**Editor’s Note**

Much finance literature has been written about the destabilizing effects of excessive speculation as well as measures that can be taken to prevent or reduce its harmful impacts on markets and economies. Our concern in this journal issue is the legitimacy of stock market speculation within an Islamic stock exchange. There are two main questions. The first question is whether or not stock market speculation is pure gambling. This is a commonly held belief. The second is whether or not stock market speculation should be regarded as pure economic wastage.

Informational efficiency is more of a jurist norm affecting the legitimacy of the normative Islamic Stock Exchange (NISE) than a hypothesis in the current controversy surrounding the nature of modern markets. The phenomenon falls into the category of serious gharar in addition to the well-documented economic damage arising from excessive speculation. While Islamic equity funds do have an additional step of shari’a audit-screening, they are still essentially managed along the same lines of conventional equity funds. No special guidelines exist within shari’a audits to guard against speculation that may lead to serious gharar. Legitimacy conferred by shari’a audits may cause some to erroneously assume away problems in the daily management of ‘Islamic portfolios’.

For example, short sales are obvious speculative practices that violate the Islamic theory of contracts since they involve the selling of stocks through a broker before they are bought by the investor. Selling what one does not own sufficiently puts short sales in the prohibited category. Excessive speculation invokes concerns about serious gharar even when it obeys the formal condition of selling what is owned. If the object of sale is a documentary title to an unknown prospect—like a gambling ticket—then the formal juristic structure of the sale contract could be valid while the objects of sale would be clearly illegitimate.

Speculation per se is a normal trade practice in real goods when reliable information is missing. It is a problem in financial securities because trade on reliable economic information is the essential function of a stock exchange. Speculators in the stock exchange work on ‘uncertainty’ unlike any normal market traders while escaping stigmatization as gamblers. Financial markets differ drastically from real goods markets in terms of information discipline. Real goods are vulnerable to unpredictable changes in consumer taste, emergence of new competitive products, and shifts in costs and productivity due to technological development. These factors account for a wider margin of ‘uncertainty’ for real goods than for securities traded in financial markets. Financial securities are reducible to the variables cash flow, time and risk. Each of these is measurable which creates a solid quantitative database.
Unlike real goods that can be sensed directly by buyers, financial securities are pure information-loaded documents perceived in the context of contractual terms and conditions as well as external market information. These considerations make financial securities more gharar-prone than real goods. This means that the jurist issue is more about ensuring a gharar-free stock exchange than one of resolving a gambling evil. Gharar is a matter of degree indicating the same issue in relation to NISE (Tag el-Din, 1985, 1996). The need for a liquid investment market makes it imperative to accommodate speculative activity. NISE calls for the placement of appropriate measures to curb excessive speculation. The two imperatives are resolved by a closely matching financial and real markets.

Stock exchange speculation is a non-productive money-making activity that threatens monetary stability when practiced in excess despite being juristically vindicated from the gambling label. A moderate policy maintains a liquid capital market through the placement of suitable regulations against excessive speculation. However, this result fails to satisfy hard-line ideologists in the Muslim world who warn against all forms of stock market speculation and stand against the very principle of a Muslim country’s integration with world financial markets. Their attitude underlies the argument that total abolition of stock exchanges must be the right Islamic policy. The primary argument is that speculation is a pure money-making activity that contributes no real value in trade.

This view coincides with the Aristotelian outlook on money and trade. Aristotle fundamentally argued against trade as a means of money making even though money was fundamental in his philosophy. He did not consider trade for the sake of money a useful or ‘natural’ practice. Economic goods have three possible uses in the Aristotelian worldview. First, economic goods should be used in consumption. Additionally, goods can be exchanged for consumption with another party or exchanged for money. Aristotle believed that the first two uses were proper and natural procedures since people can only satisfy their consumer needs directly from their own production or indirectly through exchange with others.

The third use—exchange for the simple purpose of making money—was considered unnatural because goods would not have been used for their “proper” purpose. This view point was justified on the historical grounds of the structure of Greek economy that consisted of internally self-sufficient polis or cities with limited needs for external trade. An important aspect of the polis was that citizens had limited economic wants inferring that accumulation of wealth was not a socially acceptable practice. Wealth accumulation, however, was the usual practice of traders who occasionally procured goods for the cities. Traders were not citizens. This historical background portrays self-sufficient cities as the ideal. This feature was paramount to Aristotle’s just economic order. This model also supports Aristotle’s well known theory of ‘money sterility’ that is often cited as an argument against usury. Aristotle’s sterility theory implies a view of economic justice that condemns money and trade
profits as usury. In this sense, Aristotle may have a closer affinity to Marxism than Islamic thought.

It’s possible to suggest that Aristotle failed to appreciate the economic consequences of the monetization process that may eventually lead to complete separation between producer and consumer decisions via intervention of third party intermediaries like traders. Traders’ behaviors are not completely related to their own consumption behavior when the economy is fully monetized. Traders function as market agents who work for pure money. However, traders are also householders that dispose of money to satisfy consumption needs. Therefore, the fact that traders are ‘money makers’ does not negate viable trade activities from an Islamic perspective. However, trade is essentially gharar-prone. This means that a shari’a compliant economic system must employ a wide range of jurist checks and balances to regulate trading behavior and redirect it towards the fulfillment of society’s needs. It is worth noting that the Prophet’s own tradition avoided interference with free market operations even at a time when his Companions complained about soaring market prices.

The essential questions then become how stock market speculation can be controlled and what means can be used to guard against a destabilizing impact on an economy’s exchange rate. Excessive stock exchange speculation threatens monetary stability in Muslim countries in two ways. First, any sudden massive outflow of foreign funds at the international level can seriously depress the exchange rate and fuel domestic inflation. Second, the excessive speculation can lead to a risk of collapse in the stock exchange at the local level. This has serious repercussions for the stability of the financial system.

Analysis of Aristotle’s concept ‘stability of money’ provides a genuine Islamic context. The Aristotelian version of money uses three basic functions. These functions would be that of medium of exchange, measure of value and a store of value for future transactions. Importantly, Aristotle made no reference to the uniqueness of money as a store of purchasing power. This additional feature was introduced by the Muslim scholar Ibn Rush (Averroës) (1126–1198) who noted that any commodity can act as a store of value because a commodity can be sold for money in the future. This implies that money serves as a unique store of purchasing power at a time need not be sold first. Ibn Rush drew an important implication from this additional function. He argued that the value of money has to be unchangeable since it is the yardstick to value goods and services.

The Islamic view perceives the stability of money as inherently inseparable from money’s basic functions. Ibn al-Qayyim argued that preserving the stability of the function of money as a means to value other goods is why riba al-fadl is prohibited. Note that money would be gold and silver in those days. Money making commands an ethical Islamic value only to the extent that it originates in useful trade as
cherished in the Qur’anic verse: ‘God permits sale (trade) and forbids usury (interest income)’ (al-Baqara, S2:276). Money as a vehicle of trade is a means of creating real utility that helps promote people’s welfare. However, money is both the means and the end in the context of usury.

Money’s ability to serve as a liquid lubricant that facilitates economic exchange, specialization, technological innovation has widened the scope of economic interdependence among the world economies. Still, a disruption in the flow of trade occurs when money making becomes a means and ends to itself. Money as a business to itself then sustains an idle class of money lenders who live upon interest income. Trade is therefore open to the same evil of usury that can result in monopoly and wealth concentration unless properly regulated and ethically restrained. Trade can be prudently governed by the Islamic jurist experience through appropriate ethical and legalist measures to ensure its merits and avert harm. Speculation to excess in financial and commodity markets is not an exception to these rulings.

This issue contains five articles. The first article is “Islamic Banking and Zakat: An Alternative approach to Poverty Reduction in Bangladesh,” by Abdur Raquib. It states that Islamic Banking has emerged as a promising and a viable financial institution due to Islamic shari’a principles. The fast and stable growth of Islamic banks in the world financial system during the last few decades indicate the inherent strength of Islamic banking as a challenging alternative to the interest based capitalistic financial system. This study uses comparative analysis on the performance and achievement of Islamic banks in Bangladesh with those of contemporary conventional banks. The results confirm the superiority of Islamic banking. One implication of the study is that Islamic banking combined with Zakat, Ushar, AWAKALF and Micro Investments may be an effective and meaningful pathway for poverty reduction. Recent Central Bank guidelines for Islamic banking may provide the impetus to promoting fast growth of Islamic banking in Bangladesh.

The second article is “Understanding Characteristics of Depositors to Develop the Indonesian Islamic Banks,” by Rifki Ismal. This study examines characteristics of bank depositors in Indonesian Islamic banks using a survey of existing literature. The results are used to construct a suggested program with the stated goal of developing the industry. Details provided include profiles of depositors, their investments and liquidity preferences. The study suggests ways to educate the public on the operations and benefits of Islamic banks and maintain depositor loyalty. The goal of the program is to improve the understanding of depositors, further educate them, and maintain their loyalty. The overall successfulness of this program depends on the support and commitment of Islamic banks, bank regulators, stakeholders, Islamic scholars, and other related parties.

The third article is entitled “Stochastic Frontier Approach to Estimate Branch-wise Cost and Profit Efficiency of Islami Bank Bangladesh Limited (IBBL),” by M.
Mizanur Rahman and A.N.M. Tawhidul Islam. Islamic banks are a viable alternative banking system in all parts of the world because of the many things they offer. The first Islamic bank in Bangladesh —Islami Bank Bangladesh Limited (IBBL)— became operational in 1983. Assessing the performance of the IBBL is important given that more than two decades have elapsed since its inception. This paper provides an empirical investigation of the relative efficiency of different branches of IBBL using panel data from the period of 2003-2007.

A parametric stochastic approach is used to examine branch-wise cost and profit efficiency of the bank. The average cost efficiency observed during the period was 82 to 84 percent while the average profit efficiency was 86 to 94 percent. This result implies that IBBL branches are relatively less efficient in containing cost than in generating profit. Another finding of the study was that larger branch size is associated with higher efficiency implying that economies of scale exist in IBBL branches. The study further identifies important factors that may improve profit and cost-efficiency of Islamic banks. It also elucidates conditions that would make the institutions more sustainable.

The fourth article is “The Propagation of Non-Interest Banking in Nigeria: An Appraisal of the Ideological Risk,” by Abu bakar S. Orisankoko. The future popularity of Islamic banking depends on finding ways to educate the public and convince would-be investors of its benefits. Nigerian experience provides a useful example. This article examines promotion activities in terms of acts of ibadah. The article shows that potential customers and clients must be aware that a proposed Islamic Bank is both viable and consistent with their religious practices. Nigeria has a mix of Christians and Muslims who engage in trade, business, and financial and non-financial institutions. Many of these same people are a driving force of the banking sub-sector in Nigeria and their attitudes and practices must be considered. This paper studies the use of Holy Scriptures as a means convincing prospective customers of Islamic institutions.

The fifth article is titled “An Overview of Microfinance Sector in Bosnia and Herzegovina: Is There a Room for Islamic Microfinance?” by Edib Smolo. This study provides an overview the microfinance industry and its legal framework and status. It then briefly discusses the need for Islamic microfinance services in Bosnia and Herzegovina. Bosnia and Herzegovina is a transitional country trying to recover from a recent history of violence. A conventional microfinance industry has developed reasonably well for approximately the last fifteen years.

Five of Bosnia and Herzegovina’s microfinance institutions are among the Top 50 in the World. The number of the institutions providing microfinance services has increased enormously since the mid-90s. Regulation and rules for the microfinance sector have been implemented under respective banking laws. Microfinance is a very attractive way of financing since there is a high unemployment rate that ranges
between 20-40 percent. The industry is under pressure from the recent global financial crisis that exposed flaws within otherwise exemplary and successful microfinance practices.

The majority of Bosnians are Muslims. As result, there is a need for an Islamic banking and finance industry to meet the needs of this specific clientele. There is only one Islamic bank—Bosna Bank International (BBI)—in the country to date. BBI is regulated according to conventional banking because there is no law regulating Islamic banking and finance. Supplementing these laws so they accommodate Islamic banking and finance as well as Islamic microfinancing is not an easy process. Other Muslim countries may be able to provide support and examples. The study argues that Islamic microfinancing industry could be a successful story in Bosnia with the right kinds of support and frameworks.

I hope you will enjoy reading the articles in this issue.

References:


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