

The issuance of NIDC to company A is undertaken as evidence of the bank's debt to the company, so, at the end of the day, the company can redeem the certificate with the return that it has gained through the sell-deferred payment. As one can observe, the concept of Bai al-dayn is actively applied in these processes.

3.5. *Loan Based Instrument (Al-Qardh Al-Hassan)*

Islam pays special attention to the poor and the needy of the society. The Quran clearly states that in the wealth of the rich there are due of the poor and needy. Islam provides special assistance to the poor and the needy in the society by giving interest free loan. It is hoped that such provision can reduce the tension between the rich and the poor, it is also hoped that such grant can improve the general welfare of the society thereby provide more conducive investment environment. If we look at violence happened in L.A of US in early 90s due to the jealousy to the rich Asians by the Afro-Americans and the tragedy of the Chinese in Indonesia in later 90s we will not have difficulty to appreciate such instruments. Islamic banks normally give some benevolent loan to the unfortunate group of the society. Such loan provision in Islamic banks in Malaysia is increasing from early 0.1% to about 7% now.

Chapter 4

ISLAMIC FINANCIAL INSTRUMENTS PRACTICE IN DIFFERENT ECONOMIES

Generally, there are two approaches for adapting the Islamic Financial Instruments in a country's economy. One is revolutionary approach, which seeks to replace the conventional financial system with Islamic financial system totally, another is evolutionary dual banking system approach, which Islamize the conventional system and allow the Riba' based system and Non-Riba' based system coexist in the economy. Among the countries that adopt

the first approach are Pakistan, Iran, etc. While Malaysia leads the second approach.

4.1 Islamic Countries: Pakistan

The formal Islamic banking in Pakistan started in 1979 when three major finance institutions namely House Building Finance Corporation (HBFC) Investment Corporation of Pakistan(ICP) and National Investment Trust (NIT) were instructed to change all their transactions in interest-free modes of finance. After years 'Interest-free" counters were opened in all banks offering PLS account. Banks are allowed to invest Shariah permitted projects, shares, mark-ups etc. some of the financial instruments used by Islamic banks in Pakistan and their respective shares in total funds are presented in tables 4.1. and 4.2.

Table 4.1. The twelve admissible modes of interest-free finance in Pakistan

Trade related	Investment related	others
1 mark-up	7 Musharakah	11 Qardhan al-hassan
2 mark-down	8 equity participation	12 service charge
3 buy-back	9 term certificate	
4 leasing	10 rent-sharing	
5 hire-purchase		
6 development charge		

Source: State bank of Pakistan, Banking Control Department, Circular no. 13 of 20 June 1984

Table 4.2. Interest-free modes of finance of the nationalized Pakistani banks according to their respective shares

Financing technique	Percentage share	
	End 1982	July 1984
Mark-up and mark-down	92.47	86.7
Commodity operation	78.68	73.6
Trading operation	1.73	33.6
Documentary inland bills(markdown basis)	0.35	1.5
Export bills (markdown commission)	2.52	3.5
Import bill	9.19	4.5
Musharakah	0.6	3.1
Hire-purchase	-	0.7
Rent sharing	0.08	0.6
Equity participation and purchase of shares, banker's equity, etc.	3.76	8.0
other		0.9
Total in millions Rs	12,700	19,967

Source: 1982, working paper for finance minister meeting with bankers and Pakistan Banking Council" in Jung, S.A.

1984, Government of Pakistan, Pakistan Economic Survey 1984-85 p12

The matter of Islamic banking and finance in Pakistan is jointly worked by the Council of Islamic Ideology(CII) and Panel of Economists and bankers(PEB). The CII serve as the advisory body to the government is Shariah aspect while the PEB gives practical advises.

In recent development, The Shariah Appellate Bench of the Supreme Court of Pakistan, following a controversial judgement on 23 December, 1999 has ruled that interest (Riba)has to be eliminated from the financial system by 30 June, 2001. The court also directed the government to set up a commission for the transformation of the financial System at the central bank, the State Bank of Pakistan, and two forces to achieve this objective.

The Commission had set up a committee for development of Financial Instruments and had presented an interim progress Report to the government in October 1999. The two Task Forces one working with the ministry of Finance to suggest ways and means of eliminating Interest from government transactions, and other at the Ministry of Law to suggest amendments in the legal framework to implement (Supreme Court's) judgement. Compared to many countries, the approaches taken by Pakistan in Islamizing its banking and finance is quite haphazard. This may be due to its vast population of Muslims and availability of Islamic social settings.

4.2. Newly Industrialized Economies: Malaysia

Malaysia has established its first Islamic bank, Bank Islam Malaysia Berhad (BBMB) in 1983. The country also amended its banking law to include Islamic Banking Act in the same year to facilitate the development of Islamic banking. For about 10 years BBMB enjoys a monopolistic rights for Shariah-based banking services. In 1994 the government required all the banks in the country to setup Islamic banking counters. Since then the country adopts a gradual reforming strategy established Islamic Money Market and Islamic Capital Market. In 1994 the Securities Commission established "Islamic Instruments Study Group" which comprised of Syariah scholars and industry experts. The aim of such group is to facilitate the development and structuring of Islamic investment products; and guide market participants on matters pertaining to Islamic capital market issues.

Similarly the Islamic Financial Accounting Working Committee also formed to develop an accounting framework in the field of Islamic finance and to identify the Accounting issues in relation to Islamic products and process.

In 1997, an investment holding company BIMB Holding Berhad incorporated in Malaysia and subsequently listed on the main board of Kuala Lumpur Stock Exchange (KLSE) to replace the already listed BIMB. BIMB Holding's

business covers banking, Islamic insurance(Takaful), capital market investment, property, research and training etc.

The services available now in Islamic banks in Malaysia including the following:

Customers' deposit.

- 1-current account
- 2-saving account
- 3-investment account and special investment account

project financing

- 1-Mudharabah
- 2-Musharakah

Financing the acquisition of the assets

- 1-Murabahah
- 2-Bai' Bithaman Ajil
- 3-Ijarah
- 4-Qard ul-hassan

Trade financing

- 1-letter of credit under the principles of Al-wakala, Al-Musharakah, Al-Mudharabah, and Al-Murabahah.
- 2-letter of guarantee
- 3-working capital financing

other services

- 1-remittances and transfer
- 2-sale and purchase of foreign currency
- 3-investment/portfolio management
- 4-trustee and nominee company services.

Comparatively speaking, the development of Islamic banking and finance in Malaysia is very fast. The necessary policy support, the legal framework, the religious council all come in tandem with the market expansion. However, despite of its enormous achievement, the banking and financing still heavily depend on few sells based instruments instead of equity based ones.

Table 4.3. Selected years for Bank Islam Malaysia Berhad Modes of Financing

mode year	Bay Bithamani Ajil	Ijarah	Mudharabah	Murabahah	Musharak ah	Qarad al-hassan
84	80.96 49.1%	15.28 9.30%	5.11 3.1%	61.39 37.2%	2.07 1.2%	0.14 0.1%
86	325.88 77%	20.54 4.9%	1.38 0.3%	65.72 15.5%	9.23 2.2%	0.21 0.01%
88	471.5 76%	17.77 2.9%	0.48 0.1%	117.17 18.9%	11.23 1.8%	2.36 0.4%
90	583.044 70.8%	92.643 10.1%	355 0.04%	146,788 17.40%	99 0.01%	622 0.07%
92	723.838 69%	110.205 10.5%	2,243 0.2%	188,274 18%	99 0.01%	1,058 0.1%
94	702.120 68.6%	89,742 8.76%	3,354 0.3%	183,287 17.9%	17.709 1.7%	914 0.08%
99	2,428,325 60%	136,148 3.4%	18,774 0.47%	1,228,311 30.7%	20,751 0.5%	105,217 2.6%
20	2,883,697 60%	279,389 5.8%	219,939 4.58%	1,156,849 24%	17,517 0.36%	210,016 4.3%
21	3,837,866 61.4%	231,871 3.7%	18,770 0.3%	1,455,955 23.3%	167,075 2.67%	452,318 7.24%

Source: BIMB and BIMB annual report various issues.

The development of Islamic banking and finance in Malaysia can be highlighted in table 4.4:

Table 4. 4. The Development Of Islamic Banking And Finance In Malaysia

Institutions/instruments	Date of establishment
Bank Islam Malaysia Berhad	1983
Government Investment Certificates(GIC)	1983
Srarikat Takaful Malaysia Berhad.	1985
First Islamic Private Debt Security For shell	1990
Interest-Free Banking System	1992
Islamic Interbank Money Market	1994
Bank Islam Securities Berhad	1995
Syariah Supervisory Board of Securities commission	1996
Syariah Supervisory Council	1996

After the Asian financial crisis, the Malaysia Government is dedicated to make Malaysia the Regional Islamic Financial Center. Bank Negara (the Central Bank)has commanded all the banks operating in Malaysia to increase their share of Islamic banking services, and it's Financial Sector Master Plan targeting 20% market share for Islamic Banking by the year 2010. Though it is a quite ambitious target, the current steadily grow of 48% per annual in terms asset will enable Malaysia to achieve this target(Islamic Banker 2001).¹³

4.3 Developing Economies: The Philippines

Philippine Amanah Bank (PAB)was established in 1973 as a specialized government Institution to help the government to propel the social economic reform. PAB was originally designed to serve the special banking needs of the Muslim areas in Southern Philippines, it became evidently a part of the government's response to the Muslim rebellion¹⁴. Its first primary task was to get involvement in the Mindanao, Sulu, and Palawan. PAB was devoted itself to help Muslim minority groups to get into the economic mainstream. Initially

PAB aiming to "provide credit, commercial, development and saving banking facilities at Mindanao" (sec.4 Presidential Decree No 264). Then the charter of the PAN was amended by P.D. No.542 dated on 20 August 1974. The set of economic principles that make up an Islamic paradigm for financial transactions was spelled out in broad terms as follows: "the Philippine Amanah Bank shall be based on the Islamic concept of the banking, following the non-interest and partnership principle." For better understanding the universal operational method of Islamic banking, the first study group was sent to some Middle East countries in 1979. In return, this group suggested that there was a urgent need to design an Islamic system for ever banking activity undertaken by the Philippine Amanah Bank; and the need to fit this Islamic system into the organization and/or operational structure of the Philippine Amanah Bank. In 1983 and 1984 the bank launched the Pilgrims Special Saving Deposit(PSSD) and the Inward Remittance and Investment Program(IRIP). Respectively. To gradually shift the existing accounts to Riba-free PLS accounts, and to enable the Muslims to save and be assured of the opportunity to increase the depositor's fund through investment in all spheres of trade, commerce, and industry that are lawful in Islam. The average monthly balance used as the basis to determine the PSSD return on investment.

In sum, PAB has made a breakthrough in its conduct of Islamic banking and services. The bank continues to use PLS mechanism alongside with interest not simply to substitute one technique over another, but as a transitory measure pending the approval of the PLS chart of Account. PAB also envisions to provide the institutional linkage between the Philippines and the Islamic world of business and trade.