

8. Islamic finance: a tentative verdict

8.1 INTRODUCTION

What does Islamic finance bring us? We can ask this question with different things in mind. First, one may wonder how Islamic finance scores in a technical sense when compared with conventional finance. This is not the only yardstick along which Islamic finance should be measured. Islamic finance was not primarily introduced because of an alleged technical superiority, even if the wildest claims have been made by its advocates. It was first and foremost propagated as an alternative for, and as a radical departure from, conventional finance, enabling its practitioners and its clients to follow the commandments of God. A legitimate question then is whether it really delivers the goods, from an Islamic point of view. We first discuss the first question, but before we turn to the second one, we have a look at the potential demand for Islamic financial products. All the time, it must be kept in mind that judgements can only be of a tentative character, as one cannot be sure how Islamic banking and finance will develop in the future. Much is still in an experimental phase.

8.2 PROS AND CONS IN COMPARISON WITH CONVENTIONAL FINANCE

8.2.1 Claimed Benefits

Seen through the eyes of the non-Muslim observer, applying Islamic principles in finance comes down to submitting economic activity to a number of restrictions. This cannot but have at least some negative effects. There are potential positive effects as well. Let us start with the latter. We concentrate on four issues:

- danger of insolvency
- financial crises
- participation in the official financial system
- speculation.

1. Lower danger of insolvency. Under PLS banking, if strictly applied, fluctuations in a bank's income are passed on to depositors in the form of fluctuating payments. This should reduce the danger of insolvency. PLS financing, however, is generally only a minor part of an Islamic bank's asset portfolio. Moreover, losses are not in fact always passed on to holders of PLS accounts. Quite often there is an implicit promise of some minimal return on deposits, or a de facto guarantee of non-negative returns. The bank may in that case suffer losses after all. Such a guarantee of non-negative returns is of course explicit as far as transaction accounts, that is, zero-yield current accounts, are concerned. Ideally, money on these accounts is given in amanah, custody, or wadia, safekeeping, and should be backed for the full 100 per cent by liquid funds or even base money (accounts held with the central bank). If, however, the money is lent on, there is a risk for the bank which cannot easily be passed on to depositors. Alternatively, if losses are suffered on the bank's assets and these are fully passed on to PLS depositors, these will see a more than proportionate fall in the value of their deposits. Consider a bank with a credit and investment portfolio amounting to 100, transaction accounts amounting to 20 and PLS deposits amounting to 80. If losses on the asset portfolio are 10 and these are fully passed on to PLS depositors, the latter will see the value of their deposits fall by 12.5 per cent instead of 10 per cent. Banks will, however, try to prevent their customers switching to other banks and depositors will therefore generally be given a positive return.

PLS banking may protect a bank against interest risk and credit risk to some extent, but not against operational risk. Malfunctioning computer systems or fraudulent behaviour of a bank's officers still may bring on serious losses. And even if insolvency would be less of a problem, PLS banking will do little to prevent liquidity problems. If a bank's liabilities have on average a shorter time to maturity than its assets, and depositors shift funds to other banks because of poor yields, rumours about investments turning sour or doubts about the integrity of the bank's management, it may be faced with a shortage of liquid funds and must fall back on the central bank's lender-of-last-resort facilities.

2. Protection against financial crises. It has been argued by Chapra (2002) that PLS might go a long way to prevent financial crises, as it would substantially reduce the moral-hazard problems associated with prudential supervision of banking, in particular the incentive given by deposit guarantees for high-risk lending and investment. Under PLS, there would be more discipline in the system. Depositors would be more interested in the soundness of the banks and in the quality of the banks' assets, in order to prevent having to accept negative returns, and banks

would have a better incentive to be careful in selecting borrowers and projects. Depositors will invest their funds with banks having the best risk/return profile, and possible negative outcomes have a higher weight in their decisions, as they will not be compensated by the monetary authorities. One may doubt, however, whether depositors have sufficient information to see and understand how a bank is performing before it is too late. Even sharia boards and large depositors can be misled, let alone small depositors. Several large Islamic financial institutions had deposited considerable amounts of money with the Bank of Credit and Commerce International (BCCI) but were unable to see its collapse in 1991 coming (Graiss and Pellegrini 2006a, p. 8).

3. Increase of participation in the official financial system. The benefits of PLS banking in preventing solvency problems and crises claimed by its proponents are fine in theory but often turn out to be no more than pious hopes. Still, Islamic finance can point to at least one other positive result. There are many people who could never bring themselves to enter a conventional bank's office and make use of the bank's services. If an Islamic bank sets up shop in their neighbourhood, the fact that it is Islamic might be just the incentive they need to enter the world of formal finance (Scheepens 1996; Demir et al. 2004). That was one of the reasons for Turkey's government under Turgut Özal to set up Islamic finance houses in 1983 (Jang 2005, p. 141). In this way Islamic banks have contributed to a higher degree of financial intermediation, which both economic theory and econometric research say generally fosters economic development (Christopoulos and Tsionas 2004; Levine 2004; Ang 2008). Islamic investment funds may fulfil a similar role. These also offer an alternative for some non-Muslims seeking ethical investment opportunities, even though the wholesale rejection of the amusement industry might strike some as overly strict. Unfortunately, a number of less than trustworthy characters have misused the 'Islamic' moniker to lure unsuspecting people into depositing their money with them and then used those funds for risky or un-Islamic investments. Turkey's *Ihlans Finans*, for instance, was liquidated in 2001 after it had channelled funds, against the rules, to in-group companies that squandered the money. The BCCI had promised to invest the funds deposited by other Islamic financial institutions in sharia-compliant commodity contracts. After the collapse of the BCCI it turned out that they had failed to do so, and apparently this had escaped the attention of their sharia board (Graiss and Pellegrini 2006a, p. 8).
4. Less speculation. Another claim made for Islamic finance is that it would substantially reduce speculative activities, as credit expansion decoupled from the production of and trade in real goods and services

is not possible in principle (Chapra 2002). Basically, Islamic finance should always involve real goods and services and the use of derivatives is, to say the least, discouraged. Two counterarguments can be made. First, finance is sometimes provided on the basis of fictitious real transactions or on real transactions that do not really contribute to GDP but are undertaken only for the sake of making a financial transaction formally sharia-compliant, think of *tawarruq* and *bai inah*. The money thus transferred can easily be used for speculative activities. Second, if speculative activities are hindered, hedging, which reduces uncertainty, may be hindered at the same token. One person's speculation may be another person's hedging. Furthermore, speculation may help to stabilize markets or even be necessary for stabilization. For instance, if prices on any market are plummeting, speculators may expect a recovery at a later date, step in as buyers and thus help to reverse the price movement.

In the same vein, it has been argued that interest-based debt leads to over-indebtedness, resulting in loan defaults and bankruptcies and possibly in a cyclical downturn made worse by deflation; the ban on such debt by Islamic finance might result in a lessened danger of this phenomenon (Keen 1997; Ebrahim and Rahman 2005).¹ Even if it were true that Islamic finance is less prone to cycles of over-indebtedness and debt liquidation than conventional finance, it does not follow that it is consequently superior. As will be argued below, the concentration on debt matched by real activities has serious negative effects. If we do without other debt, we will also miss the benefits of such debt. It is a bit like banning motor cars. If we have no cars, we have no car accidents, but is it worth the sacrifice? Still, it must be admitted that Islamic banks will not so easily fall prey to the temptations of such things as the derivatives market, even if they would perhaps love to do so.

It thus appears that the benefits of Islamic finance, when measured by conventional yardsticks, do not amount to much, apart perhaps in the sense that they are shielded from some of the excesses and hypes of markets in complicated products. Also, in countries with an effective system of bank supervision, which is able to keep swindlers out, Islamic financial institutions might help lower people's psychological barriers against financial institutions.

8.2.2 Negative Effects

The basic idea underlying economics is that there is no such thing as a free lunch. This maxim can also be applied to Islamic finance; the pros,

in so far as real rather than imaginary, have to be weighed off against the cons. We look at a number of negative points. With all these negative points, one may wonder whether large-scale adoption of Islamic finance might not be detrimental to economic growth. The negative points include:

- risks for depositors
 - higher costs
 - principal–agent problems and their effects on growth
 - inadequate financing of SMEs
 - limited supply of consumer credit
 - insurance with pitfalls
 - less scope for diversification and hedging, and its effects on growth.
1. Risk for depositors. If PLS principles, strictly applied, reduce the danger of insolvency for banks, the flip side of the coin is that depositors run a higher risk. A strict application of PLS principles would shift the risk of losses from shareholders to depositors. They often are less able to monitor the banking firm and even if they do, they are not in a position to replace managers. The only thing they can do is vote with their feet. And even if the banks are well managed, PLS principles make the recompense for deposit holders more volatile than some depositors might like. They simply have no choice but to accept fluctuating payments, even if many Islamic banks stabilize profit distributions to deposit holders to a great degree.
 2. Higher costs. Islamic finance will often be more expensive than conventional finance. The most widespread form of bank finance is murabaha. This involves two sales transactions instead of one and in addition may saddle the financier with the burden of physically handling goods, that is, see to it that they are properly stored and insured. More generally, Islamic contract law stipulates that each transaction requires a separate contract, which makes for higher costs. Furthermore, the circuitous ways that sometimes have to be followed to mimic conventional finance, think of bai inah and tawarruq, cannot but have financial consequences. Islamic finance also requires the setting up of separate legal entities or at least organizing a firm in such a way that clients can be sure that a financial firm's Islamic assets are financed by halal funds. Next, the room of manoeuvre of clients of Islamic financial institutions is sometimes seriously restricted. Here the virtual impossibility to sell a home before the end of the agreed loan period under a murabaha mortgage comes to mind. Sellers may incur prohibitive losses.

A totally different factor adds to the cost disadvantage of Islamic banks. This is the fact that Islamic banks have only limited opportunity, if at all, to borrow on the interbank money market and therefore are obliged to hold a larger percentage of their assets in liquid funds.

Probably the cost disadvantage can be reduced if Islamic financial institutions grow or merge and exploit economies of scale. Supervisory authorities and the industry itself can contribute to a lowering of costs by stepping up the pace of harmonization of standards.

3. Principal-agent problems. Islamic banks are less well equipped than conventional banks to deal with principal-agent problems. Under PLS finance, there is a higher moral-hazard risk than under conventional interest-based finance and Islamic finance in general struggles with the limited scope for penalty clauses under sharia law. Long-term financing seems to suffer, as a result (Aggarwal and Yousef 2000). If bank credit is not available, capital markets may provide funds, in particular in the form of sukuk, but this is only suitable for large projects. Long-term growth may suffer, as a result.
4. SMEs are not served well by Islamic banks. Islamic finance may be fine for financing the purchase of specific goods, but the lack of overdraft facilities makes it less suitable for providing working capital. Moreover, bookkeeping of SMEs in countries where Islamic banks operate is often very elementary, which works against the use of musharaka and mudaraba finance. Small-scale entrepreneurs often are not too keen on the close monitoring implied by PLS partnerships anyway, and PLS finance again does not fill the need for fluctuating funds. A more general problem for SMEs, not peculiar to Islamic finance, is the lack of suitable security. Understandably, even Islamic banks that specialize in small-scale credit tend to restrict themselves to murabaha and bai'salam finance.²
5. Consumer credit. Just like SMEs, consumers are not well catered for. For financing goods purchases, in particular durable goods, murabaha and ijara present themselves as the natural solution. Overdraft facilities are another matter. In Britain overdraft facilities for students are available, as we have seen, but for the rest banks have to take recourse to instruments that some Muslims will be inclined to see as involving hiyal (tricks): bai inah and tawarruq. These instruments are also likely to be more expensive than conventional consumer credit.
6. Insurance. Islamic insurance, takaful, may in case of high claims during any book year leave claimants with less than full compensation of damages. It is not impossible to build up reserves, and if reserves are absent or insufficient the managing firm may provide credit facilities,

but policy holders or participants cannot take this for granted and may be in for unpleasant surprises.

7. Diversification, hedging and growth. A ban on forward contracts and other derivatives may reduce speculation and add to the stability of the financial system, but it also reduces the opportunities to hedge risks or optimize the risk–return profile of a wealth portfolio. With less scope for hedging and more uncertain returns on savings and investment accounts, it is not completely clear how the supply of funds for high-risk, high-return projects, and with it possibly economic growth, reacts, but there are bound to be negative effects. Investors and business firms also suffer from the ban on trading in risk and the difficulties that brings for hedging all kinds of risks. This too cannot but have a negative effect on economic growth. Investors suffer more generally from a restricted freedom of choice under Islamic finance. A restricted choice means a reduction in welfare. It must be conceded, though, that the industry has been inventive enough to develop instruments that offer stable returns and in that respect resemble conventional interest-bearing financial instruments. Sukuk and ijara investments come to mind, though these are primarily available to wealthy investors.

Given all these restrictions, one may wonder whether Islamic finance is able to provide a spectrum of financial instruments sufficiently wide to serve the needs of a developed, or even developing, economy, at least without circumventing the principles it pretends to obey. If not, a country considering across-the-board introduction of Islamic finance and the organization of the economy exclusively along Islamic principles might be condemned to permanent low growth rates. We have mentioned a couple of mechanisms that are likely to hinder growth and the outcome might well be negative, but it is not a priori clear to what extent growth would be lowered. Similar questions have been raised about the relationship between Islam and the relative decline of the Muslim world over the past millennium or so. Surely there are links, but again it is not clear to what extent these are inherent to Islam *per se* rather than caused by specific manifestations in specific historical periods. One factor deemed important by Kuran (1997) is the closure of ‘the gate of *ijtihad*’ between the ninth and eleventh centuries. It was declared that independent judgement was no longer permissible because all the answers were available; hardly an incentive for free discussion and the development of new ideas, the breeding grounds for the Schumpeterian ‘new combinations’ on which long-term growth depends. He also points to the absence in classical Islamic law of room for corporations as separate legal entities and further to weak property rights and an inheritance system that limited concentration of wealth. Investing one’s

money in business enterprises was relatively unattractive compared with setting up a waqf, a charitable trust. Such a waqf, resembling a modern foundation, provided services to society and was not so easily plundered by the taxman. The founder could give both himself as the trustee and manager and family members in various positions handsome salaries and appoint an heir as his successor, in that way keeping the family fortune intact (Kuran 2004). In the Ottoman empire by the way, the ban on *riba* does not seem to have played a significant role. Money lenders could openly charge interest, but for the financing of businesses *mudaraba* was the preferred mode (Pamuk 2004). Large-scale business did not develop, possibly because of the reasons mentioned by Kuran.

There is no strong evidence that economic development is incompatible with Islam, but a large part of the historical forms of Islam since roughly the twelfth century does not appear to have been conducive to economic development. As for the late twentieth century, Noland (2005) could not find a systematic negative correlation between Islam and economic growth. His samples exclude such countries as Egypt, Iraq, Libya, Saudi Arabia and Yemen and thus a sizeable part of the Middle East. Attitudes and institutions may vary widely across regions. Anyhow, Islamic finance is a phenomenon that has only just taken off, and in most countries it still does not dominate the financial system, so hard facts on the relationship between Islamic finance and economic growth are hard to obtain. Theoretical considerations and casual empiricism would suggest that there is little reason to fear that Islamic finance would lead to serious economic stagnation, but negative effects might nevertheless result from higher costs, reduced possibilities for hedging risks, less long-term finance provided by financial institutions and insufficient funding of SMEs.

8.3 THE DEMAND FOR ISLAMIC FINANCIAL PRODUCTS

Obviously, there is a demand for Islamic financial products, otherwise there would be no Islamic financial institutions, at least not in countries where people have a choice between Islamic and conventional banks. We try to get an idea of the demand for Islamic products by looking at market shares, though data are not readily available. A picture of potential demand can be formed by looking at the results of surveys. These will be discussed next.

Islamic finance is spreading to regions where Muslims are a minority, including North America, Europe and South Africa. Even in the UK, with its Muslim population of roughly 1.8 million people and a fiscal system

that does not punish Islamic home finance, they have only captured a very small slice of the market. In 2007 the FSA mentioned an estimate of the size of the Islamic home finance market of £500 million out of a total stock of mortgage lending of over £1.1 trillion (Ainley et al. 2007, p. 22). In all fairness, it must be granted that the share is likely to grow, as some fiscal impediments to Islamic home finance were only removed in Gordon Brown's 2003 budget. The USA offer an even less positive picture. LARIBA has been offering home finance and car and business finance since 1987, but in 2003 it could underwrite no more than roughly \$100 million in mortgage, car and business loans, even though it had a licence for all states barring New York. This in spite of the fact that any financial constraints that it may have felt were much loosened when in December 2002 Fannie Mae, an institution devoted to buying mortgages on the secondary market, made LARIBA eligible for its facilities. A younger firm, Guidance Financial Group in Reston, Virginia, says it funded transactions totalling \$400 million in 2004 (Smith 2005).

More telling, perhaps, is the relatively small part of the market held by Islamic financial institutions in Malaysia, despite the support of the government and the innovative activities of the industry. In 2005 only 10 per cent of all banking assets were held in sharia-compliant accounts (KPMG 2006, p. 11). Given that 60 per cent of Malaysians are Muslim, that would mean that Muslims only put some 17 per cent of their money in Islamic accounts, if bank deposits were evenly spread across the population groups. As average income of *bumiputra*, the mainly Muslim ethnically Malay inhabitants, is lower than that of Chinese and Indian Malaysians, the true percentage is bound to be somewhat higher, but it will probably remain in the low 20s. In the Gulf States the share of the Islamic finance industry is estimated to be between 15 per cent and 25 per cent (Khalaf 2008). It is, however, set to grow substantially, thanks to large-scale government support and government initiatives. Developments in Saudi Arabia certainly offer hope to the industry: Islamic banks and Islamic windows of conventional, or mixed, banks took 56 per cent of total credit to the private sector at the end of 2006, up from 30 per cent at the end of 2000 (England 2007).

Surveys on the demand for Islamic financial instruments do not always give the impression that the Muslim population can't wait a day longer for Islamic finance to become available. One thorough study is a survey conducted by Dr Humayon Dar, then of Loughborough University, among over 500 Muslims. He found that only 5 per cent of UK Muslims were seriously interested in Islamic finance and that an additional 23 per cent would be interested in Islamic financial services such as mortgages if these were comparable in price with conventional interest-based mortgages (Dar

2004). Other initiatives were developed in Belgium. A Dutch company, Intermediate Marketing Services (IMS), opened a website in Belgium where those interested in Islamic financial products could sign up after paying €25. The site was said to be commissioned by Islamic banks from the Middle East that considered setting up shop in Belgium if at least 100 000 people would sign up (de Jong 2004). The attempt foundered, but others had also been busy in the meantime. In the final months of 2002 the Cercle d'Études et de Recherche en Économie Islamique CEREI of Brussels conducted a survey among Muslims in mosques and via the Internet, focusing on home finance. No more than some 700 out of the more than 4000 copies of the questionnaire distributed were returned and it was found that 65 per cent of Belgian Muslims rent their homes, against 30 per cent of the whole Belgian population. Asked why they rent and did not buy, 61 per cent gave *riba* as the reason. This would mean that at least 61 per cent out of 65 per cent, or close to 40 per cent, of the Muslim population would be seriously interested in Islamic forms of home finance. Of home owners, 35 per cent of the Muslim population, 66 per cent had taken out a conventional mortgage, but 77 per cent of those 66 per cent said they only had done so out of necessity. This means that an additional 77 per cent of 66 per cent of 35 per cent, that is, nearly 18 per cent of the Muslim population, would be interested. Some of those that did not take out a conventional mortgage would no doubt be interested as well, which would lead to the conclusion that the potential market might be as large as 60 to 70 per cent of Belgian Muslims. However, with only 17.5 per cent of the questionnaires returned this would be a rash conclusion. Most of the non-returners can probably be assumed to be indifferent, and the situation might after all not be that much different than found in Dr Dar's survey.

In the Belgian survey 53 per cent of the respondents did not invest their savings because of a fear of becoming tainted by *riba* or getting involved in haram activities. This abhorrence of *riba* has been found in the Netherlands as well, as mentioned in Section 6.3.1. For the USA, Abdelkader Thomas states that 'AJIF, First Takaful, UBK, CAIR and Falaika surveys coalesce around 25% core consumer base seeking Islamic products with a similar number open to conversion to Islamic products based upon competitiveness and clarity of presentation' (Thomas 2001, p. 1 n. 1).³ Of these surveys on the demand for Islamic investments, only the Failaka one is easily available (Failaka 2000). It was conducted at the annual Islamic Circle of North America (ICNA) conference in Pittsburgh, Pennsylvania. Though this is a gathering of 10 000 to 20 000 Muslims from the USA and Canada, no more than 100 bothered to fill in their questionnaires (*ibid.*). That does not point to a heartfelt need for Islamic financial products.

Against this, a survey by the Dutch Rabobank indicated that some 200 000 Dutch Muslim households might be interested in Islamic home finance products (Verhoef et al. 2008, p. 25). Given that the total Muslim population in the Netherlands is around 900 000, this would mean a majority, and at least a doubling when compared to Dr Dar's results. It is not clear, however, to what extent this survey was representative.

It appears that any financial firm considering whether to enter this market outside the Muslim world, and in large parts of the Muslim world as well, does not only need a good marketing strategy, but time and patience as well. Knowledge of financial matters was generally found to be low in surveys, especially among migrants groups, and with rising educational levels among second- and third-generation immigrants this may improve over time, which may help foster interest in the Islamic financial sector. Even then, firms offering Islamic financial products cannot be sure of a sunny future. In Muslim countries no less than elsewhere, cost and quality of services often is as much a decisive factor in choosing between Islamic and conventional banks as religious considerations (Gait and Worthington 2007). As far as these religious aspects are concerned, a fundamental question is to what extent Islamic finance really fills the bill.

8.4 ISLAMIC FINANCE: HOPES FULFILLED?

Islamic finance has sprung up out of a desire by salafi reformists to create an economy functioning along Islamic principles (see Chapter 2). Finance and insurance are the only areas where results can be shown. In other respects, nothing has been achieved, see the fruitless attempts to propagate zakat as a viable alternative to Western-style social security (see Chapter 3).

The relative success of Islamic finance has its downside, at least in the eyes of some of its well-wishers. Some true believers in Islamic finance claim that PLS finance would bring a totally different world. Interest brings injustice, and Islamic forms of finance that resemble interest, and even make use of interest as a benchmark, are hardly better, in their eyes. If PLS finance were embraced across the board, that would not only mean that divine commandments were obeyed, but also that depositors received higher returns, allocation of resources for economic growth would be optimized and individual and social welfare would get a boost (Siddiqui 2002). In view of the agency problems discussed in Chapter 4 and the limited range of transactions for which PLS finance is suitable, these are vacuous claims. The minor share of PLS finance in Islamic banks' total assets is not because of its attractiveness.

Bankers have been extremely inventive in developing non-PLS products that mimic conventional ones while avoiding interest, at least formally. But it is exactly this phenomenon that makes the existing Islamic financial industry suspect to some, disappointing to others. As for the suspicion, more than one half of the respondents in Dr Dar's survey had doubts about the sharia compatibility of Islamic financial services (Dar 2004). Some scholars who initially had been staunch supporters later became disappointed. Dr M. Umer Chapra, for instance, argues that Islamic finance ideally implies PLS but that financial institutions mainly provide credit and eschew the risk of fluctuating returns from PLS finance (Chapra 2007, p. 327).⁴ The same goes for Dr S.H. Siddiqui (2002).⁵ Professor M.A. Choudhury, on a more fundamental level, deplores the fact that Muslim scholars have been unable to develop a distinct Islamic worldview, starting from an Islamic epistemology that is based on the Quran and the sunna (Choudhury 2007).⁶ They simply follow Western paradigms. Another leading author, Mahmoud A. El-Gamal, sees 'an Islamic finance movement that is at best an economically inefficient replication of the conventional finance for which it purports to be a substitute' (El-Gamal 2003b, p. 17).⁷ He could not escape the conclusion that Islamic finance brings higher transaction costs and lower efficiency with nothing worth mentioning in return, as Islamic financial instruments are sharia-compliant in form but not in substance. Moreover, the Islamic norms observed by the Islamic finance industry are, in his eyes, those of a hopelessly outdated, medieval jurisprudence that also contributes to an unfortunate separatist Islamic identity fanning feelings of superiority (El-Gamal 2007a). He would now favour cooperative forms of finance that meet ethical norms and contribute to development and no longer cares for a separate Islamic financial sector (El-Gamal 2005b, 2006, 2007a, 2007b). Others are not so much disappointed as simply deeply hostile to Islamic finance in its present form, as it does not radically distance itself from debt-based money. They yearn for a return to a metal-based currency system without fractional-reserve banking (El Diwany 2003b; see also Section 3.6) and consider the existing Islamic banks as no more than conventional banks in disguise (El Diwany 1997). Their ideas are an echo of the 100 per cent reserve banking system as advocated in the 1930s by US economists such as Irving Fisher (1936), Henry Simons (see Friedman 1969) and Laughlin Currie (2004).

Ideas of radical breaks with the existing monetary system must be seen as pipe dreams. Any attempt to develop a separate religion-based epistemology will also almost certainly turn out to be a wild goose chase.⁸ Muslims are, it would seem, stuck with a choice between (1) conventional financial firms, either invoking *darura* or following liberal interpretations of the ban

on riba, (2) an Islamic financial sector making concessions to the needs of the twenty-first century by mimicking conventional financial products and (3) denying oneself many of the services of a financial system.

NOTES

1. The debt deflation phenomenon as first described by Irving Fisher is a cycle of over-indebtedness, debt liquidation, distress selling, falling money supply, falling prices and declining net worth, bankruptcies and unemployment, loss of confidence and continued downward spiralling movements, later adopted by Hyman Minsky as the pivotal element in his theory of inherent instability of the market economy (I. Fisher 1933; Minsky 1986). Ebrahim and Rahman (2005) mention the negative view on interest-based debt, but do not themselves subscribe to it.
2. Personal information from the manager of PT BPR Syariah Asad Alif at Sukorejo, Central Java. BPR is Bank Perkreditan Rakyat, or People's Credit Bank; PT is Perseroan Terbatas, or Ltd.
3. AJIF is *American Journal of Islamic Finance*, UBK is United Bank of Kuwait, CAIR is Council on American-Islamic Relations.
4. Dr M. Umer Chapra is a research adviser at the Islamic Research and Training Institute (IRTI) of the IDB, Jeddah. Earlier he worked for several decades at the Saudi Arabian Monetary Agency (SAMA).
5. Dr Shahid Hassan Siddiqui is a prominent Pakistani banker and economist.
6. Dr Masudul Alam Choudhury is a Canadian citizen and professor at the School of Business at Cape Breton University, Sydney, Nova Scotia, Canada and at Trisakti University Jakarta, Indonesia.
7. Dr Mahmoud Amin El-Gamal is an Egyptian-born US citizen and a professor at Rice University, Houston, Texas.
8. Serious attempts have been made at the VU University, Amsterdam (see Chapter 3, n. 1).