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Islamic Perspectives on Wealth Creation

Edited by MUNAWAR IQBAL and RODNEY WILSON (Edinburgh: Edinburgh University Press, 2005), ix, 294 pp. (HB, price not given.) ISBN 0–748–62100–8.

This book is a valuable contribution to the literature on Islamic economics and finance. Dr. Munawar Iqbal is Senior Economist at the Islamic Research and Training Institute of the Islamic Development Bank, Jeddah; Prof. Rodney Wilson is Professor of Economics at the University of Durham. Both the editors are well-known in this field for their seminal contributions.

Wealth is a key factor in determining a society's material well-being and its power and influence in the present-day global economy. Preservation and development of wealth is considered by *Sharīʿah* scholars to be one of the five most important objectives of the *Sharīʿah*. Ibn Khaldūn (d. 1406) included wealth among the six factors that determine the rise and fall of a society. A society that fails to create enough wealth for its members may be unable to satisfy their basic needs or even to defend them against aggression, and may ultimately become marginalized in international geopolitics. Wealth creation is, therefore, of particular interest for Muslim societies which, having played an important role in the world economy until about the fifteenth century, have now become marginalized. One of the primary reasons for this is their economic backwardness. Given this crucial importance of wealth, the title of the book under review would lead one to expect an exposition of the most crucial elements of wealth creation from an Islamic perspective. However, the book does not do this. It is concerned with only the financial aspects of wealth creation.

The finance that is needed for investment and wealth creation in any economy can become available either through equity or debt. Since debt involves interest which has been condemned by four of the world's major religions (Hinduism, Judaism, Christianity and Islam) with a combined following of over two-thirds of the world's population, Muslims are trying to establish an alternative system where equity would play a greater role. It is, however, not possible to do without debt and they do not, therefore, envisage elimination of debt. Debt would continue to exist but would not be created by sheer lending and borrowing operations. It would rather arise through the sale or lease of real assets, in which case the financiers' return would, like profit, become a part of the price, and the rise in debt would not fall out of line with the growth of the real economy.

The papers included in this book were presented at an International Seminar on 'Islamic Perspectives on Wealth Creation' held at Durham University in July 2003 under the sponsorship of the Islamic Research and Training Institute of the Islamic Development Bank, Jeddah. Fourteen of the thirty papers presented have been included in this book, divided into five parts, each covering a number of key areas of Islamic finance. The papers draw on a wide range of country experiences from Malaysia to Iran, Egypt and Sudan, as well as some Western countries. The editors' 'Introduction' provides a synopsis of the Seminar.

The first part ('Whither Islamic Banking') has two papers by Professors Zubair Hasan and Abdel-Rahman Yousri Ahmad. Both commend the rise of debt-creating modes of *murābaḥa*, *ijāra*, *salām* and *istiṣnā* as a healthy development because the equity modes of *mudāraba* and *mushāraka* could not by themselves have met all the challenges of wealth creation in Muslim countries. Nevertheless, they are both critical of the excessive use of debt-creating modes by Islamic banks. Hasan argues that this practice will not only direct the meagre financial resources of the community into consumption channels, it will also lead to interest-taking by the back door (p. 21). Yousri Ahmad also emphasizes the need for greater involvement by Islamic banks in participatory finance and innovation in financing contracts.

Part II, on Islamic retail banking issues, has three papers. 'Wealth Mobilisation by Islamic Banks: The Malaysian Case' by Sudin Haron and Badrul Hisham Kamaruddin argues that Islamic banks are expected to fulfill their socio-economic responsibilities because 'there is much more to Islamic banking than the elimination of *riba*' (p. 67). The authors try to evaluate the performance of the two fully Islamic banks in Malaysia against this criterion. Their finding is that, while both banks have been trying to meet these responsibilities, 'their efforts have been modest and fall short of the level required' (p. 67). They conclude that, even though pursuing socio-economic objectives is necessary, it is rather difficult in an environment where Islamic banks must compete with conventional banks that generally have no such responsibility. They further conclude that it would be hazardous for these banks to commit deposit funds to long-term projects involved in *muḍāraba* and *mushāraka* modes of financing (p. 68). The second paper, by Abdulqawi Othman and Lynn Owen, on 'Managing and Measuring Customer Service Quality in Islamic Banks: A Study of the Kuwait Finance House', suggests a new model called CARTER (compliance, assurance, reliability, tangibles, empathy and responsiveness) for the measurement of service quality in respect of 34 items. The third paper (Nezamuddin Makiyan on 'The Lending Policies of Islamic Banks in Iran') finds that the rate of return on loans is insignificant because the banking system is nationalized and the banks are required to grant low-cost loans. To improve the efficiency of the financial system, the author suggests a banking system independent of government, establishment of private financial institutions, and development of the existing stock market.

Part III has three papers on the measurement of the efficiency of Islamic banking. In 'Efficiency in

Arabian Banking', Idries al-Jarrah and Philip Molyneux investigate the banking systems of Jordan, Egypt, Saudi Arabia and Bahrain. They use three distinct efficiency concepts (cost, standard profit and alternative profit efficiencies) and a number of different measurement methods. They conclude that, while Islamic banks in these countries are the most cost- and profit-efficient, investment banks are the least efficient. In terms of bank asset size, the larger banks seem to be more cost- and profit-efficient. Geographically, Bahrain is the most cost- and profit-efficient while Jordan is the least so. Kabir Hassan and Abdel-Hameed Bashir conclude in 'Determinants of Islamic Banking Profitability' that Islamic banks' profitability measures respond positively to increases in capital and negatively to loan ratios. Results reveal that a larger equity to total assets ratio leads to greater profit margin. However, Islamic banks' loan portfolio is heavily biased towards short-term trade financing. As such their loans are low risk and contribute only modestly to bank profits. The third paper is by Abd Elrahman Saaid on 'Allocative and Technical Inefficiency in Sudanese Islamic Banks: An Empirical Investigation'. He concludes that the Sudanese Islamic banks in the sample are technically and allocatively inefficient. The main cause of that seems to be over-utilization of physical inputs. They expanded their operations by setting up new branches and thereby diverted capital to unproductive fixed assets in less profitable branches. This may be attributable to economic US/UN sanctions, which made it difficult for them to employ new and better technologies. Another possible factor is favouritism in recruitment practices, which may have led to the employment of less qualified persons.

Part IV has three papers on Islamic mortgages, Islamic insurance (*takāful*), and Optimal Risk Management by Humayon Dar, Mervyn Lewis, and Seif Tag El-Din respectively. Humayon Dar argues that, while the mortgages adopted by Islamic banks do not directly involve interest, an indirect link, nevertheless, gets established because of the use of interest as a benchmark. To get rid of such indirect link, he proposes a 'Shared Appreciation Mortgage' which uses historical house price inflation data instead of benchmarking against interest. Mervyn Lewis' paper compares Islamic cooperative insurance (*takāful*) with conventional insurance, noting the similarities with some of the newer conventional insurance products, and tries to show how *takāful's* wealth creation role could be enhanced. Tag El-Din's paper on 'Optimal Risk Management for Profit-sharing Finance' is also critical, like Zubair Hasan and Yousri Ahmad's paper in Part I, of the greater reliance of Islamic banks on fixed return modes. He complains that 'the real potentials of profit-sharing are far from being reaped', urges a shift from 'conventional banking profits' to 'real trade profits' and calls for a 'more efficient financial structure for *mudarabah*' (pp. 188–9).

Part V of the book has three papers. Karim Eslamloueyan's paper on 'Stock Market Operation and Equity Price Determination in an Economy with an Interest-Free Banking System: The Case of Iran' concludes that, in spite of the prevalence of non-interest banking in Iran along with restrictions on capital mobility, the Tehran stock market has survived. However, domestic and international interest rate differentials and the exchange rate are not important determinants of stock prices on the Tehran Stock Exchange. It is rather the production level of large manufacturing companies which directly affects stock price levels. Eslamloueyan also finds a negative relationship between the rise of stock prices on the Tehran Stock Exchange and the ratio of home to foreign goods' price levels. Mohamed Nasr's paper is on 'The Demand for *Musharakah* in Urban Egypt by Small Business as a Test of the Pecking Order Hypothesis' (POH). He argues that Islamic finance has so far been studied primarily from the supply side and, consequently, asymmetric information, agency problems and moral hazard have been given as reasons for the lack of use of equity finance by Islamic banks. He moves away from this and looks at the demand side. He finds that the small business owners' desire for independence is another reason for less resort to equity and more reliance on debt. This behaviour, he argues, is consistent with the POH. He concludes that demand for Islamic modes of financing 'will only blossom when demand actually rises' (p. 226). This will happen when a majority of Muslims become aware of their financial obligations under Islam. Saqib Rashid's paper is on 'Islamic Finance and Venture Capital: A Practical Approach'. He argues in favour of promoting venture capital 'not only for the further evolution of the Islamic finance industry but also for the long-term health of ailing economies in the Muslim World' (p. 229).

One important area missing in the book is the recent *sukuk* (asset-based Islamic bonds). These are playing a crucial role in wealth creation by enabling governments and corporations to raise large amounts of finance. The *sukuk* are based primarily on the *ijāra* mode and are making it possible to convert lease assets into *Sharīʿah*-compatible financial assets. As a result, they have the advantage of being tradable in the financial market as compared with some of the other modes discussed in the book. A paper on the *sukuk* would, thus, have been very illuminating for the readers. In the absence of such a paper, the 'Introduction' could have tried to briefly fill the gap. Nevertheless, this valuable collection of papers will be well worthwhile for readers wishing to advance their understanding of the role of Islamic finance in wealth creation. The editors are to be congratulated for putting them together in a book.

M. Umer Chapra

Jeddah

E-mail: muchapra@isdb.org

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