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GENERAL CRITICISM ASSESSMENT OF ISLAMIC BANKING AND FINANCE

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Abstract
Islamic banking and finance has shown impressive growth in the world over the past three decades. This achievement has come a long way, most of the financial services having interest-based banking and non-bank financial institutions have provided shari'a system. However, in some financial sectors at national and global levels are still very low in implementing the shari'a system. The main factors behind this phenomenon are the existence of a number of myths and a lot of confusion about Islamic finance theory among the public and intellectuals. So there are also misunderstandings about Islamic banking and criticisms about its theory and practice have been discussed directly or indirectly in various places, both in discussions, writings and even in books on this subject. The system that emerged was subject to a number of myths and harsh criticism, not only by those who did not accept the prohibition of interest but also by "devout" people both lay and learned who visualized the ideal system without giving any weight to the challenges of evolution and the problems of teething and difficulty. Islamic finance concepts and philosophies are based on sound reasons and are accepted by an increasing number of people around the world. What practitioners need to do is create awareness so that it can dispel myths among the public. Regarding the practice of Islamic banking, it is necessary to implement strict internal controls to avoid systemic and operational risks.

Keyword :
Islamic Banking, Islamic Finance

1. INTRODUCTION

Islamic banking and finance has shown impressive growth in the world over the past three decades. This achievement has come a long way, most of the financial services having interest-based banking and non-bank financial institutions have provided shari'a system. However, in some financial sectors at national and global levels are still very low in implementing the shari'a system. Even in the countries where the majority of the population is Muslim. In fact, almost all Muslims believe that any involvement in usury – accepting, giving, witnessing and even documenting usury-based transactions is a major sin, which is as big as going to war with Allah (SWT) and Prophet (SAW).

Then, why even though it has been more than three decades since the start of the Islamic finance movement in the modern era, the share of Islamic banking in the financial system has only reached 1.5% in Indonesia, 2.2% in Pakistan, 12% in Malaysia and 24% in Bahrain?. People know that the State of Bahrain is a center of Islamic banking, where a lot of work has been done in finalizing the Shari'ah standards for the Islamic model. The innovations carried out are by providing sharia-compliant products and providing an appropriate regulatory framework for Islamic banks and Islamic capital market.

If much work can be accomplished with a shari'a financial system, then why isn't the whole system changed according to Shari'a? This basic question must be studied fundamentally to find the answers "why most of the Muslim population is still involved in war with Allah and His holy Prophet, by not implementing the shari'a system?".

The main factors behind this phenomenon are the existence of a number of myths and a lot of confusion about Islamic finance theory among the public and intellectuals. So there are also misunderstandings about Islamic banking and criticisms about its theory and practice have been discussed directly or indirectly in various places, both in discussions, writings and even in books on this subject.

The need to dispel myths and analyze criticism to provide clarity and confidence to the audience, especially Muslims, requires significant concrete explanations. So that it will be able to create commitment among practitioners, developers in the field of finance or a more specific study discipline for this. And to obtain a true perspective that will not become a contradiction in society in the future. The main points that must be clarified are myths and general criticisms made of Islamic banking on conceptual and practical grounds. And then the veil of difference between Islamic banking and finance will be opened with conventional ones.

2. THEORETICAL STUDY

Rent of Money Capital

Money is to facilitate the socio-economic activities of humans by serving as a medium of exchange. Islamic Shari'a encourages the use of money (in any form) to avoid exploiting one another. In a number of well-known hadiths, the Prophet SAW advised against exchanging lower quality commodities of the genus with better quality commodities of the same genus (except in equal quantities) and ordained that one should first sell low quality goods and then buy, with money they received, superior quality goods, and vice versa.

The reason behind this is to save both parties from the possible loss or exploitation of one party by the other. Financial transactions, in order to be permitted and for the purpose of making a profit, must be associated with real assets or instruments that represent real assets. Money cannot be assigned a fixed fee for its use. In this regard, it should be noted that in Islamic economics, human effort and economic activity have been given a more strategic position in the distribution of results and profits than capital in the form of money.

Connecting money to productive purposes embodies labor and other resources given by Allah (SWT) to initiate the process from which goods and services are produced and their benefits are passed on to society. In contrast to the conventional system, where money is regarded as a commodity that can be bought/sold and rented at a profit, or a rent that must be paid by one party regardless of the use or role of the money lent in the hands of the borrower, the Islamic system links capital in the form of cash to activities actual effort and results.

Capital as a production factor in Islamic finance is things that can be used in the production process in such a way that all of it is consumed or used, such as gold, silver in the past and/or banknotes currency today. Such goods cannot be rented out because their bodies are used up, as in the case of fuel or edible goods, and their providers are not in a position to assume the risks associated with ownership. Financial units, including banknotes, which function as capital, are entitled to profit, as long as he accepts the risk of loss either.

In other words, monetary units cannot be rented out, because the risk of loss is caused by money-capital itself and its shape changes completely. Fixed assets such as buildings and machinery have a claim on the lease because the lessor retains ownership and assumes the associated risk. Therefore, a person cannot derive any benefit from money unless they deliver it in exchange for a commodity or service using the structure of one of the valid contracts of sale or lease. Real sector business transactions take one of the following three forms: buying/selling which can be in the form of cash or credit, loans or leasing. When being executed, these transactions have different implications in terms of the transfer of ownership, risk and liability. Earnings from profits depending on business results are allowed. Whether it is the real sector of business or financial activity, the risk is always in the ownership. The person giving the loan has the right to get it back; he bears no risk regardless of whether the borrower gains, loses or even uses the borrowed money for consumption. Therefore, he cannot demand a return on his borrowed capital.

If the person providing the funds wants any gain on his money, he must agree to bear the loss. In this case, the realized profit will be distributed according to a pre-agreed ratio, while the loss will be shared proportionally with the investment made by each investor; the loss of the user of the funds belongs to the unappreciated labor. Therefore, there is no place for "interest". It means that one is entitled to profit only if one bears the risk of loss.

If a person buys a commodity, gains ownership/risk, he can sell it on a cash or credit profit margin. As soon as the sale (credit) is made, the rights are receivable so it is created, while the risk of the asset is transferred to the buyer. If he converts his capital money into fixed/non-consumable assets, he has the right to lease it provided he bears the risks and costs associated with ownership. Keeping this principle in mind, it might be said that a person can earn a return on his investment or financing but that it must be related to certain assets which are exposed to direct or indirect business risks. As the lender or creditor does not bear the risk and is entitled to repay the entire amount of the loan or debt, he is not entitled to claim a return or rent.

Inflation and Interest

Interest cannot be legalized on the basis of inflation, mainly due to the fact that lending in Islam is a non-commutative and virtuous activity. It should not be mixed with a business carried out with the aim of making a profit. Profits can be earned if capital is linked to any liability, risk or responsibility.

Islamic finance does not have any provisions for linking any debts or receivables with any currency/commodity. The clear injunctions of the Qur'an and Sunnah reveal that if a financial contribution is in the form of a loan or debt, it must be repaid in exactly the same type and amount, irrespective of any changes in the value of the currency concerned or the price of the commodity lent or borrowed at that time from the loan repayment. If one wants to avoid the risk of depreciating value, one has to turn one's money into real assets, run any business, make a profit with it, and get a rent or share in the profits realized by taking responsibility for the loss.

In the Qur'an (verse 2: 279) explains, the idea of linking loans/debts with the purchase of the power of money cannot be justified on the basis of ijtihad, because ijtihad is carried out only where clear directions by the Qur'an or Sunnah do not exist. During periods of inflation, the intrinsic characteristics of money, namely its role as a medium of exchange and as a unit of account, remain intact. Only the relative characteristics of change, namely the future value of money in terms of its exchange rate; but this has changed since the introduction of money, even in the case of full-bodied coins. The value of the silver dirham depreciated in terms of gold dinars even during the beginning of the caliphate. But we find no reference in the entire literature on Islamic jurisprudence to the concept of indexation due to fluctuations in the value of money.

The prohibition of Riba essentially requires that all like-for-like exchanges are carried out on an equal basis in terms of the relevant unit of exchange. If this does not suit a person, he or she is free to avoid such an exchange and to pursue an alternative permitted course of action, such as a sale, lease, or any partnership arrangement. For example, through a credit sale, the needs of the buyer can be met, while the concerns of the seller can be accommodated through added margin in the deferred price. But, the price, once agreed, must be fixed. Gold, silver, and other monetary units such as paper currency are among the six commodities whose exchange should be like for like, equal for equal and hand to hand.

If a person borrows 100 dollars and it is repaid after one year, and for this amount, after indexation, becomes 105 dollars, it is included in the category of Riba. Well-known jurists such as Al-Kasani and Ibn Qudama have clearly expressed the view that the borrower should pay the same coin or currency as he took, regardless of increase or decrease in value. According to Shari’a principles, loans/receivables asking for an increase involve Riba.

In the case of inflation, the value of the currency decreases overall; it made no difference whether someone had lent it or kept it in liquid form. If he lends by indexing it with gold, for example to avoid a decrease in its value, this implies that he has taken advantage of the loan, because the debtor will make up for his shortfall in the amount of money lent, while the money kept in his own chest will also lose its value. Withdrawing profits from these loans violates Shari’a. The crux of the matter is that loans are non-remunerative contracts; as such, it must remain non-commutative and not be used as a means of obtaining compensation.

Even in conventional finance, indexation is not usually used to make up for losses incurred due to inflation. Conventional institutions make provision for floating interest rates in the deal, taking into account future inflationary pressures. Thus, each new rate is applied to the remainder of the period, while it does not affect the liabilities already accrued.

In certain modes/products, Islamic banks are also allowed to set floating or variable rates, such as in the case of leasing, but this does not affect the debt obligations ever made. For example, in leasing, Islamic banks may charge a higher rental fee, if provided for in the agreement, for the remaining lease term; but rents for a certain period of time, once accumulated, cannot be indexed. Therefore, we come to the conclusion that if the financial contribution is in the form of a loan or debt, it must be repaid in exactly the same type and amount, regardless of any changes in the value of the currency in which it is denominated or the price of the commodity lent or borrowed at the time of loan repayment.

Time Value of Money and Islamic Banking

Some people who believe in the prohibition of interest criticize Islamic banking for charging the time value of money through price fixing, while others view that avoiding interest means negating the time value of money; therefore, they argue that either Islamic banks charging credit prices higher than the spot price of Non-Islamic goods or current bank interest are not prohibited. Both views are based on misunderstanding.

The value of time is approved by the Shari'a in the trade/exchange of tangible goods but not in Qardh or Dayn, against which one cannot derive any benefit. Pricing of goods and their results is a major part of every business transaction, and for pricing purposes, the place and time of the transaction are important factors. Commodities may be cheaper in one part or market of the city than in another part or market of the same city.

Similarly, commodities may be cheaper at the peak of the season than at the beginning. Shari'ah does recognize differences in value due to place and time elements, and does not prohibit realizing the original time value of money in business transactions based on exchange (selling and renting). What is prohibited is any claim with the time value of money as a pre-determined quantity that can be calculated at a predetermined rate unrelated to real sector business. There is almost a consensus among Islamic scholars that the price of a commodity credit can actually be more than the cash price, provided one price is agreed upon at the time of execution of the contract.

Furthermore, it is quite natural that in a forward contract such as Salam, the future delivery price is lower than the price at the time of delivery of the goods. This is similar to accepting the time value of money in pricing goods. What is prohibited is any addition to the price after it has been agreed due to late payment. This happens because once a commodity is sold (on credit), it creates a debt and becomes the permanent property of the buyer and the seller is not entitled to re-set the price of a merchandise that he has sold and which no longer belongs to him.

The concept of the time value of money in the context of Shari’a is also founded on the disapproval of Riba Al-Fadl, which involves gold and silver in addition to several other commodities that may be used as a medium of exchange. The exchange of these commodities is suspended as a rule. Only hand-to-hand exchange is allowed, provided the sum on both sides is the same. This implies that the Shari’a prohibits the reciprocal exchange of gold, silver or monetary value unless it is done concurrently. This happens because a person can benefit with the medium of exchange that he has received while he has not provided a counter value from which the other party can take advantage. Valuation of credit terms for pricing goods or their outcomes differs from the conventional concepts of "opportunity cost" or "time value". Thus, "mark-ups" in trade are allowed, provided that the Shari’a rules relating to the sale of goods are complied with, but interest is prohibited, as this is an increase on any loan or debt. Therefore, no time value can be added to the principal of the loan or debt once it is created or the liability of the buyer remains.

Islamic economics has original provisions for converting money into assets, on the basis of which one can measure its utility. While most jurists uphold the concept and practice of credit prices being higher than the market price of cash goods, none of them allow generating rents on the principal amount of loans and debts. Therefore, there is no justification for assuming a zero time preference rate in Islamic economics. Similarly, one cannot add value to loans and debts due to time. Economic agents can have a positive time preference and there will be indicators available in the economy to estimate the level of their time preference, generally determined by the forces of demand and supply.

Charging Interest from Rich Debtors

The argument stated that, in today's world, borrowers from financial institutions belong mostly to the wealthy business community, and charging interest on them is not fair, is not convincing at all. This argument will be tenable only if all indebted businesses earn profits that are substantially higher than the interest rate. But if some earn less than interest rates, some earn out of proportion while others suffer losses, the claim loses ground.

This criticism actually strengthens the case against interest, because the relatively wealthier class takes funds at a much lower price than their profits from business. They give a small portion of their profits in the form of interest to the bank, which is treated as a burden and ultimately passed on to consumers. If some of them suffer losses in business, they usually use different unethical practices to avoid losses, causing harm to society as a whole. Thus, the rich get richer, the poor get poorer. The solution to the problem lies in providing a framework in which one can earn profit/return/income only by exerting mental or physical exertion, or taking on business responsibilities and risks. Interest causes exploitation of one of the parties, i.e. debtor or creditor, and therefore it is prohibited, regardless of who exploits in a particular transaction. Due to the involvement of interests and gambling on a large scale, the conventional financial system has become a means to take advantage of savers or depositors and the general public.

Different Interpretations of Shari'a

Another criticism of Islamic finance is the products are not standardized as a number of its concepts are subject to different interpretations of Shari'a. Islamic scholars do not use Ijtihad and therefore, Islamic finance cannot be a solid basis for the financial system to replace the current conventional system. However, as the Islamic banking movement has passed the important milestone of developing a general consensus on philosophy and products for business, with the mainstream acceptance of large-scale theory and practice, minor differences in concepts are no longer a matter of concern. As regarding product standardization, this will take some time. For now, developing products and the processes and procedures is a major challenge.

Furthermore, institutions such as IDB, AAOIFI and IFSB are working on this path; this may increasingly lead to standardization in the future. Islamic law has provided flexibility for Ijtihad to respond to changes and diversity in everyday life. Staying within the bounds of Shari'a, Ijtihad is required to deduce from the original sources the appropriate rules relating to business and financial transactions.

In the past, the Shariah scholars very well used this source of deriving principles to facilitate the growth of Islamic finance on a wider scale. But Ijtihad has its own limitations. This is not a source of anarchy or a means to convert Islamic Sharia from Divine to man-made laws. The concepts of custom, common wise, utility and necessity are also considered in the process of Ijtihad, based on a proper analogy, but these factors are only relevant if the basic principles given in the Nass (the clear text of the Qur'an and Sunnah) are maintained. And the results are in accordance with the objectives (Maqashid) of Shari'a.

The development of ethical and belief-based disciplines depends on the acceptance of their conceptual foundations and procedures for implementing them. The mainstream theory of Islamic finance has got this acceptance and the industry should be developed on the basis of it from an acceptable concept. Some of the concepts on which it is based in some areas have not yet gained general acceptance, and many scholars, even those belonging to those areas, have presented convincing arguments against these concepts. For example, products involving Bai'al Dayn (sales of debt/receivables) and Bai'al 'Inah (purchase back arrangements) are not genuine products for the Islamic banking business, as they do not fit the philosophy.

Islamic finance provides a solid foundation for a sound and efficient financial system by means of a risk-related capital supply and a balanced rate of return structure through the prohibition of interest and gharar and only conducting property-based business activities according to good manners. The set of rules defined for the related business. Given the original need for IFI and Shari'a rules, Shari'a clerics have provided a number of relaxations. Allowing the levy of fines based on a percentage per year on defaulters, even for charity; foreign currency forward cover through a unilateral promise to exchange two currencies simultaneously at a pre-agreed rate; the practice of buying and selling, especially in the case of sector and sovereign corporations; some flexibility with respect to Sukuk/ Bonds and securitization, such as providing third party guarantees for the possibility of making Sukuk "fixed income" securities and permits for Tawarruq where actual trading takes place and the goods are sold on the market or to any third party, some of the key areas in which scholars Sharia has provided assistance to the Islamic finance movement through Ijtihad. One should not expect a decree in favor of any new product in the conventional market, as this would undermine the sanctity of Islamic finance.

Therefore, we can conclude that the main problem with regard to interpretation has been resolved and now the practitioner should proceed with standardization on the basis of established principles, which provide solid and adequate reasons for conducting business.

Islamic Banks Using Debt Creation Mode

A number of writers on Islamic finance, both economists and financial experts, have said that Musyarakah and Mudarabah (Partnership) are the only ways to serve as an alternative to being interested in the Islamic framework. They argue that if IFI are to avoid interest, they should operate on a return-free basis or carry on business only on a Mudharabah/Musyarakah basis. However, this is a myth and a misunderstanding. Not Sharia a necessity or not possible in real life. Trading has been a wonderful part of human activities forever.

The main economic activity of humans apart from producing goods, involves trading, leasing or providing services to others. These activities can be carried out in different structures such as self-employment, employing the expertise and services of others in payments and partnerships. Any individual or institution can choose any structure by observing the relevant business rules. The only requirement made by Shari'a is order to get return, one has to make added value by working, risk or responsibility. If one chooses a trading business, one has to acquire the commodity, take ownership of it and risk it and then sell it at an added profit. In leasing, one has to take ownership risks to be entitled to a lease.

In partnership-based business activities, the financier must bear the business losses, if any, for the right to profits in the joint venture. If Islamic banks meet the relevant requirements, they can conduct business through any of the above structures. This aspect requires a discussion of two aspects: permissibility versus preference of some modes over others and suitability/possibility of using various modes, keeping in mind that the underlying realities and risk profiles and requirements of investors and banks. These are discussed below.

Debt has been prevalent forever, and will remain an important part of the individual and the economies of nations. The Prophet SAW himself borrowed and incurred debts (through the purchase and lending of credit), both for personal and State purposes, as we have discussed in Chapter 7. The only thing to be aware of is that debt should not carry any cost on the principal. Therefore, debt-creating modes such as Murabaha, Salam and Ijarah will remain as operating tools in the hands of Islamic financial institutions, and spot, credit and/or trade going forward will remain the main economic activities within the Islamic framework.

So the problem is not about the permissibility of the mode, but the preference for the equity-based mode over the debt-making mode. However, some people confuse the aspect of permissibility with preference or priority. Some modes/products are considered limiting techniques, mainly because of the setting of profit rates for banks. But the certainty of the profit margin itself is not a problem at all.

All Islamic bank transactions must be based on the exchange of commodities, goods, services or labour. If there is an exchange of commodities or services accompanied by the application of the relevant Shari'ah principles, the transaction is permitted. Murabaha and Ijarah are allowed and there is no doubt in this regard. When implemented by a bank, one of the modes may involve irregularities, making the same not Shari'a compliant. In this sense, one might label every mode of technique a limit, because a slight negligence on the part of the banker or client can lead to Shari'a compliance issues. But the problems are encountered even in the case of Musyarakah and Mudarabah; should we avoid it because some IFI have not implemented Musyarakah requirements in letter and spirit? Certainly not. So the problem is not one of "debt versus equity" but one of placing a greater reliance on equity and debt compliance with the Shari'a principle that debt, once created, should not accrue as it increases in the conventional system.

For example, due to the recklessness of the functioning of Islamic banks in Pakistan in the 1980s that their Murabahah operations involving "buybacks" and "rollovers" were simply name changes. (This is possible even now in the case of "windows" operated by conventional financial institutions without Shariah oversight by regulators or Sharia advisers.) As a result, the Federal Sharia Court in Pakistan completely banned the use of Murabahah in its ruling rendered in November 1991. The Pakistani government prefers appealed to the Shariat Appellate Bench (SAB) of the Supreme Court of Pakistan, which allowed the use of Murabaha provided that all essences of Shariah Murabaha were implemented and the bank actually engaged in the trade and took the risk of the trade. Similarly, Ijarah is an important mode that can help in increasing capital formation in an economy. But if the bank does not meet the requirements relating to the risks and rewards of the leased asset, the transaction will not be Shari'a compliant and Shari'a advisors will be justified in refusing this.

Islamic banks can charge a fixed profit/lease if they are involved in trading and leasing; so in such a way that if the price or rent is not clearly defined, then the transaction loses its validity. Therefore, the permissibility of the modes of debt creation is intact and well established. Financing through this mode, in order to be Shari'a compliant, is necessarily linked to the real sector of activity and, therefore, is a fair source of productivity and profitability. Any product or mode does not need to be questioned just because some bankers do not meet shari'a requirements. If an effective Shari'a compliance framework is in operation and Shari'a Advisors and/or regulators are vigilant about IIF operations, their product must be acceptable.

The suitability of the Syirkah Mode for Financing Regarding the application of the preferred mode based on the Syirkah principle, the bank's management or regulator may wish to issue instructions to the practitioners in the bank to implement it keeping in mind the risk profile of the fund owner and the realities in the business field in their respective areas. In many areas of business, the use of Shirkah-based modes may not even be possible. A person doing a family business may need a financial bridge instead of permanent or long term funding. Their needs can be met through trade-based or leasing modes.

In some other cases, its use may not be recommended due to: the low risk profile of the investor. Banks keep depositors' money as trust and they are bound to invest the money according to the wishes or instructions of the depositors, without compromising the principles of Shari'a. If depositors are risk averse, their money will have to be invested in leasing or trading based modes. For example, a pensioner or widow may require an Islamic banker to invest his money in a less risky but Shari'a compliant place of business because he is not in a position to bear the risk of losses that may arise in a Shirk based business. The Bank, as the trustee, will be bound to invest the funds in risk-averse investors in Ijarah-based trading and activities.

Similarly, on the asset side, the bank's clients may not be willing to make the bank a partner in their business or may not keep proper and correct records of the joint business; this can cause losses to the bank and, in turn, to savers/investors. However, it must be accepted that Musyarakah and Mudarabah or other PLS products are the best alternatives to interest. They not only make capital risk-taking, a necessary factor in growth and development even in developed countries, but also encourage entrepreneurship. But this should not lead to the negation of the non-PLS mode, which can also play a role in capital formation and economic development.

Thus, there has been a gradual change in the approach of Islamic banking experts, and it is increasingly felt that all modes of Islamic financing, if used properly in accordance with the related Shari'a requirements, can have a positive role in the development process. Islamic banks, while functioning on a non-interest basis, should perform the important task of resource mobility lization, their efficient allocation based on PLS and non-PLS mode categories and strengthen payment systems to contribute to economic growth and development.

Islamic Financial Institutions – Banks or Trading Houses?

Islamic banking is also criticized on the grounds that banking means intermediation between savers and borrowers; banks do not do business in the real sector. They facilitate trade and business, but in that case also they deal with paperwork only. Islamic Bank s should not get involved in trading or other direct business. Otherwise they will expose themselves to unnecessary risk and possible loss for investors and financial system. But this objection has no solid foundation. Even conventional financial business is conducted on the basis of different structures, namely commercial banks, universal banks, investment banks and non-financial institutions or banking companies.

In countries such as Japan, Germany, Switzerland and the Netherlands, banks are involved in real sector traders and universal banking. Investment banks, mutual funds, and other asset management companies are involved in almost all countries in non-commercial business activities. Therefore, Islamic banks, which are not supposed to work on pure financial intermediation, diation model, are not something really new and unique in global finance. As lending and borrowing are not the main activities of IFI, the universal banking and investment banking models are more suitable for their operations and certainly more beneficial to the economies and communities in which they operate. Within this structure, they are in a better position to deal with problems such as information asymmetry that commercial banks work for purely financial intermediaries to face. In addition, they are in a position to earn higher returns, enabling them to provide higher returns to depositors.

Therefore, it is usually suggested that Islamic banks should set up trading companies to finance the purchases of their credit customers. Regarding risk, Islamic finance has provisions for mitigating assets, markets and risks related to returns. Furthermore, bank management or regulators can set firewalls so that Islamic financial institutions can avoid unnecessary exposure in various sectors.

Islamic Banks Act as Social Welfare Institutions

Another, less common, criticism of Islamic banking is that IIF impose market fees on clients at the associated rates; they should not be rewarded for the facilities they provide and serve as social security or charitable institutions. It has no solid foundation from a Shari'ah point of view or economic principles. Providing loans without repayment may be an individual activity at their discretion, or the State in some special circumstances. Providing funds by an agency business without a return is not possible under the rules of supply and demand. Where do the funds come from if the bank does not provide returns to depositors/investors?

Profit generation is not the problem; the problem is how to make a profit – through interest-based loans or through real sector businesses? Islamic banks usually do not lend money; they do business in the real sector while still paying attention to shari'a principles. IFI must work as business institutions in order to carry out their functions properly in the mobilization and efficient allocation of resources. The myth in some circles that Islamic banks need to work as social security centers that provide charity to the needy and for benevolence must be dispelled, because business and virtue are two separate things. Individuals have the right to spend on virtue from their income, for which they will be rewarded in this world and in the hereafter. But a bank that holds depositors' money with a specific mandated purpose has no right to disobey the mandate.

Islamic banks will sell the goods purchased by them at a profit, lease the assets at a lease and share the profits (or bear the losses) earned from the Shirkah-based investments. They will help communities to thrive by facilitating asset-based investment and the provision of risk-based capital. States or regulators will be required to oversee their functions to ensure that the interests of various stakeholders are properly safeguarded. Subject to the policies of their councils and in consultation with stakeholders, they may also take part in social and welfare activities, but this will not be their normal activity.

3. Results and Discussion

Criticism Assessment of Islamic Banking Practice

Difference between Theory and Practice

A number of scholars who have written about Islamic banking are of the view that Islamic banks have strayed far from their philosophical foundations and that the concepts of Islamic banking and finance have changed markedly from the concepts envisioned in the second half of the nineteenth century. In the early stages of the evolution of Islamic banking (the 1940s to the early 1980s), it was considered that, in particular, the profit/loss sharing mode would be an alternative to interest to remedy the socioeconomic injustice caused by interest institutions.

For example, Dr Nejatullah Siddiqi made Banking without interest or Dr. Uzair's interest-free Banking makes reference to Murabahah. The report of the Council of Islamic Ideology, Pakistan (1980) which is a pioneering work on the subject, permits the use of Murabahah only in doubt and limits its use to cases where it is unavoidable in the process of transformation.

Shaykh Muhammad Taqi Usmani writes about Murabahah and Ijarah in the concluding chapter of Introduction to Islamic Finance: "Shari'ah scholars have permitted their use for financing purposes only in areas where Musharakah cannot work and that too under certain conditions. This allowance should not be taken as a permanent rule for any type of transaction and the entire operation of the Islamic bank should not revolve around it." But practically, Murabahah and Ijarah are widely used and their use of the PLS mode can be ignored, even in the institutions where the venerable Shaykh serves as a Sharia Supervisor or a member of the Shari'a board. This difference must be seen in a true and larger perspective, as this will determine the level of credibility that the system emerges from. In fact, this phenomenon refers more to the evolution of the concept of Islamic finance than to its divergence.

Islamic finance is still developing on the basis of the basic philosophy and principles provided by Sharia. One of the main causes of the apparent discrepancy between theory and practice is the use of Murabaha, which provides a fixed rate of return to banks. This has been dubbed "Murabahah Syndrome", with an ironic feeling about IFI operations. Conceptually speaking, it's not an actual feeling. Trading is an accepted activity in the Islamic system and if the prohibitions and recommended business ethics, as identified in the Hadith and fiqh books are maintained it will bring many conveniences to mankind, the growth of wealth and a wider distribution of the bounty of the Almighty.

In many cases, trading or leasing is the only option. Most of the depositors, especially in developing countries, are low-income people such as retirees, widows and other lower-middle class groups. Their money should not be invested in risky ventures. However, in the case of single trade transactions or where satisfactory documentation is available, Islamic banks should use Musharakah, as this will give them higher returns.

IFI Uses Interest Income as Seed/Authorized Capital

Some have criticized Islamic banking on the grounds that conventional interest-based banks use their interest income to establish an "Islamic windows", a stand-alone Islamic banking branch (IBB) or a complete Islamic banking institution. The objection is that income earned from prohibited sources should not be used for business based on Shari'a principles. But the argument is unfounded. If a person doing prohibited/illegal business intends, at any time, to stop wrongdoing, he or she needs to be encouraged. There has to be a starting time to transform into a valid, good, and socially rewarding activity from an illegal, dangerous and bad profession.

The verses of the Qur'an give the principle that "those who listen" to the command of the Almighty and stop doing usury (in the future), hopefully the profits obtained before, the case is entrusted to the Almighty (for accountability) hereafter)" (2:275) and "if you repent (by taking interest), you are entitled to a principal" (2:278). This principle provides a clear line of action: the institution's interest-based income can be the seed capital for a branch, full bank or NBFC Islamic financial institution. The only requirement is that its operations must be shari'a compliant and completely separate from interest based businesses. Furthermore, in most cases, the entire bank capital will not become interest income. Initially generated fixed capital became part of it.

A related objection could be that, as directed by the Qur'an, such institutions should abandon interest-based businesses and convert their entire operations to Shari'ah-compliant ones. This is an ideal requirement and policy makers/regulators, especially in Muslim majority countries, should have a target for transformation of the whole system within a well defined period. But this can have exceptions: a mega multinational conventional financial institution cannot be expected to change its entire operations overnight; but of course it should be encouraged to launch Shari'ah compliant businesses at whatever level one can afford, as this will probably be the driving force for the promotion of the new system worldwide.

Difference between Islamic and Conventional Banking

The most common criticism relating to the practice of Islamic banking is that there is no real difference between conventional and shari'a banking operations. Objections were raised for the following reasons: IFI charge time value of money based on reference rates, like conventional institutions, to obtain the same level of income; they do not actually deal in goods and only facilitate the purchase of goods and services by clients, like their counterparts in the conventional system, and thus earn a steady income; they need collateral from clients, penalize them in case of default, provide nearly equal returns to depositors and investors and never pass losses to depositors. The following section considers this objection.

Charging Time Value of Money as Conventional Bank Fees IFI cannot and generally do not charge the time value of money in conventional sense. They have to do trade or leasing, which they can seriously consider taking into account the time factor for the purpose of pricing the goods or the outcome, such as: discussed in detail in various sections of the book. But once the receivables are created on the performance of a valid contract, they cannot add anything to the receivables, not only in debt-creating modes like trading and leasing but also with respect to the profits realized in Musharakah or Mudharabah. The "cost of funds" in terms of conventional opportunity cost is a no-brainer in Islamic finance. The time value of money received for this purpose is the determination of the price of goods/products only and not the determination of the price of money or debt securities.

Therefore, the view that Islamic banks impose the time value of money like conventional banks is a misunderstanding. The use of interest rates as a benchmark related to interest by Islamic banks has also been criticized. The important thing that needs to be observed in this case is that benchmark or interest rates are a genuine need of all types of businesses. Reference levels may differ from sector to sector, market to market and over time – formal market levels will differ from informal markets; real estate prices will differ from commodity market prices; similarly, the level of the financial sector will differ from that of industry or agriculture. But such tariffs must exist, allowing relevant market participants to determine the prices of their goods and services.

Therefore, IIF also need a reference level or benchmark. As the market in which they have to function is financial, they can only use the financial market reference level, otherwise there will be distortion or chaos. A related question might be why Islamic banks don't develop their own benchmark interest rates? It must be accepted that benchmarks reflecting fictitious assets will not help in realizing the socio-economic objectives of Islamic banking and finance. But the point to note is that in the current scenario, where the share of Islamic banks in the national and global financial markets is very small, they are obliged to use benchmarks from the formal conventional markets in which they operate.

Governments and large public and private sector companies raise large funds on the basis of interest. Also, they place their excess liquidity at the highest possible risk-free rate of return. In fact, most stocks do not meet the screening criteria for Shari'a-compliant investments in joint stock company shares. This is why IFI currently use interest-based benchmarking in almost all parts of the world. No doubt Islamic banking, which is inherently different from the conventional system, requires its own benchmarks, but developing separate rates within each jurisdiction takes time and ongoing effort, which should remain part of the future agenda of Shari'a economists, bankers, policy makers and scholars. .

For today, conventional benchmarks can be used by IFI as these are used only as a tool and basis for determining the price of goods or their results, which are accepted by Shari'a. The seller can charge any price with the agreement of the buyer and remain competitive in the market. The use of conventional benchmarks does not mean that Islamic and conventional banking are similar. As discussed earlier, the different subject matter of the two systems (money in the former and goods in the latter) makes a lot of difference in terms of the rights and obligations of the parties.

Pre-fixed Rate of Return in Islamic Finance

A common myth, especially among laypeople, is that Islamic financial institutions should charge and only provide variable returns on financial accommodation and deposits respectively; fixed deposit or facility rate is interest. This myth needs to be dispelled, as the return of rates depends on the nature of the contract or agreement. In all transactions, Shari'a is the requirement is that a person should know enough about what he is giving and getting in return in a contract. This implies that certainty about the subject matter and its exchange rate, transparency, disclosure and free consent of the parties to enter into a contract are important factors in Islamic business and finance. It all depends on the nature of the transaction. In money or debt transactions, variable or floating/variable fees can be taken. If the deposit in the bank is in the form of a loan, as in the case of a bank checking account liability, they may not carry a return. Deposits are mobilized on a Mudarabah basis should generate variable returns for both the bank and the depositors.

In the case of a loss on the deposit, the capital of the saver will be reduced while the bank will not receive any compensation for its services as a fund manager. The bank will charge a flat fee, while the depositor will take the entire profit or bear the loss, if any. The rule that a person must know enough what he gives and what he gets in exchange in the contract implies that the price or rent must be fixed with certainty. In the case of trading, Islamic banks are required to set a price once and for all and, therefore, they can charge a fixed profit in Murabahah, whereas in Salam, the bank's return depends on the price at which it is able to market the Salam commodity. In Ijarah, the lease must remain, otherwise the transaction is void. However, since the lessor has to bear the risks associated with ownership and expenses, the net return to the bank as a lessor or to a Islamic bonds/ijarah holder is quasi-fixed and not absolutely fixed. On money loans or debt-based instruments, Islamic banks cannot get any kind of return.

Shirkah based investments can be attached to fixed income modes such as trading and Ijarah. Examples are Reducing Musyarakah based on Syirkatulmilk and securitization through Ijarah and Syirkah. Sharia investment products can be arranged in such a way that investor get a variable or quasi-fixed return.

Therefore, the determination of the load is not a problem; it all depends on the nature of each transaction or outcome and its implications. A related objection with respect to rates is that although Islamic banks get deposits on a Mudarabah basis, they never pass on any losses to the depositors. The factual position is that an IFI is a collection of deposits, and investments based on the division and mode of debt generation are made from each pool, keeping in mind the principle of diversification. The larger the pool and the wider the degree of diversification, the lower the likelihood of losses for the bank and for pool members in the turn. For example a pool belonging to a thousand depositors from various categories (tenors) must be invested; the bank invests in four, five or even more sectors/sub-sectors of the economy by facilitating 200 entrepreneurs on the basis of various modes such as Murabahah, Ijarah, Musyarakah Reduced and Musyarakah, taking into account all risk management tools.

As a result, in most trading and leasing cases, the bank will get a predetermined return; in the case of Shirkah-based financing, it may incur losses in some cases, while in most cases, it will benefit, as has implemented all the risk mitigation tools permitted by the Shari'ah. Even if it had to incur a loss in respect of some cases or several defaulted receivables, it would generate an overall profit. The overall profit earned from the pool is distributed among the pool and the bank (Mudarib) and then the pool share is distributed among the pool members based on the average daily product and the weight assigned to each category at the beginning of the period of 5, if the projected profit rate is indicated beforehand, it has no impact on the final profit sharing; only the net realized amount should be distributed on the basis of pre-agreed criteria and the bank has a limited "tool kit" to cover the shortfall, if any.

Therefore, we can say that any losses should be charged to the pool, but the profits earned by the bank in most cases cover the losses. Furthermore, the IFI can create a reserve of profits, from which any future losses can be met. Another important aspect is that Islamic banks are business entities for the purpose of making a profit. They are required to be more conscientious entrepreneurs than their counterparts in conventional settings, as they hold public money as a trust. All businesses avoid losses through proper management and risk mitigation tools. As well as Islamic banks holding depositors' money as trustees are required to implement all legal measures and possible to avoid losses. The certainty of a definite return on various types of Sukuk is, of course, a critical issue.

The gist of the discussion is that securities or "fixed income" Sukuk in the term of conventional investment instruments are not possible in Islamic finance. The prospectus for issuing Sukuk/certificates (not only Syirkah-based ones) must not contain any clause under which it is the issuer's responsibility to compensate the certificate holder up to face value in situations other than tort and negligence, or that it guarantees a fixed percentage of profits.

In Syirkah-based Sukuk, only independent third parties can provide guarantees without any compensation for any capital or profits. However, third party commitments do not create a right for the beneficiary to link the Syirkah contract with the fulfillment of the guarantee. In the event of the inability or refusal by a third party to perform as committed, the Sukuk holder cannot claim for compensation on the grounds that they have purchased the Sukuk taking into account the third party's efforts to guarantee profits or capital. In the case of mixed portfolio Ijarah or Sukuk, there may be a default in receipt of Murabahah receivables; in a lease, there is the possibility of both an ownership-related cost and a default in receipt of the lease as it matures. The owner/tenant of the asset can guarantee the buyer (the Sukuk holder), when selling it to the SPV, about the performance of the lessee, as in the case of the IDB Trust. But what action should be taken if the asset is destroyed without any fault or negligence of the tenant? This loss must be borne by the lessor – the Sukuk holder.

In the case of murabahah or other receivables, the SPV may seek assistance from the institution that has: carried out the underlying transaction, but even then there may be deficiencies. Hence, the rate of return can be quasi-fixed but not fixed in any way with respect to any category of Sukuk.

Therefore, this issue must be addressed for the integrity and continued support for the emerging financial system. Real Involvement in Real Sector Business Islamic banks are also criticized on the grounds of not actually engaging in real sector business. This is not true; Islamic banks must be involved in real business, with all its implications, because they are not allowed to charge funds or rent money in short, medium or long term loans, overdrafts, guarantees, financing of bills, receiving bonds or other instruments or selling their debt instruments. .

The most strategic difference between Islamic and conventional rules is that, in the latter case, both items of exchange in a transaction can be deferred and the goods purchased, and even "options" can be sold forward without taking ownership of the underlying asset and ownership of the associated risks.

In Islamic finance, only one of the items of the exchange contract which may be delayed during delivery/possession of the exchanged goods must be given and taken, as stipulated in the contract, together with the transfer of risk to the buyer. Islamic bank operations involve the exchange of goods for money, which can take several forms such as simultaneous on-site exchange, spot delivery with deferred payment and on-site payment with deferred delivery.

The subjects of Islamic banking are goods; IIF uses money only as a medium of exchange to purchase goods for the purpose of being rented or sold, thereby earning rent or profit. They have to virtually buy the commodity, take it into possession and possession, necessarily implying the transfer of ownership of the risk to them; only then they are entitled to profit by selling it forward. Upon execution of the sale, the risk of the asset is transferred to the client, who is bound to pay the price at set time. In Salam, the bank must take delivery of the purchased goods in advance, regardless of decreasing or increasing their prices. In Istisna'a, the producer hands over

the asset to the bank along with all risks related to the asset and the market. In Ijarah, ownership of the leased assets remains with the bank and according to established Shari'ah rules, the risk also remains with them.
Islamic banks, however, do not and cannot maintain an inventory of all the goods they trade within; they are not a grocery store. Nor is it a Shari'ah requirement that one should always place his wares on the shop counter before selling them. The procedure that an IFI can purchase goods for subsequent sale at the request of the client is based on: real sector business practices which are very common and, therefore, acceptable from a Shari'ah point of view.
Thus, the Shari'a Standard on Murabahah prepared by AAOIFI has renamed the Murabahah Standard a Purchase Orderer. Making a client an agent for the purchase or sale of goods by a shari'a bank is also accepted in shari'a without differences of opinion. The goods held by the agent are at the risk of the principal as long as negligence or breach of trust on the part of the agent is not proven. It seems preferable that Islamic banks set up some asset management or trading company that can maintain a stock of commonly needed goods and assets for conducting merchant banking; but it is not possible to keep all the inventory of goods and brands of goods required by the client, nor is it a Shari'ah requirement for a true trading and ijarah business.
Taking Collateral/Collateral and Documentation with another objection raised is that Islamic banks, like their counterparts in the conventional system, take collateral/collateral in all financing, including Musyarakah/Mudharabah. A related objection is that Islamic banks ask for too much documentation. This is a misunderstanding about IIFS should facilitate their clients on the asset side without collateral requirements. In principle, this objection is unfounded. Islamic banks are commercial institutions; they can take a pledge/guarantee with their satisfaction level for the recovery of their receivables. When IFI handle goods and create accounts receivable, they require more guarantees and documentation than conventional institutions require. The Qur'an and As-Sunnah emphasize documentation, transparency and guarantees in all credit transactions.
The Quran commands a person to write down and take witnesses in all transactions involving credit in one way or another. Likewise the Messenger of Allah. encourage disclosure of all features of traded goods and a competitive environment in which people are adequately informed about goods and their prices in the market.
Therefore, in all modes of debt creation, the bank can ask the client to provide collateral in the form of a mortgage, lien or fee on one of its assets. In forward purchases, the bank may require the client to provide security to ensure that it will deliver the commodity on the agreed upon date. In PLS mode too, the bank can ask for a guarantee against negligence or breach of contract; however the bank has no right to impose collateral if a loss in business has occurred without error or negligence on the part of the client who is a bank partner. However, practically, there may be a requirement that, in certain cases, the conditions relating to collateral are relaxed to allow clients of small means to do some micro-level business.
Experience has shown that small businesses and middle class clients of financial institutions do not adopt the practice of dilation in the payment of their obligations. Therefore, IFIs should also launch several schemes to facilitate the unemployed and the poor to start several businesses to earn sustenance on the basis of personal and/or group guarantees.
Risk Profile of Islamic Commercial Banks
Another misconception is that Islamic banks, like conventional banks, do not take risks; they adopt such modes and techniques so that they can earn targeted income, as in the case of conventional banking. What needs to be emphasized in this regard is that risk taking and risk management are two different aspects.
Islamic banking involves taking risk very naturally; risks can be minimized with valid risk management tools but are not completely avoided or eliminated. Conventional banks give and receive risk-free returns in the sense that the principal and additional interest is guaranteed; depositors and banks are entitled to all loans and interest. If a number of defaults, due to management/governance issues, as a contractual right to receive the amount remains intact. This is not the case in Islamic finance; IFIs have to do real business, so they can make a profit or incur a loss, and so they take risks.
The additional risks that Islamic financial institutions have to face compared to conventional national institutions are asset risk, market risk, Shari'a non-compliance risk, greater return risk, greater fiduciary risk, and greater legal risk. Asset risk is involved in all modes, particularly in Murabahah (before it is sold to the client), Salam (after receiving delivery) from the Salam seller) and Ijarah, as all risks related to ownership belong to the bank as long as it is an asset in its possession; if the asset is damaged without fault

on the part of the lessee and is unable to provide the benefits normally intended, the bank's right to obtain a lease will cease entity.
In the Shirkah-based mode, the risk is borne according to the share of ownership. Market risk is involved because the bank may not be able to market the goods purchased on the basis of: Salam, Istisna'a, etc. at a favorable price. The risk of rate of return is involved as the price, once fixed in Murabaha/Salam, cannot be increased. Remaining in Sharia principles, Islamic banks are allowed to take mitigation/risk management measures. But the transfer of risk to another person without transferring the associated reward is not allowed. Therefore, the criticism that Islamic banks, like conventional banks, do not take business risks is illegitimate.

Identical Final Results of Conventional and Sharia Banking

Islamic banking has also been criticized on the grounds that the end result of operational Islamic banking is the same as conventional banking. Apparently, this may be true, for reasons why IFIs use the same benchmarks, operate in a competitive environment and, as such, are not in a position to provide or charge rates that differ significantly from that of conventional banks. Financial sector benchmarks make administration and regulation by bank management and regulators easy, effective and transparent. Therefore, Islamic banks generally use benchmarks used by conventional institutions. But just using a benchmark doesn't mean that the end result will be the same. While conventional banks use benchmarks to price their loans or money-based transactions, Islamic banks use them to price their goods, products and services; and this feature makes a lot of difference between the two systems. Islamic banks will not be able to create money from nothing or without the support of real assets, as is the case in conventional systems. They can only secure their asset-based operations for the purpose of generating liquid funds, thereby transferring their ownership to the securities holders along with the risks and rewards. Financing the government budget deficit by Islamic banks and financial institutions will not be possible until the government has sufficient real assets to raise funds in a Shari’ah compliant manner or for the conversion of debt shares into Shari’ah compliant securities.
The two systems differ even in terms of commercial operation. While national institutions provide loans for consumption or for the purchase of raw materials/finished goods/assets and continue to bear interest as long as the receivables are not paid, Islamic banks sell the relevant asset/commodity after taking ownership and risk at a specified price which remains the same even in the default case. In leasing, they bear the associated ownership risks and costs. If the leased assets are destroyed for any reason other than the negligence of the lessee, they bear the loss and if the amount received from the insurance/Takaful is not sufficient to cover the entire loss, they cannot claim the difference from the lessee. Similarly, in Salam they receive the goods and if they have to get back the prepaid price for any reason, they cannot claim a “fee of funds” for the use of the money by the Salam seller.
Therefore, it is not true to say that the final result of Islamic and conventional bank practices are the same, as long as the Islamic bank complies with the Shari’a requirements of the Islamic mode of business. Islamic finance increases the supply of risk-based capital and aids in capital formation in the economy, which ultimately benefits the general public, whereas conventional finance tends to create individuals who earn money from money without participating in real business activities – making the rich richer and the poor poorer.

Combined and Complex IFI Contracts

Another point that has been criticized about Islamic banking is that IIFS combine a number of contracts in relation to one whole transaction, while, according to Islamic finance theory, entering into "two contracts for one contract" is prohibited. But the factual position of the Shari'ah is that only two mutually dependent treaties are prohibited. The combination of several contracts is allowed under certain conditions. Syirkah and Ijarah can be combined, meaning that a partner can give his share of ownership of an asset that is leased to any partner, as in the case of Reduced Musyarakah. On the other hand, Bai' and Ijarah are two completely different contracts of effect; while in Bai', the ownership and risk are transferred to the buyer, in Ijarah, neither ownership nor risk is transferred from the lessor to the lessee. It is necessary, therefore, that the lease and sale are kept as separate agreements. However, either party can make a unilateral promise to sell, buy, or gift the asset upon termination of the lease. It will not bind the other party. Likewise, sales of owner units The fish to clients in the Reduced Musyarakah must be completely separate, requiring an "offer and an "acceptance" for each unit and the partner will bear the risk pro rata based on the shares in the holdings at all times.

Musyarakah and Mudarabah can also be combined. For example, banks manage depositors' funds on a Mudarabah basis; they can use their own funds in the business provided that the profit ratio for the sleeping partner should not be more than the ratio that the capital has total capital. Agency contracts (Wakalah) and guarantees (Kafalah) can also be combined with sales or rental contracts, provided that the rights and obligations arising from the various contracts are taken up according to their respective rules. Islamic banks can structure products by combining different modes, depending on the fulfillment of their respective conditions. For example, they can combine Salam or Istisna'a with Murabaha for pre-shipment export financing. Reducing Musyarakah is a combination of Syirkah and Ijarah coupled with an agreement by one of the parties to periodically sell/buy the goods belonging to/from other partners. In all major contracts such as Musyarakah, Ijarah, Salam and Istisna'a, the Islamic bank makes an agency promise and contract with the client or any third party the Parties. This is acceptable in Shari'a as long as all accessory agreements and contracts are independently enforceable by implication. However, interdependent agreements or provisions that lead to uncertainty about the rights and obligations of the parties to the contract cannot be concluded.

Taking Binding Promises from Clients

Some scholars have criticized Islamic banks for treating "promises to buy" by clients as a binder. But because it does not involve any violation of Shariah principles, mainstream Islamic finance theory has declared it binding, given the practical problems of finalizing contracts (see Chapter 5, Section 5.6). Given the intricacies of today's business, especially when carried out by Islamic banks, contemporary scholars have reached consensus that the promise of one of the parties in an economic/financial transaction is enforceable by law until and unless the giver of the promise is not in a position to fulfill it with the responsibility of each *force majeure*.

If it is not fulfilled due to the willful act of the promise giver, he will have to make up for the promised loss. The rationale behind this consensus decision is that, in most cases, a binding promise becomes a genuine condition, the fulfillment of which does not violate the basic principles of shari'a. This has important implications for the operations of Islamic banks in terms of Murabahah being a Purchase Orderer, Ijarah Muntahia-bi-Tamleek, Musyarakah Reduced and for the disposal of goods purchased by the bank with Salam/Istisna'a. Since it does not conflict with any Nass (text) of the Quran or Sunnah, it is acceptable under the Asliyah principle (all economic activities unprohibited are legal/permissible).

Imposing Penalties on Offenders

The application of fines for late payments by Islamic banks has also been criticized. The argument is that while the Qur'an recommends giving debtors more time and even waiving debts, IFIs impose fines on a percentage per year basis. As a result, the cost of financing for the client is the same as in the case of conventional banks, or may be higher. Therefore, Islamic banks must provide additional time without additional costs. Defaults are one of the main challenges facing the financial industry worldwide. Conventional systems have built-in tools to control defaults, because defaulters are charged an interest fee that is part of the income of conventional financial institutions. IFIs have been permitted by Shari'ah clerics to impose penalties on defaulters to discipline them, but the amount of the penalty must be spent on charity and cannot be part of the bank's income.

The situation is not that simple. Most of the bank's clients on the asset side are resourceful entrepreneurs. They do not pay their dues to the bank, while they continue their luxurious lifestyle. In such cases, they are not covered by the idea of the debtor in distress being entitled to relaxation or waivers. While full and timely debt repayment cannot be overstated. In Islamic economics and finance, we must distinguish between intentional and intentional defaults that actually arise due to real economic problems faced by debtors. As per Shari'a rules, intentional defaulters are like usurpers made to return any profits, along with property, made by them in the confiscated property. We must also distinguish between Qard and Dayn, as the jurists have agreed to impose punishment in the latter case only. That is, in the case of a loan (Qardh), the creditor must allow more time, whereas if an obligation to pay has been created due to a business transaction – a sale transaction or Ijarah – and the client delays payment using negligent tactics, he may be required to pay a fine, which is used to charity, and even to compensate the bank for its losses.

In relation to that, the Fiqh Board of the OKI has decided that the provisions of the penalty must be null and void when the client proves that his failure to fulfill obligations was due to reasons beyond his control, or when he proves that, as a result of breach of his contract, the bank has not suffered loss.

Default in the settlement of obligations has become a socio-economic crime in modern times, mainly because of the unjust principles of the capitalistic and interest-based system and the law of loopholes. In the Islamic framework, debtors are not given such discretion that even though they are billionaires in terms of assets, they do not pay their obligations due to some legal loopholes. Since Islamic banks have to work in the same overall environment, Shariah scholars allow them to impose penalties in case of default, because default is more about them than conventional institutions. They cannot claim a "fee of funds" or damages as conventional banks can charge a fee. Since defaults are detrimental to deposit holders, IIFS need to take every possible step to minimize their chances.

Availability of Cash for Overhead and Deficit Financing

Another criticism made of Islamic finance is, if money is always linked to real assets, how can the need for cash for overhead costs and for deficit financing be met? Islamic finance has a number of modes/instruments on the basis of which liquidity needs can be met properly. Forward sales such as Salam/Salaf and Istisna'a are the best examples. A producer of homogeneous goods can actually sell his production in advance, and thus use the cash received for consumption or business purposes. The needs of the government and the corporate sector can be met by issuing Sukuk Syirkah or Ijarah. Therefore, this criticism is no longer valid.

Socio-Economic Impact of the Current Islamic Banking System

Last but not least is the criticism that Islamic banking and finance in its current structure is not capable of achieving the socio-economic goals of Islamic economics, as claimed in the theory. Several pioneers have expressed their deep concern over the neglect of fairness-based fashion and the general prevalence of debt creation modes. That concern is justified insofar as if IFIs continue to work in a competitive environment without much support by the State, policymakers and regulators, as is the case today, they may not be able to realize the goals of the Islamic financial system as envisioned by its pioneers, even in the long term. But some are tougher and consider today's Islamic banking "an attempt to legitimize imitating conventional Western banking by distorting Shari'ah".

It seems that the writers who make such statements may not have tried to gain sufficient awareness of the concepts and philosophies of Islamic economics and finance (despite their scholarship in some other areas). Next, they must consider "the complex problems that the current generation of mankind faces in following divine guidance" (as Dr. M. Nejatullah Siddiqi put it in his response to Dr Asad Zaman; Ahmad and Siddiqi 2006). In response to the above criticism, Professor Khurshid Ahmad said: "We are all concerned that a systematic and sustained movement towards that (equity-based) economy has not been made.

It would be a tragedy if the Islamic movement did not move in that direction. But it would be less than generous to condemn all these efforts and rewards as an exercise in the legitimacy of the interest-based banking model." Furthermore, banking is only one part of the economy; public finances must also follow a fair and equitable system to get real benefits. The scope and need for the use of equity-based modes will be discussed in the last chapter, "The Way Forward".

4. CONCLUSION

The system that emerged was subject to a number of myths and harsh criticism, not only by those who did not accept the prohibition of interest but also by "devout" people both lay and learned who visualized the ideal system without giving any weight to the challenges of evolution and the problems of teething and difficulty.

Islamic finance concepts and philosophies are based on sound reasons and are accepted by an increasing number of people around the world. What practitioners need to do is create awareness so that it can dispel myths among the public. Regarding the practice of Islamic banking, it is necessary to implement strict internal controls to avoid systemic and operational risks.

The training of operational staff at all levels, aimed at: enhancing their vision, confidence and commitment, is a prerequisite for the continued growth of the new discipline. They must find ways and means to implement an equity-based mode, taking into account the risk profile of the fund owner and the nature of the business on the financing side. The starting point in this direction may be consignment-based trade practice financing, micro-business operations, syirkah-based securitization and fund management. Taking collateral and guarantees fully applies to Islamic banks. However, they must also facilitate clients who are able to conduct profitable business but are not in a position to offer any tangible guarantees, to enable them to start a business to generate income on the basis of personal and/or group guarantees.

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