J.KAU: Islamic Econ., Vol. **19**, No. 1, pp. 37-39 (2005 A.D/1426 A.H)

MUNAWAR IQBAL and PHILIP MOLYNEUX

Thirty Years of Islamic Banking: History, Performance and Prospects

Palgrave Macmillan, London, UK, 2005, pp.190

Reviewed by:
ABDELKADER CHACHI
Islamic Economics Research Centre
King Abdul Aziz University, Jeddah, Saudi Arabia

Thirty years ago, Islamic banking was unheard of. It was considered as, mentioned by the authors, as "wishful thinking" (p.ix). It is only in the early 1970s, and especially after the launch of the First International Conference on Islamic Economics organized by King Abdul Aziz University in Makkah, Saudi Arabia and the establishment of the first commercial Islamic Bank, Dubai Islamic Bank (DIB) in the United Arab Emirates followed by the establishment of the international Islamic Development Bank (IDB) in Jeddah, Saudi Arabia and the many private and semi-private commercial Islamic banks that were established after that in Egypt, Sudan, Kuwait, Bahrain, etc. that Islamic banking established itself not only as a feasible and viable alternative of financial intermediation but also as an efficient and productive way of undertaking financial intermediation between surplus and deficit economic units.

Since then, Islamic banking has gained momentum and has been growing very fast at a double digit average annual rate of growth. Today, Islamic banking is not a negligible or merely temporary phenomenon but it is here to stay and there are signs that it will continue to grow and expand (Ariff, 1988). At the moment, it is one of the fastest growing industries. Its size has grown tremendously from a mere few hundred thousand dollars in 1975 to reach hundreds of billions of dollars by 2005. The practice of Islamic banking is now not limited to only Arab and Muslim countries but has spread "from East to West, all the way from Indonesia and Malaysia towards Europe and the Americas" (p.1). Not only that, but the fact is that "many conventional banks, including some major multinational western banks have also started using Islamic banking techniques" (p.1). *Al-Hayat Al-Iqtisadiyah* (2005) reported that the world have been witnessesing a widespread of Islamic banks all over the five continents. Today, there are 280 Islamic banks in 48 countries, whose total deposits have reached US$400 billion, in addition to 300 conventional banks, which opened branches, windows or provide Islamic financial products.

Despite the fact that "if the assets of all Islamic banks were pooled, they would still be less than those of any single bank in the top 50 banks in the world, and the assets of the largest Islamic bank are equal to only 1 percent of the assets of the largest bank in the world" (p.132), this development is a remarkable experience that needs to be assessed, celebrated and guided.

The authors Munawar Iqbal, Chief of Islamic Banking and Finance Division at the Islamic Research and Traing Institute of the Islamic Development Bank and Philip Molyneux, Professor of Banking and Finance at the University of Wales, Bangor, have undertaken this task with the aim to provide an objective and professional assessment of Islamic banking over the last thirty years. They succeeded in discussing the experience of Islamic banking from theoretical, legal, and empirical perspectives. They divided their book into ten chapters, the first being the introduction and the last being the summary and conclusions.

Chapter One, the Introduction introduces the reader to the structure and content of the book and to the aim and methodology of the study.

Chapter Two concisely highlights the Islamic doctrine of 'universal permissibility' in business dealings, which states that: "everything is permissible unless it is clearly prohibited" and discusses the rationale behind the rejection of conventional banking that is based on interest which is considered as prohibited *riba* and behind the establishment of Islamic banks that are, instead, based on Profit and Loss Sharing (PLS) system. It introduces the theoretical foundations and principles on which this new alternative is based and highlights the alternative modes of finance and instruments on which Islamic banking and finance are based, such as *musharakah, mudarabah, murabaha, ijarah, salam* and *istisna'*. However, in doing so, the authors did not mention the most controversial mode of finance *tawarruq* that has recently been practiced by Islamic banks and considered as illegal or non compatible with the Islamic *shari'ah* by *Majma' al Fiqh al-Islami* in its Bahrain session in 2004. In fact, there is no mention of *tawarruq* even in the Glossary of Arabic Terms given at the beginning of the book or in the Index at the end of the book.

Chapter Three presents the model of Islamic banking as a viable alternative to the conventional model of banking and compared their salient features. It finishes by describing some of the benefits that are expected to be derived from the practice of Islamic banking.

Chapter four traces the historical origin and development of Islamic banking from a modest beginning in the 1960s and 1970s to a level where many mega-international banks are offering Islamic banking products and services. It underscores the fact that Islamic banking is now well established and recognized at an international level and highlights the various manifestations of Islamic banking and finance in various parts of the globe. They provided empirical data and key information about Islamic banks, Islamic mutual funds, Islamic insurance companies, etc.. They analyzed the growth of key variables such as assets, deposits, investments, profits, etc..

Chapter Five analyses and assesses the performance of Islamic banks using a number of proxies such as soundness, prudence, effectiveness, profitability, etc., through the use of financial ratio analysis. They confirmed the studies to date that has shown Islamic banking by no means inferior to their counterparts. As a matter of fact, most studies conclude that they usually show better results than conventional banks.

Chapter Six rigorously discusses in some details the efficiency of Islamic banks. It discusses the relevant theoretical developments in the field of studying bank efficiency. However, in doing so, the authors did not undertake the task of measuring the efficiency of Islamic bank. Instead, they relied on the studies that have already done so and provide a survey of several such studies analyzing the efficiency of Islamic banking in some Middle-Eastern countries. They concluded that Islamic banks are at least as cost efficient as conventional banks, and in many cases more so.

Chapter Seven highlights and tackles the theoretical and practical challenges facing Islamic banks such as the unresolved *fiqhi* issues and Chapter Eight examines how in the view of the authors the Islamic banking industry needs to respond to those challenges as it enters the twenty first century.

Chapter Nine points out some of the theoretical and empirical issues that need further research and discussion, in order to provide continued support to the practice of Islamic banking. A brief consideration is given to four areas: (i) the problem of asymmetric information and the cost involved in reducing it; (ii) the problems of moral hazard; (iii) the problem of verifying *ex-ante* the promises and intentions that are frequently involved in financial transactions (adverse selection problem); (iv) the agency costs and the need for monitoring the counterparties' behaviour. The chapter then goes on to study some specific features of profit sharing contracts as compared to debt contracts. In examining the argument that PLS financing is too risky for banks to adopt, the authors found two fallacies in this line of arguments. First, the variability in the rate of return is not the only risk involved in financial contracts. Second, the so-called 'fixed return' contracts, like interest based contracts may not in fact yield a fixed return! Therefore, they concluded that the argument that PLS contracts are too risky for Islamic banks to adopt is not convincing.

Finally, Chapter Ten presents the summary and conclusions of the study and provides guidelines for Islamic financial engineering, which they summarized in what they called the four Cs (Consciousness, Clarity, Capability and Commitment). It numerates the potential benefits of Islamic banking, highlights the challenges facing Islamic banks and points out the areas of further research such as the ownership structure, transparency and corporate governance of Islamic banks. It concludes by saying: "bearing in mind that despite the remarkable progress within the last thirty years, Islamic banking is still a nascent industry that has a long way to go before it can bear full fruits and rival other well developed models of banking".

The book also contains a glossary of Arabic terms used in the book and furnishes valuable information on Islamic banks, Islamic insurance companies, mutual funds, and Islamic windows in conventional banks.

References

Al-Hayat AL-Iqtisadiyah (2005), "The Total Deposits of Two Hundred and Eighty Islamic Banks in Fourty Eight Countries Reach Four Hundred Billion Dollars, 25/09/2005 (21/08/1426), Issue No. 3567

Ariff, Mohamed (1988) "Islamic Banking", *Asian-Pacific Economic Literature*, Vol. **2**, No. 2, (September 1988), pp. 46-62.