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Development of Islamic Economics and Finance and the Role of International Conferences

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1. Historical Overview

It is well-known that conferences play an important role in mobilizing and contributing to research in their areas of specialization. Until the early 1970s, research in the field of Islamic economics was, largely, restricted to a critique of conventional economics and its institutions. That research showed that Islamic economics has the potential of emerging as a new paradigm. Some leading personalities of the Islamic world realized that potential and decided to give that research a direction so that a new discipline may emerge in due course of time. This effort was spearheaded by the then President of King Abdulaziz University, Jeddah, Dr. Muhammad Omar Zubair. With those efforts, the first International Conference on Islamic Economics was held in Makkah Al-Mukarramah, Saudi Arabia, in 1976, under the auspices of the King Abdulaziz University, Jeddah. The Conference marked the renaissance of Islamic economics as a modern scientific discipline.

Though it was decided in the Conference that similar international conferences on Islamic economics and finance should be convened every two years with specialized seminars held more often, it was not until 1983 when the Second International Conference was held in Islamabad, Pakistan. In between, a seminar on Monetary and Fiscal Economics of Islam was held in Islamabad in 1978. During the Second Conference, a resolution was passed to establish an "International Association for Islamic Economics (IAIE)". The Association was constituted shortly afterward. From then on, it was IAIE which assumed the responsibility of initiating the process of the next conference. These conferences were organized with the active collaboration of seats of higher learning in Muslim countries, by choosing a local host university as co-organizer. The Islamic Development Bank (IDB), Jeddah also came on board as a co-organizer. For the next few Conferences in this series, the academic work was done by some active members of IAIE, under the supervision of a Steering Committee and an Academic Committee constituted very early in the process of organizing the Conference. The Secretary General and/or the President of IAIE played a key role to take the Conference to its conclusion. After almost all Conferences, the publication of its papers in the form of books published jointly with some renowned international publishers was arranged. The papers presented at these Conferences are one of the most important additions to the literature of Islamic economics and finance. Books published out of Conference papers were provided to many libraries leading to further research by graduate students.

The Conferences discussed both theoretical and practical issues and were attended by academicians as well as practitioners. In this way, these Confere-

nces provided a boost to the growth of the Islamic financial industry. Whenever feasible or needed, specialized seminars/workshops were held in between the Conferences to discuss specific issues facing the Islamic financial industry and the nascent discipline. That also led to the initiation of some teaching programs in universities in Muslim as well as non-Muslim countries. One of the first teaching programs in Islamic finance at Lough-borough University started with the initiative of the office holders of IAIE. Either financial and/or academic support was provided for many other teaching programs in Western countries by the IAIE through its office holders and senior members. Books published out of Conference papers were also provided to their libraries.

The initial financial support was provided by the IDB. IAIE arranged other sponsors to raise the necessary funding. *A special feature that distinguishes these Conferences from many others on Islamic economics and finance that became widespread later (mainly as an income generating source for the organizers) is that the main objective of these conferences was "service to the discipline".*

A summary about the eleven conferences held so far under this series is given in Table 1 below:

Table (1)
Summary of International Conferences Series Held By IAIE, IDB, and Local Host University

Conference/Venue	Dates Held	Local Host	Theme
First Conference, Makkah, Saudi Arabia	21-26 February, 1976	King Abdulaziz University, Jeddah.	General
Second Conference, Islamabad, Pakistan	19-23 March, 1983	International Islamic University, Islamabad.	Development, Finance, and Distribution in Islamic Perspective
Third Conference, Kuala Lumpur, Malaysia	28-30 January, 1992	International Islamic University, Kuala Lumpur.	Financing Development from Islamic Perspective
Fourth Conference, Loughborough, UK	13-15 August, 2000	Loughborough University.	Islamic Finance: Challenges and Opportunities in the 21st Century
Fifth Conference, Manama, Bahrain.	7-9 October, 2003	Bahrain University and the Central Bank of Bahrain.	Sustainable Development and Islamic Finance in Muslim Countries
Sixth Conference, Jakarta, Indonesia	21-24 November, 2005	Indonesian Ministry of Finance and the Central Bank of Indonesia.	Islamic Economics and Banking in the 21st Century
Seventh Conference, Jeddah, Saudi Arabia	1- 3 April, 2008	King Abdulaziz University, Jeddah.	Thirty Years of Research in Islamic economics: Solutions and applications for Contemporary Economic Issues
Eighth Conference, Doha, Qatar	19-21 December, 2011	Hamad bin Khalifa University, Qatar Foundation, Doha	Sustainable Growth and Inclusive Economic Development from an Islamic Perspective
Ninth Conference, Istanbul, Turkey	9-10 September, 2013	Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESRIC), Istanbul.	Growth, Equity, and Stability: An Islamic Perspective
Tenth Conference, Doha, Qatar	23-24 March, 2015	Hamad bin Khalifa University, Qatar Foundation, Doha	Institutional Aspects of Economic, Monetary and Financial Reforms
Eleventh Conference, Kuala Lumpur, Malaysia	11-13 October, 2016	International Islamic University, Kuala Lumpur.	Rethinking Islamic Economics and Finance: Paving the Way Forward for Inclusive and Sustainable

2. Special Issue of the JKAU: IE and the Methodology of this Paper

The Eleventh Conference was held at the International Islamic University, Kuala Lumpur during 11-13 October 2016. A total of 370 papers were submitted in response to the call for papers. Each paper was reviewed by two referees before the Conference and rated on a scale of 1-5 (5 being the highest), and 110 papers were selected for presentation at the Conference. After the Conference, the organizers decided to publish selected articles in Special Issues of four relevant journals, the JKAU: IE being one of those. Seven papers were short-listed for possible publication in JKAU: IE. As a matter of JKAU: IE policy, papers are accepted based on *two* positive referee reports using double blind review process (i.e., recommending publication without changes or after required changes are made by the author). The Editorial Board decided that for the Special Issue, the pre-conference evaluation based on which papers were accepted for presentation at the Conference shall be considered as one positive referee report. Out of the seven papers shortlisted for a second review, one was rejected; one was accepted without changes, and five were accepted after the authors carried out the changes required by the referees appointed by JKAU: IE.

The methodology used in this paper is subject-oriented. We have attempted to identify the major topics in the field of Islamic economics and finance discussed in the papers published in this Issue. We then deliberate on those topics as discussed in the literature and try to identify the value-addition of each paper on that topic. It is by no means a survey article of the literature on a particular topic, but an attempt has been made to provide necessary background on each topic and then put each paper in that perspective. Naturally, some papers figure under more than one topic. Similarly, each paper may have discussed more than one topic.

3. Important Issues Covered in the Special Issue

The following major topics in the field of Islamic economics and finance, (hereafter IE&F) have been discussed in the papers published in this Issue.

1. Use of Variable versus Fixed Return Modes for Achieving Islamic Goals in the Financial Sector.
2. User Perceptions about IE&F and the Reasons for that.
3. The Role of Finance in Poverty Alleviation and Reducing Income Inequalities.
4. Role of Values and Institutions in IE&F;
   A. Positive versus Normative Economics.
   B. Institutional versus Islamic Economics.

In the rest of this section, we discuss these issues one-by-one and relate the discussion to the papers.

3.1 Use of Variable versus Fixed Return Modes for Achieving Islamic Goals in the Financial Sector

Islamic financial transactions are of two kinds. One is based on a fixed charge on capital, and the other is based on profit sharing that does not guarantee any rate of return. In the beginning, Muslim theoreticians and Islamic banking specialists built up their hopes on Islamic banks to provide a significant amount of profit-sharing finance. For example, the report of Pakistan's Council of Islamic Ideology on the elimination of interest from the economy states:

> The Council has pointed out that the ideal alternatives to interest in an Islamic economic system are profit/loss-sharing and qard-hasanah. However, in view of the difficulties in the practical application of the system of profit/loss-sharing in certain spheres, the Council has endorsed the recommendations of the Panel of Economists and Bankers that certain other methods like leasing, hire-purchase, Bai Muajjal, …. may also be used in interest-free banking operations. *Cautioning against the danger that these other methods could be misused as a means for opening a back-door for interest, the Council has urged that a basic policy decision should be taken to the effect that with the passage of time the operational field of profit/loss-sharing and qard-hasanah should gradually be expanded while that of the other alternatives reduced.* [Emphasis added] (Council of Islamic Ideology, 1981, p. xv, Preface).

In practice, the modes of financing being used by most Islamic banks are dominated by fixed-return modes such as *murābaḥah*, *tawarruq*, and leasing. Some scholars have argued that this is one of the most serious problems facing Islamic banking as an alternative model which is distinguished by risk-sharing. A renowned Islamic jurist of present times, Taqi Usmani, writes:

> Islam, being a practical way of life, has two sets of rules; one is based on the ideal objectives of Shari'ah which is applicable in normal conditions, and the second is based on some relaxations given in abnormal situations. The real Islamic order is based on the former set of principles, while the latter is a concession which can be availed at times of need, but it does not reflect the true picture of the real Islamic order. Living under constraints, the Islamic banks are mostly relying on the second set of rules, therefore, their activities could not bring a visible change even in the limited circle of their operations. However, if the whole financing system is based on the ideal Islamic principles, it will certainly bring a discernible impact on the economy." (Usmani, 2004, pp. 15-16).

Similarly, one of the pioneers of Islamic banking theory, Nejatullah Siddiqi (1983) laments:

> We cannot claim, for an interest-free alternative not based on sharing, the superiority which could be claimed on the basis of profit-sharing. What is worse, if the alternative in practice is built around predetermined rates of return to investible funds, it would be exposed to the same criticism which was directed at interest as a fixed charge on capital. It so happens that the returns to finance provided in the modes of finance based on *murabahah, bay' salam*, leasing, and lending with a service charge, are all predetermined as in the case of interest. Some of these modes of finance are said to contain some element of risk, but all these risks are insurable and are actually insured against. The uncertainty or risk to which the business being so financed is exposed is fully passed over to the other party. A financial system built solely around these modes of financing can hardly claim superiority over an interest-based system on grounds of equity, efficiency, stability, and growth. (Siddiqi, 1983, p. 52).

There is general agreement that *murābaḥah* and leasing are permissible modes of financing if practiced according to the rules determined by Islamic jurists. They also have some desirable features such as simplicity, convenience, and safety. Furthermore, if these modes are used properly, then some risk sharing *is* involved. The fact that these risks are insurable should not be an issue as long as the insurance instrument used is itself permissible. However, it is important to ensure that the cost of insurance is borne by the owner of the 'asset'.

While it is desirable that Islamic banks gradually increase the proportion of profit sharing modes in their asset portfolios, banks, given their current asset and liability structures cannot afford to increase their risk exposure largely. It may lead to bank failures creating a bad impression about Islamic banking. For increasing the proportion of investment based on sharing, there are other financial institutions in the economy. It is desirable to promote those institutions. That will automatically increase the proportion of sharing modes in the economy.

One of these institutions is the stock market. Saraç and Ülev (2017) argue that in the composition of the Islamic financial sector, Islamic banking is dominant. One of the results of that dominance is that the rates of return in conventional and Islamic finance have become very close to each other. The investment account returns of Islamic banks depend heavily on interest rates. As compared to this, Islamic stock markets are based on profit and loss sharing and are not directly dependent on interest rates. Using daily data of Participation 30 index returns in Borsa İstanbul (BIST) and interest rates on indicative bonds in Turkey for the 2011-2015 period, they investigate the relationship between the Islamic stock index and indicative interest rates. They also include the BIST 100 index in the model, as a control variable. The results of Maki cointegration test show that Participation 30 index is not cointegrated with interest rates, while the general index of Borsa İstanbul is significantly cointegrated with interest rates. Toda Yamamoto test based on Granger causality analysis shows that no causal relationship exists between interest rates and the Participation 30 Index, while the general index of Borsa İstanbul *is* influenced by interest rates.

The paper is a good case study providing evidence that the returns on Islamic stock investments are not dependent on interest rates. Their results also prove that the Sharīʿah-compliant firms are less sensitive to interest rates due to their financial structure in which the interest-bearing assets and sources are quite limited. The important message that emerges from this paper is that the best way to increase the proportion of profit sharing in the economy is to increase the proportion of stock investments in the Islamic finance market. The statement of Nejatullah Siddiqi quoted above that, "we cannot claim, for an interest-free alternative not based on sharing, the superiority which could be claimed on the basis of profit-sharing" definitely carries weight. However, the task of using risk/reward-sharing investments should not be the sole (even major) responsibility of the Islamic banking sector.

3.2 Perceptions about IE&F and the Reasons for that

The general perception about the practice of Islamic finance is that it has gradually deteriorated into only a change in name. The practice of Islamic banking is such that the ordinary investors can hardly distinguish between the 'so-called' Islamic products and their conventional counterparts. Skeptics have labeled them "old wine in new bottles". While there is some truth in this criticism, the fact of the matter is that *theoretically* there *are* visible differences between the two types of products. However, when it comes to *practice*, there are indeed several lapses. There are numerous examples of clear divergence between theory and practice. We quote here only the most serious ones:

(a) Genuine versus Synthetic *Murābaḥah*

As a mode of finance, *bayʿ al-murābaḥah* (commonly stated as *murābaḥah* simply) necessarily involves credit. It works as follows. A client orders an Islamic bank to purchase for him a certain commodity at a specific cash price, promising to purchase such commodity from the bank once it has been bought, but at a deferred price, which includes an agreed upon profit margin called markup in favor of the bank. Ideally, the bank should buy the commodity directly from the supplier, but in practice, for buying the commodity from the supplier, the bank appoints the client as its agent. Once he notifies the bank that he has done so, the bank makes the payment to the supplier. The client takes possession of the commodity on behalf of the bank. At that point, the bank becomes the owner of the commodity. It then sells it to the client at the agreed credit price through an offer and acceptance which are necessary features of every trade contract. Usually, the client makes the payments to the bank in installments.

In practice, one or more of the following necessary conditions of a "genuine *murābaḥah*" contract set by the jurists 'may be' violated. If so, the contract becomes a 'pseudo' or 'synthetic' *murābaḥah* which is not permissible.

(i) In *murābaḥah*, being a sale transaction, it is essential that the commodities which are the subject of sale must be existing, owned by the seller and in his physical or constructive possession. Hence, it is not permitted for the bank to conclude a *murābaḥah* sale with the client before concluding the purchase from the supplier and before actual or constructive possession of the item. Physical or constructive possession implies that the item must move from the risk of the supplier to the risk of the bank.

In practice, the commodity is 'purchased', and the so-called 'constructive possession' is taken only by signing some papers. The commodity is neither purchased nor moved to the godowns of the bank or its agent.

(ii) The customer's promise to purchase is not an integral part of the *murābaḥah* transaction (it is a non-binding promise). It is intended only to provide assurance that the customer will complete the transaction after the item has been acquired by the bank. If the institution has other opportunities to sell the item, then it may not need such a promise.

In practice, the promise to buy is made binding. While any damage to the bank arising from a breach by the customer of his promise may be claimed, making the promise absolutely binding is controversial.

(iii) A bilateral promise between the customer and the institution is permissible only if there is an option to cancel the promise which may be exercised by either one or both of the parties.

In practice, parties may be bound, and the promises are considered as being a contract. "The third party" is "the letterhead" of a company, which may or may not exist.

(iv) *Murābaḥah*, like any other sale, requires an offer and acceptance which will include certainty of price, place of delivery, and date on which the price, if deferred, will be paid. In this regard, a mere quotation by the supplier is not to be considered enough. In both sales, the one between the bank and the supplier and the one between the bank and the client, there must be offer and acceptance of the sales contract on clearly specified conditions.

In practice, the price plus markup is agreed between the orderer of purchase and the bank. The rest is only paperwork.

(v) In the contract of sale between the bank and the client, the cost of the item to the bank and its markup should both be clearly specified as part of the total price. It is not permitted under any circumstances to subject the determination of the price or the markup to variations that are determinable in future, such as making the markup dependent on the rate of the likes of LIBOR that will prevail in future.

This is also done by some banks.

(vi) Once the sale of the item takes place between the bank and the client, it is not permissible to withhold the transfer of the ownership of the item to the client.

When it is only a fake sale, the bank postpones the registration of the assets in the customer's name as a guarantee of the full payment of the selling price and receives an authority letter from the customer to sell the asset in case the customer delays payment. All these arrangements are against the spirit of a sales contract.

(b) Individual versus Organized *Tawarruq*

Tawarruq literally means obtaining cash against something. If done bilaterally, this is an acceptable contractual arrangement which can take more than one forms. One way of obtaining cash when someone is in need of that may work like this. Suppose A asks B for a loan. B says that I do not have any cash, but I can lend you a hundred grams of gold. A takes that loan in kind, sells it in the market, and gets cash that he needed, to begin with. At the time of repayment, A goes to the market buys a hundred grams of gold of the same quality and returns it to B. This is a case of *qarḍ ḥasan* in kind that obtains cash for A. It is an acceptable contractual arrangement that fulfills the need for cash at present. Alternatively, A may sell B a commodity on credit using *bayʿ al-murābaḥah*, i.e., cash plus a markup. B can sell that commodity in the market (or to a third party, C) for cash. Usually, the cash price will be lower than the credit price that he has to pay to A, but his need of cash is fulfilled. There is a risk in the second alternative that A may not be able to sell the commodity immediately. Hence, usually only fast-selling commodities will be chosen as the subject of the first sale contract. Let us call it "Two-Tier Tawwaruq" for later comparison. This kind of *tawwaruq* has been discussed in classical *fiqh* and has been declared permissible by a vast majority of *fuqahā'* and the two most important contemporary *fiqh* academies; the Makkah-based *fiqh* academy under the aegis of Rabita al-Alam al-Islami and the Jeddah-based International Fiqh Academy[1]. The important elements in these two transactions are that:

1. They are done independently.
2. They are not pre-planned.
3. The first buyer does not sell it back to the original seller.

In recent years, use of *tawarruq* as a financial instrument has become pervasive. It is being used by some banks, both conventional and Islamic, in the following manner. Say, Zaid goes to the bank for obtaining cash on loan. The bank fulfills his need using a series of steps one after another, without him leaving the bank. (i) The bank buys, at a credit price, on his behalf some commodities on paper. (ii) In order to do that Zaid signs a *wakālah* contract appointing the bank as his agent for this purchase. (iii) The bank certifies that it has done so at, say a credit price of $1.0 million due to be paid after three months. (iv) Zaid undertakes to make this payment to the bank. By that undertaking, Zaid

(1) Previously (and more commonly) known as the "OIC Fiqh Academy". Both of these academies are engaged in "collective *ijtihād*" and their *fatāwá* are well-respected in the academia.

becomes the owner of these commodities. (v) He now signs another *wakālah* contract, this time appointing the bank as his agent to sell those commodities. (vi) The bank certifies that it has done so at a cash price of $900,000 and pays this amount to Zaid. All of these transactions are only on paper. It can easily be seen that it is money obtained now ($900,000) for more money to be paid later ($1.0 million). The real asset involved in the process is no more than a dummy. A single piece of real asset can form the basis of innumerable successive *tawarruq* deals. This is called "Pre-arranged or Organized *Tawwaruq*". While the first type (Two-Tier Bilateral *Tawwaruq*) is permissible by Sharīʿah scholars/ academies, the second is not. The two most important *fiqh* academies; the Rabita al-Alam al-Islami Fiqh Academy (Makkah) and the International Fiqh Academy (Jeddah), both having representative *fuqahā'* from almost all schools of thought have given *fatāwá* against organized *tawarruq*.

(c) Buy-Back Arrangements in *Ṣukūk*

In recent years, *ṣukūk* have mushroomed both in the corporate and government sectors. Te generic term *ṣukūk* refers to financial instruments meant to mobilize resources from the market based on the strength of one's balance sheet, credentials, track record, goodwill and prospects of the proposed project. They are *not* Islamic bonds. Rather, they attempt to provide an alternative to conventional bonds. Financial engineers have come up with fancy, often confusing, names for various types of *ṣukūk* where 'engineering' is more in names than in substance. The basic ideas are quite simple. Basically *ṣukūk* are certificates based on ownership of certain assets (or their usufruct). Generally, these certificates are negotiable in secondary markets. They represent 'ownership' of the assets (or usufruct) underlying the issue. Those with variable returns are based on *muḍārabah* or *mushārakah*. More popular are those with pre-determined, fixed incomes like the one based on *ijārah* (lease). There are also *ṣukūk* based on *salam* or *istiṣnāʿ* contracts. There are also hybrid issues whose underlying assets are mixtures of these. *Murābaḥah* receivables being debt obligations are not considered fit for *ṣukūk* issues. But they have been accepted in such a basket of assets as long as they are less than 50% of the asset-basket being securitized[2]. Due to this last point, while *ṣukūk* offer a potentially useful mechanism for secondary market resource mobilization, they can also be used as a roundabout way for the sale of debt receivables (as minority share in a general *ṣukūk* issue). Since the sale of debt except at its face value is not generally acceptable by scholars, the use of *ṣukūk* where debt receivables are a *noticeable* proportion, still remain suspect from a Sharīʿah point of view.

Sukūk issuance got a jolt when in November 2007 Taqi Usmani, the then chairman of the Sharīʿah Board of AAOIFI, circulated a working paper[3] for consideration of AAOIFI's Sharīʿah Council. In that paper he stated that *muḍārabah* and the *mushārakah ṣukūk* were in breach of the principles of Sharīʿah because they provide the issuer with a purchase undertaking to buy back the underlying assets from the issuer at face value on the expiry date of the *Sukuk* or in the event of a default. While that paper was to be discussed the meeting of the Sharīʿah Council of AAOIFI, in an interview with the media he remarked that "85 per cent of existing *ṣukūk* issues would fall foul of basic Sharīʿah principles"[4].

Furthermore, in the practice of Islamic banking, a commonly used trickery is to structure a product by combining more than one contracts; each one of which taken independently is permissible. However, the end result of the combined contracts is to (a) produce a guaranteed financial rate of return for the investor (b) and/or reducing the financiers' risk to zero from the outset of the transaction.

To conclude the discourse on user perceptions about Islamic finance, Islamic finance *does* have a crisis of confidence. Though exact statistics are not available, according to rough estimates made by this author, *murābaḥah*, *tawarruq* and *ṣukūk*, account for more than 80% of the Islamic financial industry and all three have serious Sharīʿah-compliance issues as explained above.

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(2) This is based on the Sharīʿah maxim, "For the majority (part), the rule of total is applicable".

(3) Usmani, Muhammad Taqi (2007).

(4) Please see, http://www.arabianbusiness.com/most-sukuk-not-islamic-body-claims-197156.html.

When a customer sees Islamic banks charging a fixed markup, he concludes that it is only a change in name. Unfortunately, the way Islamic banks do the paperwork, confirms those doubts. His doubts become more like a belief when he observes that the markup rate is almost the same as the rate of interest on conventional loans. The most important reason for the closeness of markup and leasing rates with the interest rate is that Islamic banks use the likes of LIBOR as a benchmark for determining the mark-up rate in *bayʿ al-murābaḥah* and net return in leasing. While there is no objection from the Sharīʿah point of view in using *any* rate *only* as information for benchmarking, the practical implication of depending on these benchmarks (i.e., making markup rate very close to the market rate of interest) creates doubts about the "genuineness" of any product being Islamic. Thus, it is a serious factor in creating the wrong perceptions about Islamic financial products.

In their paper, Tekin et al. (2017) analyze the relationship between conventional deposit rates and profit share rates of participation banks (Islamic banks) in Turkey by employing both static modeling tools including ARDL, FMOLS and DOLS models and dynamic modeling tools including DCC-GARCH models using monthly data from Turkey covering the 1998-2016 period. They found that conventional deposit rates significantly affect the 'so-called profit share' rates offered by Islamic banks and the dynamic correlation between conventional deposit rates and these profit share rates are generally stable around 0.9 when the markets are not disturbed by shocks or crises. This empirical study, first of its kind, confirms that in practice, the rates of return for the fixed return modes used by Islamic banks are very close to interest rates on loans in conventional banking. Therefore, customers do not see any difference between the two.

Another factor that creates doubts about the genuineness of Islamic banking in the minds of customers is non-Sharīʿah compliance since many practices of Islamic banks violate Sharīʿah rules. In their paper, Ashraf and Lahsasna (2017) rightly point out that customers interested in Islamic banking continue to question whether the bank they wish to do business with is practically implementing Sharīʿah rules and guidelines despite being registered as an Islamic bank and having a *fatwá* from the competent authority (their Sharīʿah Board).

The "Islamicity" of Islamic financial products become tainted by Sharīʿah-incompatible practices. The literature on Islamic finance has discussed many such practices, but the paper of Ashraf and Lahsasna (2017) adds value in this area. They highlight the unsuitability of the major rating models such as Fitch, Moody's and S&P for Islamic banks since they do not take the Sharīʿah-compliance into consideration. They also point out shortcomings of the one proposed by the International Islamic Rating Agency (IIRA) to measure the non-Sharīʿah compliance of Islamic financial institutions. Then they propose a model of their own for Sharīʿah Compliance Rating for Islamic banks. The paper proposes a set of 14 rating factors to measure the risk of Sharīʿah non-compliance at an Islamic bank. Weights for these factors have also been proposed. These factors are then used as an input to develop their Sharīʿah Risk Rating Model. The 14 factors are:

1. Legal Support.
2. Central Bank Support.
3. Independence of Sharīʿah Supervisory Function.
4. Opinion of the Sharīʿah Supervisory Committee/ Advisor.
5. Legal Identity of Islamic Banking Business.
6. Numbers of Years in Islamic /Sharīʿah-compliant business.
7. Compliance with AAOIFI and IFSB Standards.
8. Profit Equalization Reserve.
9. Charity Fund.
10. Equity Based Products (*mushārakah*, *muḍārabah*, and *ijarah*-based assets).
11. Width of Asset Products.
12. Debt-based Products (*murābaḥah* and *tawarruq* as percentage of total financing).
13. Structure of Deposit.
14. IFSB Capital Asset Ratio (CAR).

This is a unique attempt that needs to be examined seriously. The appropriateness of the 14 proposed factors and the corresponding weights may be the subject of further research. However, Sharīʿah-compliance being the wherewithal of Islamic finance, the effort is a welcome addition to the literature.

Doubts about Sharīʿah-compliance in the minds of Islamic banking customers get strengthened due to the involvement of some mega multinational banks such as Citibank; HSBC, Deutsche Bank etc.; the attempts by UK and Hong Kong to make their capitals a hub for Islamic finance and the floating of Islamic financial products by Germany, Luxembourg, China, Philippine Russia, etc. This is seen by some as a proof of the viability of Islamic financial products, while others consider it a sinister attempt to attract the trillions of petrodollars unleashed by oil booms of 1970-80 and the post-Iraq war era. If the Islamic financial institutions cannot get their act together, how can the common man expect the multinational banks and secular governments to serve the real cause of Islamic finance? A top officeial of one of the international bodies which sets standards for the industry when asked about the participation of Western banks, replied: "That's a tough question -- there *is* a Sharīʿah-compliance issue" [emphasis added] (Anjuli Davies: Reuters, 23-2-2012).

3.3 The Role of Finance in Poverty Alleviation and Reducing Income Inequalities

It is generally agreed that the use of the rate of interest as the mechanism for allocating financial resources aggravates income inequalities. It favors collateral-possessing borrowers (who are generally in the upper income groups) as against productivity of the project since the major consideration of the banks is getting a fixed return with collateral guaranteeing return of the principle, except in exceptional circumstances. As against this, the distribution of credit in an Islamic banking system is more equitable than an interest-based economy (Iqbal and Molyneux, 2005, p. 32). The reason being that in the case of profit sharing, banks are more interested in the results of the project. Of course, they are concerned with the safety of the capital itself but in an interest based system the safety of the capital is the sole criteria. Because, rate of interest is guaranteed, a bank's main concern is that they get their principal as well as the interest back. In a profit sharing arrangement, the banks as well as the entrepreneurs will try to maximize their profit. So their interests are common. They are working for the same objective, that is, getting a better return which they will share. Even if a person's credibility may be low, if the potential of the project is high, the banks may be willing to finance that project because they will obtain a better return on their investment. Therefore, smaller savers and entrepreneurs who belong to lower and middle class portions of the population get a better opportunity of obtaining finance from the banks as the criteria to lend is based on the profit prospects of the investment project and not solely on the creditworthiness of the borrower. In an interest based system, typically most of the funds flow to large industries, multinational corporations and big industrialists. Small savers and middle class small entrepreneurs do not get sufficient finances even for their very good projects. This is not only a theoretical argument; it is an empirical fact. The distribution of credit in an interest-based system is skewed in favor of the wealthy and big industrialists whereas in a profit-sharing system, bank finances will be more equitably distributed.

In recent years, "financial inclusion" (making credit to reach the lower income groups) has become an important policy in a number of countries. Zulkhibri and Ghazal (2017) examine the links between financial inclusion, institutions, and governance using panel data analysis from Muslim and developing countries and argue that in this respect corporate governance plays an important role. The governance structures and the distribution of credit have also been subjects of discussion in the IE&F literature. As pointed out by Chapra and Habib (2002, p.14), corporate governance issue is important even in the conventional financial system. It is, however, of even greater importance in the Islamic system because of the additional risk to which the depositors get exposed as a result of risk-sharing. One of the most important objectives is the resolution of the principal/agent conflict of interest with a view to promoting the interests of all stakeholders as well as the soundness and stability of the financial system. The most important mechanisms for this purpose are the Board of Directors, senior management, shareholders, and depositors.

Due to asymmetric information which leads to moral hazard and adverse selection problems whenever principle/agent relationship is involved, the Board of Directors and senior management (who are generally different than the "owners"), problems

of insider trading, corruption and inappropriate use of resources such as perks for the top management of corporations crop up. Another bad effect is a misallocation of credit. The distribution of credit tends to concentrate in the hands of higher income groups because they have more collateral to get loans and generally have a better credit rating. Financial inclusion is important even in conventional finance, but it is more important in Islamic finance. Entrepreneurs with good projects should get credit because in Islamic finance productivity of a project becomes the primary consideration as the banks have to "share" in the profits rather than getting a fixed return. Credit-worthiness becomes secondary. This is exactly the opposite for the conventional banking institutions.

Zulkhibri and Ghazal (2017) use data of more than 100,000 individuals' characteristics in the Global Findex database. They find that strong economic governance and institutions are important elements in improving financial inclusion especially for the poor segments of the society. Markets, economic activity, and transactions cannot function well in the absence of good governance. This is another case study included in the Special Issue that provides empirical evidence for the theoretical claims made by academicians and hence, is a welcome addition to the literature.

The results of this paper suggest that governance positively influences financial inclusion by increasing the number of bank accounts and saving in formal financial institutions, but impacts negatively on the borrowing behavior. Financial inclusion (providing finance to lower income individuals) has important implications for reducing poverty and income inequalities; objectives that are important in Islamic economics. The study suggests that removing corruption, increasing transparent legal framework, fair judicial proceedings and administration are essential for development and raising financial inclusiveness prospects.

3.4 Role of Values and Institutions in IE&F

There is a long-standing discussion in economics on the role of values. From the very beginning, scholars have been arguing that the distinguishing feature of the Islamic economics paradigm is that it is clearly based on values (Zarqa, 1980, pp. 4-8). As compared to this, conventional economists "claimed" to be neutral with respect to values. In recent years, even the conventional economists have realized that the so-called "positivism" is more myth than reality. Munawar Iqbal (2014) summarizes the issue as follows:

> The main emphasis in conventional economics was on the claim that it is value-free (the so-called positivism). Conventional economists faked that but did not believe in it. Conventional economics has never been value-free. Many conventional economists themselves have shown that better than us. Since Lionel Robbins (Robbins, 1935), conventional economists have been following the dogma that economics is a 'positive' science. Logical positivism and Weber's idea that social science must be value-free strongly influenced the development of economic methodology in the early 20th century. In more recent times, several economists showed the flaws in this methodology. Most prominent among these are Quine (1953) and Putnam (2002) who show how aesthetic and epistemic values of elegance, simplicity, coherence, power, etc., are inevitably involved in the selection of scientific theories (Iqbal, 2014, p. 267).

Emerging Paradigms in Economics

The orthodox economics is being strongly criticized from within conventional economics. A number of new approaches have gained prominence under the common banner of "heterodox economics". The most prominent among these is "institutional economics". The paper of Necati in this Issue (Necati, 2017) makes an important contribution by linking the role of institutions and values found in the Golden Ages of the Muslim world and how they moved to the West. It then presents new institutional economics as an effective tool to understand long-term development. The paper adds a new layer to institutional economics literature by addressing the importance of hidden internalized institutional values. He identifies 10 such values which are: liberty, critical thinking, justice, rule of law, equality, participatory culture, accountability, competence, punctuality, and plurality, in explain-ing the socio-economic success of the West and failure of the Muslim world over the last few centuries. The paper suggests some developmental policy recommendations for Muslim countries based on these internalized institutional values.

At a more disaggregated level (micro), Furqani (2017) examines consumer behavior in an Islamic economy. He asserts that the Islamic economic agents are expected to adopt the Islamic morality principles in their actual consumption. He lists four principles of consumption (permissibility, responsibility, balance and priority) for an Islamic consumer. While concentrating upon consumer behavior in an Islamic framework, he also touches upon the role of values in Islamic economics in general. His categorization of wants into *ḍarūriyyāt*, *ḥājiyyāt* and *taḥsīniyyāt* is not new but draws the attention to the fact that in Islamic economics consumer is not "sovereign" as "orthodox economics" claimed. The orientation of the paper is normative with the aim of conceptualizing moral principles in economic behavior which are discussed using consumer behavior as a specific case. He rightly states that the goal of consumption in an Islamic framework is not *only* to gain the satisfaction of personal wants *per se*. The goal instead is to direct the consumption towards achieving individual as well as social wellbeing and the higher purpose of achieving Allah's pleasure.

4. Conclusion

The International series of conferences in Islamic economics and finance that started in 1976 has played an important role in promoting both the theory and practice of Islamic economics and finance. Over time, these Conferences became more and more well-attended. The number of contributors also increased. An important aspect of these Conferences is that their major objective throughout has been the promotion of the discipline and the industry. Among other contributions, the publication of selected papers either by renowned international publishers such as Edward Elgar, Palgrave Macmillan, and the Islamic Foundation, or in other forms, has made a very useful contribution to the literature in this field. The decision to publish selected papers from the Eleventh Conference in four major journals in the field of Islamic economics and finance, including the Scopus-listed Journal of King Abdulaziz University: Islamic Economics is a welcome step. It is hoped that this will lead to further research, both by scholars and graduate students[(5)].

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