic products or Islamic financial institutions appear within a conventional, western bank (islamic windows). Typical Islamic finance institutions are also mortgage or insurance companies.

Islamic finance would not succeed without a system as basis, involving a banking system, financial and capital markets and the legal system. The question has to be asked, if an Islamic finance system would survive without the conventional system. While western banks bear more risks and losses, Islamic banks are more intermediators between investors and borrowers. The real sector has more influence on the financial sector than in conventional systems. An Islamic finance system has a tendency for stability because of its connection with real assets and the non support of speculation. Also lower costs for refinancing (interest rates), stabilize the system and the dependency on success thrives participants to careful behavior. Insolvency should occur less in an Islamic system. Each Islamic country has to decide whether to follow a centralized system (like Germany or Japan) or a market system, like in the Anglo-Saxon countries, where the central bank has a greater influence. The question arises if bonds and derivatives are shariah compatible. The majority of the scholars deny it, because of its gambling part.

CONCLUSION
The ongoing international financial crisis has reignited debate over the development of a risk-sharing financial system, such as that required in Sharia Law. Only since the late 1970s analytical background about Islamic Finance exists and still needs to be developed. Western bankers and economists criticized there would be no market for Islamic Financing, especially when there is no interest (riba) involved. Reality shows a market for Islamic Finance, but a lack of knowledge about the cornerstones of the system and of experts – like on Shariah boards – to support such a
system. While the (western) finance system almost collapsed in 2009, bankers, politicians and economists were and still are thinking about a system that is more based on assets then debts, on real economy more than futures and derivatives. Maybe the knowledge about an Islamic Finance system could open doors to develop a new, safer and more reliable finance system, independent of any religious background. But only if people are curious, tolerant and keen on knowing more of each others religious, financial and cultural background, society and economy can profit.

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