Editor's Notes

Economists and researchers generally agree that the interest-based banking system is inefficient in encouraging development that maximizes production, ensures equitable distribution, and prevents cyclical fluctuations. In part as a reaction to this alleged inefficiency, but more so due to religious beliefs in the Islamic community, a new system of banking has emerged known as Profit-Loss-Sharing (PLS). PLS is currently integrated into 50 countries around the world, with over 250 Islamic financial institutions in operation. Islamic Banking is garnering significant international exposure as an ever-growing number of Islamic banks are being established across the globe.

Aside from economic concerns, the main reason behind the emergence of the PLS-banking system is the holy Quran's prohibition of *riba* (or interest). The establishment of Islamic banks was driven primarily by the desire of Muslims to reorganize their financial activities in accordance with the principles of Shariah, thus allowing them to conduct financial transactions without engaging in *riba*. There are two kinds of *riba* outlined in Shariah. The first is called *riba al-nasiah*, which is the fixing in advance of a positive return on a loan as a reward for waiting to be repaid. The second is called *riba al-fadl*, which occurs in hand-to-hand purchases and sales of commodities. Both types of *riba* are prohibited by Shariah. The justification for the prohibition of *riba al-nasiah* is that Islamic principles do not allow a profit to be made from the mere use of money with no attendant measurable increase in real economic activity. However, when the investment of money leads to an increase in business activity, this is not considered *riba*. It is important to note that Islam has no objection to true profit as a return on entrepreneurial efforts which benefit society as a whole. Moreover, the prohibition on *riba al-fadl* is motivated by a desire to guarantee justice and fair play in spot transactions and thus avoid exploitation through unfair exchanges.

The Islamic community has rationalized the elimination of *riba* by citing the broad goals of justice, efficiency, stability, and growth. With regards to justice, the removal of *riba* results in a borrower and lender both sharing the risk of a project. In addition, the resulting returns are more equitable in good times and bad because the reward of the investment is tied to the performance of the business venture. Returns are earned only when the business venture results in the creation of added value, which benefits all of society. With regards to efficiency, interest-based lending with adjustments for risk capital tends to result in serving more creditworthy borrowers, not necessarily the most productive projects. However, Islamic PLS-banking allocates financing to the most productive business ventures. This results in both the borrower and lender working more closely together to ensure the business venture's success, which is more

productive for society. The PLS system encourages cohesion between different social classes because financing is equally available to anyone with a productive idea. With regards to stability, Muslim economists argue that interest-based banking systems breed inflation, as the creation of money does not necessarily make a business venture more productive. This may result in a higher cost to society if business ventures fail without any economic benefits.

Muslim scholars have rebutted three common arguments about the supposed benefits of interest, namely that: 1) interest is a reward for savings; 2) interest reflects the productivity of capital; and 3) interest provides a means of adjustment between the value of capital goods today and their value tomorrow. Regarding the first argument, Muslim scholars contend that interest is only justified if it results in reinvestment and subsequent growth in capital. Thus, interest cannot be justified solely as a reward for foregoing consumption. Regarding the second argument, modern Muslim scholars argue that interest is paid on money and has to be paid regardless of whether or not capital productivity results. Thus, it is not justified. Regarding the third argument, Muslim scholars assert that if interest serves as a way to adjust for the difference between the value of capital goods today and their value tomorrow, then this only explains its legitimacy and not its inevitability. That is, there are other ways to adjust for this difference. A more reasonable way would be to allow next year's economic conditions to determine the extent of the premium as opposed to predetermining it in the form of interest.

Islamic finance's requirement of Shariah compliance leads to a host of rules and regulations that distinguish it from conventional finance. Chief among these are the prohibition of usury (*riba*), gambling (*maisir*), and unjustified ambiguity (*gharar*); the prerequisite that income be derived from productive economic activities and profits be shared fairly; and the ban on investing in certain industries that are considered forbidden (*haram*) due to their toxic effects on society.

The first paper identifies ethical finance and Islamic finance as two important topics in the post-global financial crisis market environment and examines them in the context of sustainable development goals and the circular economy. Is Islamic finance inherently ethical finance? What is the difference between the two? Economic transactions in Islamic finance are governed by legal and moral principles that are both universal and divine. However, contemporary Islamic financial practices are strongly criticized for giving preference to legal forms over ethical substance, thus leading to an increasing gap between moral ideals and practical realities. Ethical finance is a deliberate human effort to reform finance that embraces environmentally, socially, and morally conscious

practices. In this paper we examine two banks, namely Islami Bank Bangladesh Limited (IBBL) and Triodos Bank. We categorize the first as an ideal Islamic Bank and the second as an ideal Ethical Bank. We undertake an analysis of balance sheet disclosures of the two banks and gauge the similarities and divergences in their business principles and practices. The analysis reveals that the current practices of IBBL far exceed other Islamic banks in terms of financial inclusion, microfinance, gender balance, SME financing, and green banking, all while ensuring financial stability and profitability. However, Triodos Bank has a significant advantage over IBBL regarding ethical practices because it only promotes sustainable businesses. If Triodos Bank exceeds IBBL in ethical expectations as we conclude, then it is also far ahead of other Islamic banks. The implication of our conclusion is that Islamic banking needs ethical reform and Triodos Bank's business model can provide a benchmark for such reform. For Islamic banks the correct approach would be to strike the right balance between ethics, moral standards, Shariah compliance, and profitability. The Islamic banking model has built-in features to ensure Shariah compliance. These can be enhanced by adopting sound ethical practices as well as dedicating efforts towards being environment-friendly. This paper presents some considerations which, if followed, would absolve Islamic banks from the criticism of being *for-profit* in motivation. Triodos has balanced its *for-profit* and *not-for-profit* motivations by letting the latter guide the former.

The second paper examines the intricacies of *Tawarruq*, a modern Islamic financial product. Islamic banking operates in a very competitive and fast-paced international industry in which mainstream banking is dominant and the people's needs for financial services are growing day by day. To meet these rapidly growing needs, Islamic banking must be able to develop innovative and competitive Shariah-compliant diversified financial instruments that provide a compelling alternative to conventional cash-based ones. The serious challenges posed by the aggressive environment of the international banking industry have shrunk profit margins and forced Islamic financial institutions (IFIs) to find new profitable markets and attempt to cut costs by any possible means. The desire to avoid the risks that are intrinsic to some classical Islamic financial products such as *Mudarabah*, *Musharakah*, and deferred sales products have led many IFIs to deliberately expand their operations on *Tawarruq* as an alternative approach to deliver cash to customers regardless of the objectives of the prohibition of *riba* in Shariah and the principle of realism in Islamic contracts. This paper argues that *Tawarruq,* instead of mitigating risks as intended, actually exposes IFIs to four potential types of risks: reputation, credit, legal, and compliance.

The third paper critically evaluates various Islamic banking models. Since the publication of M. N. Siddiqi's book *Banking Without Interest,* which contained the

first ever comprehensive, consistent, and feasible model of Islamic banking, several theoretical models of Islamic banking have been conceived. The initial academic attempts of developing and instituting Islamic interest-free commercial banking were based on a pure financial intermediation model. After this, diverse discourses on the nature, scope, and operational framework of an appropriate model of Islamic banking culminated in the formation of models such as Business Bank, Mutual Saving and Investment Association, Islamic Saving Bank, Islamic Investment Bank, Islamic Narrow Bank, and Islamic Universal Bank. Some of the latest additions to the literature are generally unknown but deserve to be comprehensively understood, compared, and contrasted with the earlier models of Islamic banks. Against this backdrop, this research paper brings together the seminal published theoretical literature on the subject.

The fourth paper looks at American home financing products within a crowdfunding framework. The primary Islamic banking product in America, the Shariah-compliant home financing product, has fallen into a developmental conundrum. In an attempt to capture a larger segment of the market, current Shariah-compliant schemes have evolved to be devoid of Islamic attributes, fundamentally converging with conventional products in function, form, and procedure. Correspondingly, the recent phenomenon of crowdfunding has demonstrated an overwhelming resemblance to the teachings and methodology of Islam. This paper identifies the opportunity to unite the best attributes of crowdfunding and Islamic finance to create a home finance product centered on a non-interest bearing marketplace lending platform. Crowdfunding offers such attributes as cooperation, consultation, and altruism, while Islamic finance offers such attributes as non-interest bearing, dissuasion of debt, conservative loan terms, and unambiguity. While hindrances to the implementation of such a model definitely do exist, such as the relatively high value of real estate and risk of default, the crowdfunding platform offers a resolution that could impel the next generation of Islamic home finance products to be fully compliant with Islamic teachings. Ultimately, developers of Islamic home finance products are urged to advance products that incorporate the innate Islamic attributes found in crowdfunding platforms.

The fifth paper investigates the state of the Wakf industry in India. India, housing the third largest Muslim population in the world, has Wakf properties worth billions of rupees located across the country. However, over the years there has been mismanagement of these properties by Wakf institutions, with political connivance resulting in the erosion of valuable assets. While the Central Government is taking several measures for the efficient administration of these assets and institutions, the response from the State Wakf Boards appears to be lukewarm with respect to transparency. This is an exploratory study calling attention to the Wakf administration system currently followed in India,

with a special emphasis on the financial disclosure pattern of the State Wakf Boards. The study underpins the necessity of a more transparent financial reporting system in order to safeguard the wealth of Wakf properties in India.

The sixth paper examines the determinants of Islamic banking performance. This paper is an empirical investigation into the effect of bank size and age on the financial performance (FP) of Islamic banks as measured by ROA and ROE. The study sample consists of 102 Islamic banks from 24 countries throughout the world, covering the period 2008-2012. A hierarchical regression analysis was applied to test the research hypotheses. The main findings indicate that the age of a bank has an impact on its FP. In contrast, our study shows an insignificant effect of bank size on FP. The results suggest that age helps banks learn useful new things with the passage of time. Older banks should create measures to counter new changes in market circumstances. In addition, these aging banks can use their reputation and experience to obtain higher margins on sales and enhance their FP. This study is novel in that it uses hierarchical regression analysis. In addition, it is the first study to date that focuses on a large sample of Islamic banks from around the world.

The seventh paper assesses the feasibility of Islamic finance and banking in the small island nation of Mauritius. The early 1970's saw the advancement of a surrogate banking system, the Islamic Development Bank (IDB), developed by the Organization of Islamic Countries, which officially became the first Islamic Bank. The initial aim of the IDB was to provide economic help and assist in profit sharing. Islamic banking and finance has evolved considerably since then and is now capable of rivaling conventional finance. Very few Islamic financial institutions operate in Mauritius and there is scant literature available for local context, so this paper shines a light on this innovative and flourishing means of finance, perhaps providing a catalyst for the expansion of Islamic finance on the island. By way of a survey we evaluate the local market's level of acceptance of Islamic finance and identify the relevant questions that need to be tackled before operating a parallel financial system. Our findings demonstrate that there will be a demand for Islamic financing as long as Islamic banks' returns are competitive. Muslims and non-Muslims seem to share a similar attitude towards Islamic banking.

The eighth paper uses an event study methodology to test the impact of addition and deletion of stocks on the performance of a participation index. This paper investigates the impact of index additions (deletions) on the stock price and trading volume of the Participation-30 Index in Turkey over the period April 2011 –June 2015. The results demonstrate that stock prices generally respond negatively to index additions and positively to index deletions during the research period. Trading volumes of added and

deleted stocks are influenced positively on the announcement day while the effective day exhibits the exact opposite behavior. The results of the Participation-30 Index in Turkey are similar to the results of non-Muslim countries found in previous studies.

The ninth paper examines affordable housing in Nigeria from an Islamic perspective. Globally, there is an urgent need to finance affordable housing. This need is especially pronounced in Nigeria. As of 2015, Nigeria is home to over 80 million Muslims, underscoring its great need for Shariah-compliant home financing. The immutable principles of Islamic commercial transactions that prohibit *riba* and *gharar* have given rise to a sharp distinction between the concepts of Islamic and conventional home financing. Nonetheless, despite the establishment of Islamic banking in Nigeria and the willingness of Muslims to embrace it, home financing in Nigeria remains largely conventional. Drawing on a review of literature on Islamic finance in Nigeria, this paper examines factors that may hinder the implementation of Islamic home financing in Nigeria. The study reveals that a low level of awareness, a lack of long-term financing, the presence of religious and cultural disparities, and an unfavorable framework are the main factors hindering the adoption of Islamic home financing in Nigeria.

The last paper analyzes the basic tenets of the Islamic welfare state. The natural worth of anything consists in its fitness to supply the necessities and serve the convenience of human needs. The welfare state always strives to ensure the material and spiritual well-being of the people in its domain. The Islamic welfare state integrates social, economic, cultural, and political engagements into a complementary whole guided by the basic principles of Islam (Shariah) for the purpose of establishing a society where justice, equity, and economic prosperity are prominent, and the benefits of worldly life and the hereafter are maximized. This paper examines the interrelationship between the political and economic contents of Shariah and discusses the nature and functions of the Islamic welfare state towards enthroning a better society in light of basic imperatives within the framework of financial constraints.

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