

the international capital markets. There is a now a collective will on the parts of the Government and the corporate sector alike to continue and indeed to speed up the changes and reforms in the financial markets.

Chapter 6

ATTEMPT OF ISLAMIC BANKING AND FINANCIAL INSTRUMENTS IN CHINA

6.1. Macro-Environment For Islamic Banking And Finance In China

Islamic banking and finance have got ground in many of the Islamic countries where Islamic law has being in place of social economic settings. In many none-Muslim countries Islamic banking and finance also got ground. Islamic banks are quite active in US, UK¹ and even the Philippines also have adapted some Islamic banking and finance. Dow Jones even launched Islamic Market Index (DJIM), UK has FTSE South Africa Islamic Index, and the Philippines has (Philippines Amanah Bank). While some Islamic scholars suggest that implementation of Islamic banking system has to take revolutionary approach, i.e. financial reform has to go hand in hand with introduction of Islamic law. For them Islamic banking can not be well implemented in a none-Islamic society. Some scholars argued, that practically speaking some countries can not be an Islamic country, the Muslims there however can not be denied from using Islamic banking services. Therefore, instead of revolutionary approach the evolutionary Islamization approach has to be adapted, Islamic banks can be equally efficient in the none-Islamic banking system.(Abudul Gafoor 1998)¹⁷. In our real world Iran, Pakistan took the revolutionary approach while Malaysia, Egypt and many other countries took gradual Islamization approach.

¹ According to the Islamic Banker issue no 62 march 2001, there are more than 20 Islamic financial institutions and dedicated units in the United Kingdom

The presents of Islamic banks in all major cities of western countries and the experience of Philippine can well prove that Islamization of banking system is workable. There is only a small percentage of Muslim population in China, hence making complete legal political change is not practical therefore Islamization should be the appropriate way.

In China the matter of banking and finance is directly controlled by State Council and the people's bank of China. The issuance of license also has to be proved by the State Council. The banking sector for the timing being is still highly restricted. After the Asian financial crisis China devoted to consolidate its weak banking industry and gradually commercialize the state owned banks. Although China's accession of WTO promises some opportunities for more liberate financial market, it is however, very unlikely that China can open door for the Islamic banking. Establishing formal Islamic banks in China is not very feasible, at least for the timing being, because the following problems:

- Lack of legal regulatory framework. China's Banking Act does not touch anything on interest free banking, nor will its change anything to accommodated interest-free banking in at least for next few decades. The past reforming style of China indicates that China is rather very passive in the financial sector reform, therefore it is very unlikely that China will allow any bank to operate without being bounded by the interest mechanism.
- Commercial banks are not allowed to involve in any business other than borrowing and lending. This fact will be changed after China permit foreign multi-functional banks operate in China, banks in China will be forced to learn from the foreign banks in terms of service, product mix, corporate governance etc.
- Due to the relatively poor earnings and weak economic situation in Muslim majority regions(see our survey result for average income in the Muslim region), it is difficult to meet the minimum paid up capital requirement of

RMB 1billion to set up a commercial bank. or RMB100 million for an urban cooperative commercial bank, or RMB 50 million for a rural cooperative commercial bank to set up a bank.¹⁸.

- Our survey also indicate that the vast majority of the Muslims still do not know what an Islamic Bank is and how it operates.
- The relatively underdeveloped capital and money markets in China cause people have poor understanding on the risk and return concept. The frequent suicide cases after the collapse of stock market can indirectly evidencing this.
- Lack of expert fund managers to manage the fund. Our survey shows that Muslims in China expect the return on investment fast less than one year this is rather hard target for the fund managers to achieve.
- Lack of political will and policy support from the central government. The success of economic reforms not means China will also make political open up very fast, the ideological struggle is still dominating China leaders' mind . The government is very sensitive to activities that can be related to religious belief. Policies are still very restrictive to the religious groups including Muslims. Islamic banking may be easily associated with foreign religious penetration activities and will be banned.

Based on the above facts it may be more practical for the Chinese Muslims to practice Islamic Financial products in the form of financial companies and asset management companies. Such initiative not only can prevent premature death of Islamic Banking and finance but also can help to Muslims there to formulate an appropriate strategy through gradual practicing.

China has allowed private financial companies and assets management companies to operate in different regions. Now with the commitment of China

government to develop its west regions, a lot of policies are in favor of Muslims in the North-West regions. Among five Muslim concentrated states two are Autonomous regions, and there are also many autonomous counties in these regions. The government normally gives special administrative rights to these autonomous places. For example, Lin Xia Hui autonomous state was granted first license to set up Muslims financial house in 1987.

From year 1986 to 1999, China also had allowed some rural areas to have their rural cooperative funds. Each of such funds was raised from particular rural area and used in the same area. China Agriculture Bank provided guidance to such funds in terms of credit and loan.

The very rapid growth of such funds indicating there is huge demand for such financial institutions. From 1986 to 1992, there were 17,400 town level cooperative funds and 112,500 village level cooperative funds with a total capitalization of 16.49 billion yuan. Such growing was reach its peak after the then Chinese leader Deng Xiaoping's famous "Southern Tour" which reconfirmed the reforming determination of the government and encouraged private investment¹⁹. Although due to weak governance and operative skills the government finally closed all of such funds, it is however, very obvious that there is tremendous demand for such funds.

6.2. The Prospect Market For Islamic Financial Products

Based on the year 2000 population censer there is a total 1.3 billion of people in China. Total ten Muslim nationalities' in China has exceeded 65 millions. The majority of these Muslims live in North West part of China. Their estimated per capita income is 5,000 yuan. If multiply the Muslim population to their per capita income we can derive an estimated market size of 325 billion yuan.

Table 6.1. Development comparison between the selected regions in China year 2000

Region	Population million s	GDP billions yuan	GDP growth Rate (yoy)	GDP per capita yuan	Industrial product billions yuan	Industrial Product growth rate yoy)	Fix assets investm. (yoy)	Loan growth rate
Beijing	14	264.05	11%	22, 000	73.7	13.2%	19.7%	15%
Gansu	25	98. 3	8.7%	3, 836	32.8	10.2%	15.43%	12.37%
Qinghai	5. 2	26.312	9.0%	5, 170	8.01	10.51%	20.64%	6.74%
Xing Jiang	19	136.5	8.2%	5, 818	42.2	9.0%	14.5%	5.6%
Shan Xi	38	141.0	9.3%	3, 915	468	9.5%	28.4%	15.0%
Ning Xia	7	265	9.8%	4,912	29.3	15.9%	23.1%	18.1%
Jiang Su	70	858.4	10.6%	11, 700	999.3	21.4%	9.2%	15%

Source: Compiled from Public Report on National Social and Economic Statistics year 2000.

China is a non-Islamic country, Islamic law is therefore not the legitimate law in China. The Islamic-Economic system never being treated as national economic system. Neither is there any unified system which is binding to all Muslims in China. Despite of these facts, the Islamic financial practices are not so alien to Muslims in China. The practice of Shariah compliance financial instruments can be traced back as far as Ming dynasty of China. Financial practices in the past among the Muslims in China which is worthy to study.

6.2.1. The economic system of Xi Dao Tang

Xi Dao Tang is a Chinese version Islamic School of thought settling in China's North West province of Gan Su. This group started since beginning of the 19 century, the group consists of Han, Tibetans, Hui, Sala, and Dongxiang nationalities. Through the years the group had built a unique economic system. They live a life similar to what the communist called "Ideal big Community". Under Xi Dao Tang's system, the members in the group are not allowed to own any property, the wealth of the people is pooled together and owned jointly by all members. The group has it own corporate management system, under the system there are different boards managing the different affairs. The material consumption use centralized distribution system. The group managed virtually every thing of the members. The group called on equality of all members in all aspect. There are only two canteens for the whole group, one for woman one for men, all people including the leaders are eating in these two canteens. The group based their economic system on universal equality and humanitarian principle. They depart some portion of their annual income to build WAQAF, and they have special fund to assist the travelers and poor and needy.²⁰ Until now although there are changes in the groups system, however, the general principle of joined efforts joined rewards has not being changed. The gradual yet stead growth made it a influential religious and economic group in north west part of China.

Although it looks somewhat irrational to adapt such "communism-like" system, however if we think such system started as early as 19 century and survived until now though there are some changes. The system adopted by Xi Dao Tang had profound impact in the Muslims economic life in China, it has being considered as the first formal Muslim economic system in China.

6.2.3. The Mosque Fund Management

Many mosques in China, especially in the north west of China have their own mosque fund. These funds are sourced from contributions of the Muslims

settling around the mosques and some also from oversea contributions. Some mosques have their properties which being leased out for income. The excess money of the mosque is give to the capable Muslims to do business and share profit with the mosque in the form of Mudharabah or Musharakah.

Due to the large number of mosques in China(currently are more than 20 thousands mosques in China) the mosque funds if pooled are not a small number. If this fund can be channeled into productive investment then a lot of can be done with it. Perhaps mosque also will be the best place to initiating the concept of Islamic Financing in China. Since in many places of China the Imams have higher authority than the state laws in the heart of the Muslims. And Mosques also serve as the Islamic educational center. In fact, mosque can be the best place to start with Islamic banking and finance practices, because the practices initiated by the mosque will be more receptive by the Muslim mass. Of cause, the management of the fund can be performed by other parties who are more acquainted with practical knowledge of banking and finance.

Though there was attempt of implementing of Islamic financials instruments in China, there is yet any Islamic bank in China. The banking industry is highly regulated by the central government of China. The requirement for setting up an institution that carries the word "bank" is extremely high in terms of paid up capital and management expertise. The rural credit house requires fewer and less capital and slightly lower operational expertise.²¹ But these remains in legal level while in practical ground the government does not allow any banks being set up beside the four states owned banks. This is to build bigger and stronger banking industry and to protect the weak state banks from insolvency due to the high non-performing loans. For the time being, banks are not allowed to involve in any activities beside borrowing and lending.⁹

The entry of China into the world body WTO brings some hope for the enthusiast of Islamic banking to exercise their muscle in China especially in

⁹ Law of the People's Republic of China on Commercial Banks 1995, Article 43.

Muslim concentrated North West provinces of Xing Jiang, Gan Su, Qinghai, Ning Xia and Shan Xi. In the WTO agreement China has already promised to allow foreign banks to commence business in China by year 2002, and by the year 2005 foreign banks are allowed to dealing in local currency Renminbi business. To fulfil this promise China is starting to commercialize its banks and slowly opens the door of asset management and other business such as insurance to the banks. The listing of Bank of China on the stock exchanges has very positive response from both domestic depositors and foreign investors. Therefore, in the near future the difficulty of implementing Islamic financial instruments will lie on the technical and management aspects rather than legal and political. Moreover, with China's determination to globalize its economy and government strategy to settle the problems of the North west region the political environment will also gradually become more favorable to implementing Islamic banking.

Our survey shows that Muslims in China trust the state owned banks, this is because the safety of money in these banks is guaranteed by the government hence they enjoy the state level rating. However, our survey also provides evidence that Muslims are in a dilemma to avoid Riba' based banking activities and to expose themselves in the premature Islamic financial institutions. The traditional way of keeping money in the pillow is still practiced by a lot of Muslims. If there is any option that allows them to avoid Riba and in the same time can meet their banking requirement then most probably they will go for it. Such institution will be able to attract a large number of Muslims to pull money out of their pillows and invest in it. The challenge lies how to convince Muslims to legitimacy of Islamic financial instruments in the manners acceptable by them. The case demonstrated by Lin Xia Muslim Financial House (LXMFH) is therefore worthy to study.