Introduction

Islamic Banking and finance have become more and more popular in the global financial market. The developed countries, the emerging markets and some developing countries, are all offering Islamic banking and finance now. Although there are Muslim financial companies in some places of China[a], there isn't until now any formal Islamic banks in China. The sizes of current Muslim finance companies are small and their influence in the society is marginal. For quite a long time I have been planning to explore the feasibility of implementing Islamic banking in China. However, after had some researches I found that at least for the time being it is not practical to have any Islamic banks in China. Since the necessary legal framework, the general understanding of the society to the matter of Islamic banking, and the political will are not exist yet. However, institutionalize the informal practices of Islamic finance by Muslims in China is not only feasible but also having bright future.

China has become an important member of WTO, and is liberalizing its financial market. The banking and financial environments are becoming more and more conducive to conduct Islamic banking, this is perhaps a golden opportunity for Muslims in China to introduce Islamic banking and finances into China. At near future, only the operational skills and expertise will become the determinants for the fate of Islamic banking and finance in China. The challenge in front of Muslims is not a small one, but the prospect for Islamic banking and finance in a market of over sixty millions Muslim is surly a great one.

To better comprehend the issues this project is divided into nine chapters. In chapter one, I analyzed the inherit problems of conventional financial systems and their "contributions" to the Asian financial crisis. In chapter two, the equity based Islamic Financial system is introduced as an option to the current debt dominated financial system. In chapter three, I give conceptual explanation to

[a] There is a Muslim Financial Company in Lin Xia, Gan Su province of China.

Islamic financial instruments and some of their practical implication. In chapter four, the practices of Islamic instruments in US, Pakistan, Malaysia and the Philippines are studied. It is to prove that Islamic financial instruments are applicable in all sorts of economies. To study the feasibility of implementing Islamic financial instruments in China, I looked through China's economic development since 1978 till now, financial reform, the banking industry, the capital market, its regulatory framework and corporate governance, as well as its dramatic changes after enter into WTO in chapter five. Attempt of Islamic Banking and Finance in China is presented in Chapter six. Two real cases are revealed in chapter seven to give more insights on the practice of Islamic finance by Muslims in China. To cross prove my theoretical assumption I made a survey in two Muslims concentrated provinces of Gan Su and Qing Hai of China. The survey results and recommendation are given in chapter eight. The summary and conclusion are provided in the last chapter.

As for methodology of the research, a combination of survey, secondary data, and comparative and critical method is being used.

5. contribute to the economic development of a country.

However, what we have evidenced is the inability of such system to promote growth and prevent financial crisis. We see enlarging gap between the poor countries and the rich countries; The constant capital flow from the developing countries to the developed countries; the debt burden of the developing and under-developing countries further deteriorate the situation. The Asia financial crisis spread to most parts of the world, trigged the economic growth of the world slow down. Various formulas of IMF and Wold Bank to rescue the world from going to deeper recession seem have little help. Therefore there is an urgent need to review the current financial system and find a more secure more productivity oriented financial system. Perhaps Islamic financial system can be one of the options.

1.2. The myth of the Interest-problems to the monetary authority

Interest is until now being used by the central governments of all modern economies as the powerful monetary instrument to adjust the money base and money circulation in the country and abroad. Most of central banks rely on interest adjustment to change people's saving and investment behavior. This instrument seems work well in the booming period of economy however, when the general confidence in the economy is lacking most of governments will face multifaceted problems. Interest reduction during recession time has no effect or minimum effect to the people's consumption behavior; Neither is the investor willing to borrow more despite the low interest rate. Because for the savers, the interest rate in the recession period is already very low, the doom and gloom prospect to the economy cause them feel very uncertain about their future therefore, they tend to buy valuable items such as gold to protect the value of their wealth. The actual amount of money they put in the circular flow is very limited. On the other hand, for the investors the drop of the consumer spending will cause drop of the demand for their products. The deflationary pressure reduces their incentive to produce; hence they will tend to reduce their workforce and produce less, they need lesser capital to invest therefore, lesser loan is required by them. The vicious circle will continue until the confidence of the people to the economy is restored due to some other factors.

People lack of confidence is due to the uncertainty. If the profit and loss system is in place then the cost of capital will not be determined ex ante, there will be a link between cost and return of the capital. The producers will not worry so much to serve the loan. They may have courage to retain the workforce and produce as normal or even more, this in return will give confidence to the wage earners and they will spend their disposable income to support the economy.

Moreover, if the financial market is designed to implement the profit and loss sharing system then the excess capital can be channeled to the real production activities. The problem of "capital flight" also can be eased since all funds are being invested in medium or long term productive projects.

1.3. Causes of prefixing the return of the capital

In the western financial theory money is treated as commodity so it has a price, such price is determined by the supply and the demand of money. It is also assumed that the money held today is deferent in value to the same amount of the money in the future. To compensate this difference, one has to pay a premium to the owner of the capital. that premium is called “interest” in the case of saving, "cost of capital" in the case of loan, and “coupon interest” in the case of bond. such compensations are all fixed and determined ex-ante, that means whether or not the capital user has made money he still has to commit himself to pay the prefixed amount of the money to the lender. The nature of the business is risk, risk means the potential to gain or lost, hence the conventional system tend to be bias to the borrower since he has to bear both market risk and business risk while the lender will gain in any situation.

Such prefixing of the return to the capital also cause moral crisis problem and limits investment (Sadeq 1989)[2]. In the period of economic downturn, the genuine investors will not expose themselves in too much market risk and business risks, hence they will tend to downsize the business and retrench some workers thereby create unemployment. The monetary authority's stimuli measurement will only encourage the speculators borrow more to either service their old debt or to take chance to involve in high risk activities. the economy will fall into what John Maynard Keynes termed "liquidity trap". However, it is argued that the user of the capital can use other financial instruments to minimize or even eliminate the risk. These instruments including the financial futures and options or so called financial derivatives. The derivative market moves in opposition to the cash market, so one can invest both in cash and derivative market to offset or minimize the risk.

Risk is always exist in business, it is a matter of who bares it. The choice the user of the capital can do is to manage the fund through diversification in portfolio, going for derivative is not the solution. The futures and the options are simply Zero-sum games, the market as a whole does not benefit from the activities except incurring more transaction cost .

The belief that the derivative market can promote the liquidity in the financial market and stabilize the economy is not quit justified. (Sivalingam 1998)[3]derivatives are syntactic, artificial, and normally highly leveraged instruments. Financial derivative doses not reflect the real performance of the economy. Rely on the artificial market activities to solve the real financial problems is dangerous. Therefore, the problem of the conventional financial system arises from the people's attitude towards wealth creation, and their perspective to the risk. Wealth only can be created through real economic activities not by synthetically formulating an artificial system. So unless the financial system is investment oriented and real economy based one, the wealth of the nation will not be channeled to improve the productivity and economic growth.

The very nature of the derivative is speculation rather than investment. Speculation only can motivate people to be short-term oriented and cause them to involve in various "get rich fast" activities and ignore the productive economic activities. In this sense, the financial derivatives contribute very little to a nation's economic growth. In fact, they may serve as the powerful means of the speculators to attack the weak economies.

1.4. Paper money-the very root of the problems

The problems of the conventional financial system originated from the very nature of the current form of money. Any money supposedly has face value and intrinsic value. In the past the intrinsic value and the face value are the one and the same thing, because money was in the form of the real things needed by everyone or at least by most of the people. Gold, silver, date, banana, shell etc all had being used as money because those things themselves give same sort of value to people. The basic functions of money are medium of the exchange, store of the value, and unit of the value. Since the creation of the paper money by the ancient Chinese there is a disparity between the face value and the intrinsic value of the money. Inflation will destroy the store of value function of money while devaluation of the currency will destroy the unit of value function of the money. The then gold standard request nations supply money based on their gold reserve, hence it is supposed to be no problem since people can use the representative of the gold to do transactions. The Bretton Woods Pact initially fixed the US dollar as the reserve currency which is also pegged to the gold, and other country's currency pegged to the US dollar. The US dollar became the reserve currency, such statues of US dollar enable the US to become the biggest debtor in the world. The Uncle Sam defaulted and misused the trust given to it, the Bretton Woods Pact failed. However, the use of the paper money is still going on. In theory, the value of a nation's currency can be determined by both the external forces such as international trade, foreign direct investment(FDI), balance of the payment (BOP)etc, and the internal forces such as interest rate, price level, money supply and so on. Despite of the wide acceptance of such theory and the usage of the paper money, the recent financial fiasco in Asia, Russia and now in Argentina indicates that something must be wrong with today's monetary system.

Under such situation, some suggest to create 100% gold currency and hoped it will be the only legitimate form of money (Vronsky and Westerman1997).[4] Since an ounce of gold is an ounce of gold, whether it is in the form of coin or bar. It is also suggested that by going back to the gold there will be a unification of the world currency which has being increasingly advocated by economists in today's increasingly globalized economies. Some newly emerged Industrial countries like Malaysia has tapped to Mint Islamic Gold Dinar as a single Islamic currency.

The Malaysian-minted Dinar, are to be larger in total value than the US$3 million worth of coins that have been minted in Dubai. offered to the public via some 240 outlets.

Plans are also afoot to shift e-Dinar's gold repository, either partially or completely, to Kuala Lumpur or Labuan. The move is inspired by the Prime Minister Datuk Seri Dr Mahathir Mohamad's apparent support for the use of the Islamic currency. The Prime Minister has expressed interest in promoting the Islamic Dinar as an alternative to the US dollar in international trade.

The gold Dinar coin, with a specific 22k gold weight equivalent to 4.25gm, was first minted in 1992. It has been used initially by the Murabitun World Wide Movement, an indigenous Muslim organization, and has since gained huge popularity in Europe, South Africa, and the UAE, where it has also been minted. It is now used in some countries for retail transactions

Such move can somewhat restrict countries from simply print money and inflate the economy. The impact of such advocating is so great that some people perceiving it like bomb-the Gold Dinar Bomb.

Perhaps going back to the gold standard is an extreme view and quite impractical, but there must be a mechanism to tackle the problem of inflation and devaluation of currency otherwise money will not serve its basic functions.

Financial system can facilitate the economics activity only when there is a direct linkage between the real production of the economy and the financial activities. However, in our modern financial economy, financial system is helping hot money flowing cross boards, the money that goes to the long term investment is comparatively much less. Such situation has created great instability in the financial market and caused many countries vulnerable to the external funds. The reason why China can stand exceptionally firm in the current Asia financial crisis is that China does not overly trust the myth of the capitalist system. It is rather lucky that China keep close its capital account so the short term fund can not freely in and out from the country. More over, external debt of China is relatively low, about 14% of its GDP and 60% of its export, short term debt is only about 10% of total external debt(Hana Brixi, Dingyong Hou, Xiaofan Liu, David Scott, Jessica Szeto and Chunlin Zhang 2001)[5]. Moreover, through the years China built up a high foreign exchange reserve, about USD190 billion, and maintained a high surplus of the current and capital account. The timid development approach of "touch the stone beneath your foot while crossing the reviver" has saved China from systematic market collapse, and does give China a grace period to restructure its financial sector. China's financial market is still in it's infant stage, but the rather conservative to the current nuked open market system has helped its to dance in the wave. In fact the banking system of China is not by any measure better than other financially affected countries.

The measures taken by Malaysia in preventing the further depreciation of its currency and capital flight shows another pitfall of the current financial system[b]. The whole system is just like a casino game with no strict rules to

[b] Malaysia government has fixed its currency exchange rate to 3.8 to a dollar, and imposed regulation that foreign capital has to remain in Malaysia at least one year, and Tobin tax (exit tax) had imposed to the foreign capital. All offshore transactions of Ringgit were suspended.

follow. If one country does not want to play the game then the whole game will collapse. Large amount of short term capital flight into a country created artificial prosperity which again caused excessive borrowings by both government and private sectors. These excess liquidity went to the property and share markets and inflated the economy cause over capacity and over investment. What worse still is that some of these investments were financed by the banks while the collateral are over valued share and property. Once the venerability of the economy is prevailed then the game can not continue any more. The games like a group of indebted people borrowing from one side and pay to other side. If one party decides to quit from the game than the whole system is in trouble.

Chapter 2

THE ISLAMIC FINANCIAL SYSTEM

2.1. The Islamic Financial System-Definition

Islamic financial system is the financial system which based on the principle teaching of the Quran and the tradition of the prophet Muhammad. It is the integral part of the Islamic economic system which set it's goal to improve and human economic life, eliminate economic injustice, and facilitate human to efficiently utilize their God-giving factors of production to achieve their ultimate aim as the vicegerent of Allah on the earth. Such financial system should be applicable in all sorts of societies and economies. Since the Quran only gives the principle rather than the details there is wide room for the economist and