Islamic Finance in Global Economic System

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Abstract

We explain in this research on the Islamic finance system and its development over the past three decades. The foundation of the Islamic finance system in the global economic system. With the mention of models of financial and banking institutions used the Islamic finance system. Where the size of Islamic financing assets amounted to two trillion dollars. The research mentioned examples of Islamic finance in some economic sectors including housing, auto finance and air transport.

Keywords: Islamic finance, economic system, Islamic Banks

Introduction

Islamic finance is growing within international finance. In its modern form, Islamic banking started with pioneering experiments in the early 1960s in Egypt. The Mit-Ghamr Islamic Saving Associations (MGISA) mobilized the savings of Muslim investors, providing them with returns that did not transgress the laws of the Shari'ah. The MGISA attracted a flurry of deposits, which grew at the rate of more than 100 percent per year in the first three years of operations. Later, the Pilgrims Fund Corporation (PFC) enabled Malaysian Muslims to save gradually and invest in Shari'ah-compliant instruments, with the purpose of supporting their expenditures during the Hajj period (pilgrimage). In 2012, the PFC had eight million account holders and deposits of more than $12 billion. Formally, Islamic banking started in the late 1970s with a handful of institutions and negligible amounts, but it has increasingly grown over the past two decades, with total assets reaching about $2 trillion at end-2014.

The establishment of the Islamic Development Bank (IsDB) in 1975 was a watershed moment for Islamic banking, coming just after the establishment of the first major Islamic commercial bank—the Dubai Islamic Bank—in the United Arab Emirates. The success of the latter led to the establishment of a series of similar banks, including Faisal Islamic Bank (Sudan) and Kuwait Finance House (Kuwait)—both in 1977. As early as the late 1970s, steps were taken in Pakistan for making the financial system compliant with Shari'ah principles. The legal framework was then amended in 1980 to allow for the operation of Shari'ahcompliant profit-sharing financing companies, and to initiate bank finance through Islamic instruments. Similarly, Iran enacted a new banking law in August 1983 to replace conventional banking with interest-free banking. The law gave banks a window of three years for their operations to become compliant with Islamic principles. Sudan's efforts to align its entire banking system with Shari'ah principles began in 1984.

The financial infrastructure, including standards setting and regulatory institutions, has also been catching up with the rapid growth of Islamic financing. International standard-setting institutions were established to guide the operations of the industry around the world, Although standardization of Islamic products across different countries remains a challenge. Since 1991,the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), based in Bahrain, has been issuing accounting, auditing, and Shari'ah standards for financial reporting at Islamic financial institution

The Islamic Banking and Finance is supported by a detailed, easy to use Instructor Manual, powerful Test Bank Generator and dynamic PowerPoint Slides. It's all part of the Pearson service. This introductory text provides students with a conceptual framework for understanding the key concepts, theories and principles associated with Islamic banking and finance. Important elements of the discipline are explained over ten chapters, providing students with a thorough understanding of the central products and services the Islamic banking and finance industry offers. Current issues and concerns pertinent to Islamic banking and finance are also considered, giving readers insight into the possible future directions of this rapidly growing industry. Students are encouraged to connect with the subject matter through the inclusion of case studies and practice problems based on current industry trends and practices. With an emphasis on engaging readers through the use of relevant and applicable material and activities, this book gives students an excellent grounding in Islamic banking and finance.

Research Questions

This research is guided by the following questions:

1- Reasons for the emergence of Islamic finance
2- Factors affecting the emergence of Islamic finance
3- The differences created by Islamic finance in many financing sectors

Significance of the Study

The current study is significant for the following reasons:

1- Concerns Many people are turning to Islamic finance rather than other banks
2- To clarify the methods of Islamic finance in many sectors of finance
3- Encourage orientation to the Islamic banking sector in the global economic system

4- Statement of main building blocks for enhancing the stability of the Islamic financial system

Brief Modern History of Islamic Finance

- Interest in reviving a banking and financial system started in early 1900s.
- 1950 s – Appearance of early writings about problems of conventional economic systems and how Islam's principles of economics offer an alternative.
- 1960 s – End of colonialism and independence of countries
- 1970 s – Oil revenues (Petro-$) create demand for banking without interest. 1st Islamic bank in Dubai is established.
- 1980 s – Growth of commercial banking
- 1990 s – Emergence of Islamic funds and investment banking
- 2000 s – Capital markets and Globalization

Islamic Financial Institutions and Their Role

Islamic financial institutions are distinguished by their keeping away from lending or borrowing on interest. An Islamic bank accepts investment deposits on a profit sharing basis. It supplies some of these funds to businessmen on a profit sharing basis. But currently other modes of finance permitted by Shariah are in greater use so that these banks can earn profits for their shareholders and depositors. Islamic investment companies operate like mutual funds.

They invest clients' monies in common stock or use them to earn profits through Islamic modes of finance as Islamic banks are doing.

Broadly speaking, there are two ways in which Islamic banks and other Islamic financial institutions can mobilize private savings for public sector projects related to infrastructure.

The first way is based on profit sharing and can be applied to projects capable of yielding measurable monetary returns e.g.in the form of a toll tax for using a highway or motor vehicles licensing fees for using roads in general, etc. Funds mobilized in this framework can be rewarded by a percentage share of the actual returns.

Secondly, funds can be mobilized by selling at a higher than cost price services / benefits of certain infrastructures which are 'purchased' on deferred payment from the private sector which builds them for the government in expectation of good returns on their investments. Thus an airport can be built by a private company, local or foreign, and sold or rented to the government which pays the installments due out of money collected as airport tax and landing fees etc.It may be noted that whereas the returns to the investor in the first mentioned way is variable it is predetermined in the second case. Islamic economists have devised certain financial instruments under both frameworks reported above. We proceed to describe them.For many banks and customers in the Middle East and Islamic world, the availability and the ability to apply Islamic Shariah rules on financial activities is very important. In some cases, business and technical barriers can limit the ability to apply and offer financial services that are implemented according to Shariah rules. In this point, we discuss enforcing Shariah rules from information technology viewpoint and show how such rules can be implemented and enforced in a financial establishment. Security authorization standard XACML is extended to consider Shariah rules. In this research XACML architecture, that is used and applied in many tools and system architectures, is used to enforce Shariah rules in the banking sector rather than its original goal of enforcing security rules where policy management systems such as XACML are usually used.

We developed a model based on XACML policy management to show how an Islamic financial information system can be used to make decisions for day to day bank activities. Such a system is required by all Islamic banks around the world. Currently, most Islamic banks use advisory boards to provide opinions on general activities. The gap between those high level general rules and decision for each customer business process is to be filled by Islamic financial information systems.

The flexible design of the architecture can also be effective where rules can be screened and revisited often without the need to restructure the authorization system implemented. Authorization rules described here are not necessarily the perfect reflection of Shariah opinions. They are only shown as a proof of concept and a demonstration of how such rules can be written and implemented.

The main building blocks for enhancing the stability of the Islamic financial system include:

- Developing a robust liquidity infrastructure for facilitating both liquidity risk management at Islamic banks and helping conduct monetary operations and liquidity management by central banks.

- Strengthening the banking supervision and regulation framework with a set of comprehensive, cross-sectoral prudential standards for Shari'ah-compliant institutions and markets, such as capital adequacy and the loss-absorbing feature of unrestricted profit sharing investment account holders, and corporate governance including Shari'ah governance issues.

- Developing a Shari'ah-compliant financial safety net infrastructure, including a SLOLR facility, emergency financing mechanisms, and deposit insurance, to support the soundness and resilience of Islamic financial institutions and the conventional financial services industry in times of distress.

Fundamental concepts for Islamic finance

Before considering the different types of Shariah compliant structures which can be used in financing, it would be useful to first understand some of the basic principles that differentiate Islamic financing from the conventional (i.e. interest bearing) method.

- One of the most important tenets of Islamic finance is the prohibition of "riba", which in simple terms, means "extra" or "excess".

This prohibition against excesses has been interpreted by Islamic scholars to mean a prohibition against the charging or receipt of any interest. As a result, interest is banned in all types of Islamic transactions.

- Islamic banking is also an asset-backed system. Shariah does not recognise the time value of money. Money has no intrinsic value and is simply perceived as a medium of exchange. Under Shariah, it is believed that profits should only be generated as a result of a business activity or when a commodity is traded.
- Another key feature of Islamic finance is the prohibition of gharar (uncertainty and ambiguity) in contacts which makes conventional speculative transactions (such as derivatives, futures and insurance) difficult to reconcile with Shariah.
- There are also certain activities which Shariah deems as haram (forbidden) such as dealing with weapons, gambling, alcohol and pork.

Examples of Islamic finance for some sectors

Islamic finances for Building

Financing infrastructure building: Role of Islamic financial institutions

Infrastructure refers to roads, bridges, railways, water-ways, airways, and other forms of transportation and communications as well as water supplies, electricity and telephone.

It also includes financial institutions and such public services as health and education. More generally it includes all institutional prerequisites of efficient working of competitive markets and expansion in production.

The building up of infrastructure requires huge amounts of capital. The benefits of these huge investments are great but many of them are indirect and all of them accrue gradually over a long period of time. In the developing countries, especially, the private sector either lacks the means to undertake these projects or it is unable to find the (low) returns and (long) time period involved suitable. So the state is called upon to undertake these projects in order to create an environment suitable for growth and development.

It is presumed that government revenue from all sources including politically sustainable levels of taxation falls short of the amounts needed for financing infrastructure. So the issue before us is how to mobilize public's savings for this purpose. In an interest free Islamic economy the question is: how can the Islamic financial institutions help in this regards.

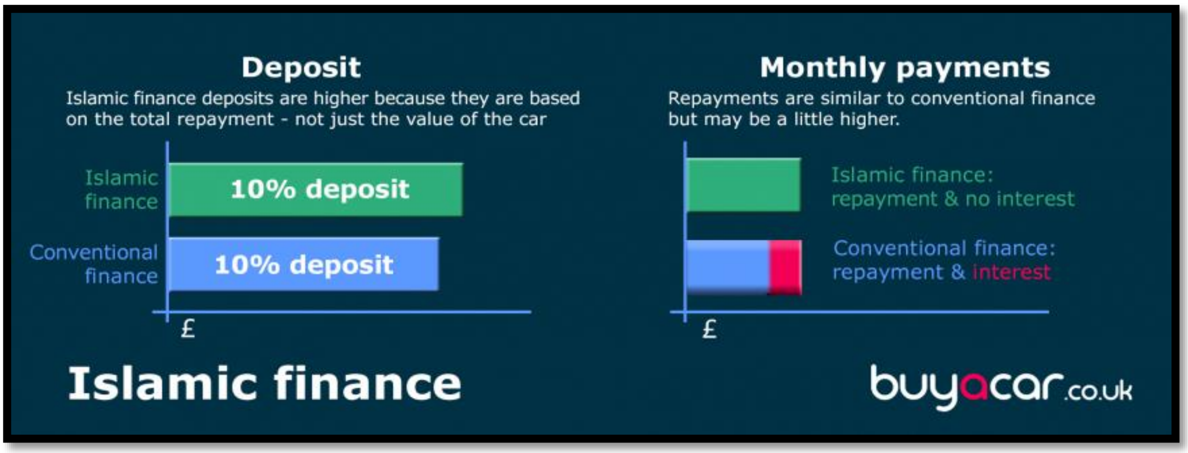
Islamic finances for Car

Islamic car finance lets you spread the cost of your next car without paying interest - also known as Halal car finance .Islamic - or Halal- finance is a way of spreading the cost of a new or used car that's compatible with the faith. It offers access to finance, while adhering to Islamic restrictions on lending with interest and speculating.

This might sound like an excellent way to cut the cost of your car repayments but the amount you borrow is more than the market value of the car, and so it's rarely cheaper than conventional finance. In fact, it can often be more expensive and your deposit is usually larger too.

Islamic finance doesn't offer the same range of options as conventional finance. For example, Personal Contract Purchase (PCP) which offers low monthly payments, and allows you to return the car or buy it at the end, is not available.

How does Islamic car finance work?



It's not possible to apply for an Islamic finance loan with BuyaCar, but you may be able to arrange this separately.

In general, Islamic finance takes the form of a personal loan. The lender buys the vehicle from a seller and then recoups the money by charging monthly instalments over an agreed term. Instead of charging interest, lenders significantly increase the price of the vehicle to absorb the cost of lending. As the price is higher, the deposit required is also larger.

Results:

Through the above can be said that Islamic finance. Secures fair financial transactions. Without financial speculation it could affect the public.

Islamic finance unlike conventional finance, the cost of your monthly repayments under Islamic finance can vary depending on the value you choose and your profile. If you're in a steady job with a good income, then you're likely to be seen as a low-risk borrower, which can increase your chances of being accepted for finance and may reduce your monthly repayments. Putting down a large deposit will also cut your instalments.

Conclusion

When it first appeared in the mid-1970s, Islamic finance was generally dismissed as an inconsequential epiphenomenon of the oil boom. Introducing the religious factor in what was perceived as a quintessentially secular area struck many as bizarre, and many critics asserted that the growth of Islamic banks was bound to remain stunted. However, in reality, Islamic finance experienced growth rates in the double digits, and has become a permanent feature of the global financial system. It did not, however, quite live up to its original billing. While it has come near to the structure of conventional banking, Islamic banking did offer an alternative. Islamic products, while lacking originality, retained their specific features. Islamic institutions warded off predatory transactions and vulture funds. And Islamic banks avoided investing and partnering with institutions belonging to non-halal sectors. Because of this, Islamic banks are criticised for being conservative and for upholding the Shariah law.

At a time when conventional banking was transforming beyond recognition, Islamic banks remained conservative and ethical. These qualities served them and shielded them from the financial meltdown. In sum, as the financial crisis has brought about a rare moment of reflection and critical thinking, the logic of Islamic finance can no longer be dismissed out of hand. At the same time, it may be dangerous to overstate the virtues of Islamic finance and present it as a panacea, especially since its principles state what is permissible and not what is necessarily advisable. Islamic finance is still in its early stages of development and is still beset by tensions and problems.

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