ISLAMIC FINANCIAL PRINCIPLES AND THEIR APPLICATIONS IN PROJECT FINANCING

by

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Abstract

Perhaps the most remarkable phenomenon in the Middle East financial world in recent years, and one which has implications stretching far beyond the region, has been the growth of Islamic financial institutions. With the recent international economic developments, and especially the setbacks of the debt crisis, new approachs have been sought to enhance financial flows to developing countries.

This thesis is concerned with reviewing the available mechanisms for financing projects in developing countries. The main focus is on Islamic financial principles and the potential role of Islamic financial institutions in international financial intermediation.

After the discussion of the status of financing in developing countries, the basic concepts underlying the Islamic financial system will be presented. This will be followed by a survey of existing Islamic financial institutions, their operations and their potential for project financing. Finally, a comparison between the Islamic and the conventional financing techniques will be presented, in the context of the variation in contractual arrangements and lender-borrower relationship.

Thesis Supervisor: Professor Fred Moavenzadeh
Title: Professor of Civil Engineering

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Finally, I am greatly indebted to my parents, for their love and encouragement, and, for teaching me the value of integrity and hard work. It is to them that I dedicate this thesis.

Dedication

To My Parents.

Table of Contents

List of Figures

List of Tables

Chapter 1

Introduction

Perhaps the most remarkable phenomenon in the Middle East financial world in recent years, and one which has implications stretching far beyond the region, has been the growth of Islamic financial institutions. The oldest of these institutions were founded in the mid-1970's and were not at first taken seriously. The extent of the change can be seen in the fact that one group alone is in the midst of a capitalization exercise that could exceed $ 1 billion, while financial institutions observing Islamic principles now exist in, or are planned for, almost all states where Muslims form the majority of the population or a substantial minority.

However, it was during the mid-thirties that special attention was first given to Islamic financial principles by some of the *ulama* (Islamic religious scholars) who addressed themselves to the problem of *riba* (interest or usury as defined in Islamic law). This led to the development of a more rigorous analysis of the Islamic rationale for the prohibition of *riba* and of the alternative system of banking and finance. Significant contributions in this direction were made at the First International Conference on Islamic Economics held at Makkah in 1976, the International Conference on Islam and the New International Economic Order held in London in 1977, the two seminars on Monetary and Fiscal Economics of Islam held at Makkah (1978) and Islamabad (1981), the conference on Islamic Banking and strategies for Economic Cooperation held in West Germany at Baden-Baden (1982), the Second International Conference on Islamic Economics held at Islamabad in 1983 and the conference on Islamic Banking held in London in 1984 under the aegis of the Middle East Association. Over a dozen books and monographs have been produced containing papers and discussions emerging out of these conferences and seminars. Perhaps one of the most significant contribution has been made by Pakistan's Islamic Ideology Council which, on the basis of a Report of its Panel of Economists and Bankers, has produced the first comprehensive and systematic blueprint for the elimination of *riba* from a modern economy.

A parallel development during the last decade was the development of interest-free banking and financial institutions in the private as well as in the public sector. This has reflected the need to satisfy the demand by devout Muslims for instruments and institutions enabling them to deposit funds and earn a return on their savings without having to violate basic tenets of their religion. Indeed in 1982, the Jeddah based Islamic Banking Association estimated that up to $ 40 billion was being accumulated outside the western style banking system in Islamic countries. This it felt, was due to the failure of conventional commercial banks to attract funds of the faithful, because of their inability to separate their funds from those attracting *riba*.

The intent of this thesis is to review the Islamic finance and the role it can play in project financing in the Middle East. The development will focus mainly on the need for and the forms of financing in developing countries, Islamic financial principles and the financial instruments used by Islamic financial institutions, the role of Islamic financial institutions in the development of Third World countries, and finally a comparison of the Islamic and the Western financial instruments for project financing.

Chapter 2

Financing in Developing Countries

2.1 Need for Financing in Developing Countries

External financial resources become necessary when the investment needs for the development programs of a country require funds which exceed the domestic savings. Table 2-I gives us information about the gross investment and gross national savings as share of the GNP, by geographic region, between 1960 and 1984. Note that industrialized countries have managed to balance their investment with their savings. North African and Middle Eastern countries show a higher rate of savings compared with their investment, while in the rest of the world a significant gap exists between investment needs and existing savings.

This gap has been partly filled with grants and concessional loans from bilateral and multilateral sources, and partly by private foreign investment and by borrowing from international capital markets.

The potential benefits of international capital flows can be appreciated in the extent that they can:

- shift savings from areas of low to areas of high productivity,
- enhance the potential national income of developing countries over time by investing in profitable projects that can not be financed with domestic resources,
- smooth consumption in response to sharp fluctuations in income or required outlays,
- shift foreign exchange to areas where it is temporarily in short supply,

- shift risks associated with particular development strategies or economic ventures to investors with comparative advantage of bearing them.

However, an important condition for this capital mobility to yield its potential benefits is that the structure of lending should match the needs and economic conditions of both the borrower and the lender.

Therefore, a government must be realistic about the long-term effects of the use of external financial resources. The loans must be repaid and foreign investors normally remit profits back to their country. If exports of goods and services do not increase in the future to provide the exchange needed for debt repayments, the use of external financing may affect the balance of payment negatively and endanger the ability of the country to obtain further foreign financing.

Hence, developing countries are asked to show their capability to service the external debt. Three main aspects are usually considered when a country applies for a loan: (1) the trade position and the various currencies involved in the trade activities; (2) the reserves of the country and their currency denomination; (3) the currency in which the country is borrowing. A country's ability to meet its obligations are thus derived from its external trade, from the utilization it makes of the currency it borrows, and the further borrowing it may have access to. Moreover, the repaying of a debt is affected by the structure and terms of the debt and by the economic environment during the repayment period, with special regard to world trade activities and unexpected changes in the rate of inflation.

To try to quantify the problem, some financial parameters are usually calculated. The most important ones are: (1) the debt-servicing ratio, defined as the ratio of the sum of amortization payments on long-term debt and interest payments expressed as percentage of goods and services for exports; (2) the debt to GDP ratio; and (3) debt to exports ratio. Table 2-II shows the external debt and the previous debt servicing ratios for the three categories: all indebted developing countries, the Western Hemisphere and the Sub-Saharan Africa.

Table 2-III gives a detailed summary of the total net resource flows to developing countries from 1975 to 1985. The data shows a decline in the aggregate amount of financial flows to developing countries. This is due to the decline of private flows and export credits, official development finance remaining approximately at the same level.

2.2 Need for Financing in Construction Projects

Construction is the prerequisite of economic development and growth. The need for constructed facilities varies from country to country depending on the stage of their economic development. The construction share of Gross Domestic Product (GDP) usually ranges between 4 and 8 percent and is generally higher for developed than for developing countries (See Table 2-IV).

Third World countries, with their great need for infrastructure development and industrial development projects represent a great opportunity for the construction industry. In general, developing countries account for a substantial share of the work of the largest international construction companies and engineering firms.

The international demand for construction increased rapidly after the first oil shock of 1973. OPEC countries, particularly those of the Middle East, realized large oil revenues and used them to finance their development, which included large expenditures for construction. To many oil importing developing countries, however, the increase in energy costs was a crippling blow. In order for them to gain access of funds in order to continue their development programs, a recycling scheme for the petrodollars was devised in coordination with official and private financial institutions.

Between 1973 and 1977, the international capital markets recycled more than $200 billion. The increase of deposits in international financial centers and the low profitability of investment in industrial countries due to high energy prices induced international commercial banks to become more involved in international lending primarily to medium-and high-income developing countries. Eurocurrency bank credits rose sharply, from $1.5 billion to non-OPEC developing countries in 1972 to a high of $35.4 billion in 1979 [Demacopoulos & Moavenzadeh 85].

According to statistics published by the United nations, in the 1970s construction grew faster than the GDP for developing countries despite the opposite trend in the world as a whole (See Figure 2-1 (a,b)). In particular, Middle Eastern countries invested a large part of their oil income in construction, reaching an average growth rate of 25 percent in 1974-1975 (See Figure 2-1 (c)). Similarly, with the successful recycling of oil surplus funds after the first oil shock of 1973, other middle- or high-income developing countries, like those of Latin America were able to keep up with their development programs (See Figure 2-1 (d)).

However, the deterioration in international trade conditions, the global debt crisis and the decrease of oil revenues of oil exporting countries in the late 1970s and early 1980s have had a significant impact on international construction activities and especially construction financing. The reluctance of commercial banks to continue the overexpanded lending of the 1970s and the limited capacity of international development banks to provide sufficient financing for the development programs and projects have transfered the burden of project financing to international construction firms. For the last 15 years, developing countries have asked foreign contractors to submit with their bids proposals about financing of the projects. The task of financing a project has thus become more complicated and now requires increased cooperation with financial institutions, appropriate management strategies and innovative financing techniques.

2.3 Sources of International Financing

A developing country can have access to different sources of international financing. The packages offered by the different sources vary in financial terms, and in the amount of concessions and restrictions they impose on the developing country.

Potential lenders to developing countries can be grouped in two main classes:

- Official lenders, which include governments and governmental agencies, central banks, international development banks, and other public bodies. Official lending can come from: (1) bilateral sources, which constitute funding provided directly by a donor country; or (2) multilateral sources, which constitute funding channeled through international organizations active in development.

- Private lenders, which include all suppliers, exporters and manufacturers extending credit to their clients and all the private banks and other financial institutions engaged in lending to developing countries.

There are various forms of international financing of projects in developing countries. These are mainly:

- Official Finance,
- Direct Foreign Investment,
- International Capital Markets financing.

Table 2-V shows the composition of the net flow of external finance to indebted developing countries from 1977 to 1984, while Figure 2-VI gives a composition of net capital flows to developing countries for the years 1960, 1970, 1980, 1983 and projections for 1987.

2.3.1 Official Finance

Official finance comprises four main categories:

(1) Official transfers, which comprise that part of development assistance or aid for which the donor does not expect repayment, even on concessional terms. These transfers were still growing in real terms in the 1970s, but since 1981 the total has stagnated in dollar terms (See Figure 2-2).

(2) Bilateral loans which are given on concessional terms and thus are included in the definition of development assistance or aid. Concessional loans are also referred to as "soft" loans because they usually offer grace periods, lower interest rates than the market and longer maturities. The total of bilateral loans has been declining since 1980 (See Figure 2-2).

(3) Multilateral loans, which consist overwhelmingly of lending by the multilateral development banks. Part of this lending is concessional, but some two-thirds is not. The non concessional part has been growing steadily but is expected to decline in 1987, as shown in Figure 2-2.

(4) Official export credits, which contitute export credit extended by industrial countries' governments to developing countries. Official export credits have been high in recent years, which might reflect an attempt by developed countries to sustain their exports despite the cutback in commercial lending and, in some cases, an intention to temper the effects of the debt crisis [Lessard & Williamson 85].

Development Assistance:

The term "development assistance", as used by OECD, is synonymous with the word "aid" and includes grants and concessional loans offered by bilateral and multilateral official sources.

The donors are categorized in three major groups:

- The Development Assistance Committee (DAC), which is composed of the 17 most affluent countries of OECD,
- The Organization of Petroleum Exporting Countries (OPEC),
- The Council for Mutual Economic Assistance (CMEA, COMECON).

(See Table 2-VI)

The main purpose of development assistance is to improve the economic performance of the recipient country, without imposing reduction in its growth rate or rate of consumption.

From the donor's perspective, aid can be extended for humanitarian motives to alleviate poverty and promote social justice; or for economic self interest to enhance imports of goods and services by the recipient from the donor; or finally for political reasons to impose political policies on the recipient government. Table 2-VII shows long-term trends in aid by major donors. Table 2-VIII shows the geographical distribution of aid that was disbursed in recent years. The terms of the loans extended by DAC members are shown in Table 2-IX, and those of OPEC are shown in table 2-X.

From the recipient's perspective, aid can be viewed as a symbol of dependence on external resources and foreign countries, but also as a valuable tool to achieve economic development and hence economic independence. Most of the aid is used to finance social and economic infrastucture development (See Table 2-XI). Developing countries' goverments tend to favor aid with the fewest possible strings attached, and hence, prefer program aid rather than project aid, and international capital markets loans rather than bilateral loans. As shown in table 2-III, the share of international capital markets lending of the total flows to developing countries increased prior to the debt crisis and was in 1980 much higher than official flows.

Development Banks:

Development Banks are financial institutions which are financed by contibutions from member country governments. They primarily focus their activities on the assistance of their member countries. They serve as intermediaries in the transfer of capital from developed to developing countries. They mobilize funds from international capital markets and provide medium- and long-term credit, technical assitance, and management expertise to promote growth in developing countries. They primarily support public projects rather than those of the private sector. Table 2-XII lists some of the most important development banks and their commitments.

Presently, development banks are facing a period of unprecedented change. Their traditional sources of funds are decreasing as governments of developing coutries are preoccupied with adjusting their budget deficits and repaying outstanding debts, and as external assistance from industrial countries is declining. Moreover, the oil exporting countries, whose aid spending rose dramatically in the 1970s (See Table2-VI), are forced to cut their assistance because of declining oil revenues and the fund drain of the Iran-Iraq war. In addition, since the international debt crisis, commercial banks have been trying to cut back on their lending to developing countries leaving the development banks to face the demand for funds of development programs of most of the indebted countries.

2.3.2 Direct Foreign Investment

Direct Foreign investment (DFI) involves the transfer across national boundaries of resources, including intangibles such as knowhow and access to a global production and marketing system as well as funds, in return for claims on all or part of the future profits of the foreign venture. At an abstract level, the pattern of international investment, both in term of location and ownership of specific undertakings, is the result of the interaction of the supply of investment opportunities and the demand by investors for these opportunities. At an aggregate level, countries with large opportunities relative to available resources will tend to draw resources from those countries with fewer opportunities relative to current available resources [Lessard 85a].

The attractiveness of foreign investment depends on the perspective taken. The investing firm is seeking the maximum present value of remittable financial returns, while the host country wishes to maximize the economic or social value of the project, including not only the local financial returns but also relevant spillover and distributional effects, such as the transfer of technology and managerial knowhow.

Three main issues should be addressed when analysing a DFI venture and its potential benefits. These are:

- the incentives it creates for the design and management of the activities undertaken,
- the way it allocates the rewards and risks of the venture between the investor and the host country in terms of their comparative advantage in bearing the risks involved,
- the contracting costs that result from conflicts of interest between the various parties coupled with the impossibility of creating completely enforceable contracts across boundaries. [Lessard 85a]

In terms of the nature of the financial flow, DFI can have desirable attributes since (1) it provides a reasonable match with the country's capacity to generate foreign exchange to the extent that the profits remitted by the foreign investor are subject to the same risk factors as the economy as a whole; (2) it provides the foreign investor with a stake in the success of the local undertakings; and (3) shifts part of the macroeconomic risk to foreign investors.

However, DFI can also have undesirable effects to the extent that foreign control over domestic economic activities subjects it to abuses of market power and reduction in the scope for domestic institutional development. For this reason, DFI has been subject to increasing controls and requirements imposed by the host country.

Foreign investors are often faced with a wide range of risks. These include commercial risks, expropriation risks, transfer risks, and the risk of changes in commercial policies. This may explain the higher rate of return on investment that foreign investors expect from DFI operations.

The flow of DFI to developing countries has increased from 1960 to 1979 as can be depicted from Table 2-XIII. Outside the extractive industries, the dominant motivation has been to gain access to the market of the host country. The collapse of growth prospects in many developing countries after 1981 could have led to the decrease in FDI after 1981. However, an increasing portion of FDI has recently gone into manufacturing for exports, and this might explain the projected increase for DFI in 1987 (Figure 2-2).

2.3.3 International Capital Markets

The importance of international capital markets can be seen in the light of the demonstrated efficiency of private relative to official institutions: in a period when the IMF recycled $7 billion (1973-1977), the international capital markets recycled more than $200 billion [Demacopoulos & Moavenzadeh 85].

Flows from international capital markets can take several forms, the major ones are Eurocredits, International Bonds and Export Credits.

Eurocredits:

Eurocredits are short-, medium- and long-term loans made by Eurobanks. Eurobanks are banks that work in the Eurocurrency market, where deposits are made in currency other than that of the country in which the bank is located. The most important Eurocurrencies are the U.S. dollar, the Deutsche mark, the British pound, the French franc, the Swiss franc and the Japanese yen.

Borrowing rates are typically at LIBOR (London Interbank Offer Rate, which is the rate at which a Eurobank would lend Eurocurrency to other Eurobanks) plus a premium or spread. The spread is a function of the risk and maturity period of the debt. Eurocredits are usually short-term and hence, have relatively low interest rates. The credit is usually rolled over at maturity and the interest rate is adjusted to reflect changes in the LIBOR. Occasionally, loans are written with floating spreads over the base rate.

Eurocredit financing is normally done on an unsecured basis and does not impose any compensation balances or working capital requirements. Eurocredit markets are also characterised by high liquidity and large transactions. This has caused such line of credit to be attractive to developing country due to its efficiency, flexibility and minimum restrictions or intervention in the use of the funds from the part of the lender.

Eurocredits are usually provided through syndicates of banks and about 500 Eurobanks are actively involved in Eurocurrency lending with a limited number of the world's largest commercial banks being most active in the management and syndication of the credits [Demacopoulos & Moavenzadeh 85].

Syndicated Eurocredits increased substantially after the first oil shock of 1973 and the recycling of the petrodollars (See Tables 2-XIV, 2-XV). However, after the debt crisis, bank lending collapsed and took the form of "involuntary" lending in which the banks collectively agreed, along with the IMF and the debtor countries to extend the minimum amount of finance needed to sustain the agreed adjustment program [Lessard & Williamson 85].

International Bonds:

International bonds include foreign bonds and eurobonds. The main difference between the two is that the former is an international bond sold by a foreign borrower, generally underwritten by a national syndicate and is denominated in the currency of the country in which it is placed, while the later is an international bond underwritten by an international syndicate and is sold in countries other than the country of the currency in which it is denominated.

The volume of international bonds issued by developing countries fell off in the late 1970s (See Tables 2-XVI, 2-XVII & 2-XVIII). This was mainly due to the easy availability of commercial bank credits and the disadvantage of fixed-rate lending, characterizing the loans, in the face of uncertainty regarding inflation and interest rates. However, there are now signs of recovery, as the bond market has moved into an expansionary phase following the widespread adoption of floating rate notes [Lessard & Williamson 85].

Export Credits:

Export Credits play an important role in project financing. They constitute credit extended by the supplier of material or equipment, at usually low interest rates and variable maturities, depending on the relationship between lender and borrower.

2.4 Appraisal of Current Structure of Financing in Developing Countries

Current Structure :

Floating rate bank credit has become the predominant form of external finance for developing countries in recent years, rising to more than 70 percent of new financing in the late 1970s and the early 1980s [Lessard 85a]. This type of financing became popular for several reasons.

From the borrower's point of view, the non-specific nature of general obligation lending allowed for a complete control over the use of the funds. Moreover, this type of lending was available at much lower rates than long-term bond financing and even World Bank financing denominated in the same currency [Lessard & Williamson 85]. This low cost was due to its relatively shorter maturity and its greater enforceability, which stemmed from the fact that general obligation lending was concentrated in a relatively few lending institutions which had the power and common interest to exercise collective actions against defaulters.

From the lender's point of view, ie the commercial banks, general obligation lending was a profitable business which was made possible because of the incapability of development banks to handle the increased demand for funds by developing countries. Moreover, the lending was believed to be of low risk since it was government guaranteed and sovereign risk in such lending was believed to be nonexistent.

However, as was demonstrated by the debt crisis, general obligation financing proved it can have detrimental effects on developing countries under certain circumstances. The undesirable attributes of this type of financing can be described as follows:

- The repayment profile of floating rate general obligation debt shifts with changes in short-term nominal interest rates, which reflect changes in anticipated inflation as well as changes in real interest rates. Over the recent pass, increases in interest rates have tented to coincide with a worsening of the economic situation of developing countries, hence creating a mismatch between the debt service requirements and the borrower's ability to pay.

- General obligation lending provides lenders with no stake in the outcome of the specific projects or programs being financed, and hence does not give any responsability for the selection or execution and management of programs and projects to the suppliers of capital.

- Because it rules out earmarking the revenues of specific undertakings for debt service and requires repayment regardless of outcome, general obligation lending precludes the shifting of risk to the lender except through non-performance, and favors financing projects with low returns in credit worthy countries over highly promising projects with the misfortune of being located in a country whose general credit worthiness is poor.

Desirable Attributes :

Several principles on which finance to developing countries should be restructured have been recommended. If a more efficient international distribution of risk and a more appropriate distribution over time of debt-service obligations is to be achieved, finance to developing countries should have the following elements:

- Cash-flow matching, which links the debt obligations to some aspect of the borrower's economic situation and its capacity to pay by tranfering risks to parties with comparative advantages of bearing them, and by time matching of the repayment profile with the resources available.

- Performance incentives, which is a consequence of the linking of debt-service obligations to the outcome of the specific undertaking and which enhances the stakeholding of the lender and improves the quality of the projects financed,

- Use of domestic capital markets in developing countries, which stimulates domestic capital formation and savings.

Recommended Adjustments :

Several financial mechanisms have been recommended for satisfying the need for external finance of developing countries within the framework of desirable attributes. These are:

- Risk capital investments, which transfer risk from borrower to lender. These comprise, in addition to direct foreign investment, (1) portfolio investment in equities quoted on public stock markets, and (2) quasi-equity investments which englobe a wide range of financial arrangements such as project loans with equity kickers, production sharing, revenue sharing and profit sharing.

- Stand-alone finance, also refered to as project finance or limited recourse finance, which links the return to the lender to the success of the project, but only to the promised contractual interest rate. Thus, the lender is exposed to the downside risks, but in contrast to equity or quasi-equity claims, does not share in the upside potential. The lender's incentive to undertake project finance would be higher interest rate or provisions shielding him from other risks involving the project.

- Improvements in the volume and form of general obligation finance, which entails better risk management through financial capital markets, by the use of instruments such as interest and currency swaps, options and forward contracts.

Table 2-XIX shows the composition of external sources of financing to developing countries from 1981 to 1988 (economic situation and prospects). It shows a gradual decrease in the private lending since 1981. Table 2-XX shows the potential sources of expanded capital flows to developing countries for the late 1980s as predicted by Lessard and Williamson [Lessard & Williamson 85].

2.5 The Potential Role of Islamic Finance in Project Financing

As will be shown in greater detail in the following chapters, Islamic financial principles are primarily based on equity participation and profit and loss sharing. These principles have given way to a set of permissible contracts, accepted by the majority of Islamic jurists, and around which the financial activities of currently existent Islamic financial institutions are geared.

It is interesting to note that the characteristics of the Islamic financial instruments are quite similar to the desirable attributes recommended for financing projects in developing countries. As the protagonists of Islamic finance argue, the advantages of profit and loss sharing or equity participation operations are:

- A more equitable distribution of the risk involved in the undertaken venture, since some of the risk is shifted to the supplier of capital in return for a greater stake in the outcome of the venture. Hence for Islamic jurists, it is unjust to require a fixed return on the loan extented to the user of capital regardless of the outcome of his venture, namely in the case of loss, as it is also unjust for the user of borrowed funds to remit a fixed amount to the supplier of capital regardless of the amount of profits aquired from the venture;

- A more efficient linkage of the debt servicing with the ability of the borrower of capital to repay the debt. This linkage is provided, as will be discussed in later chapters, by a set of contractual arrangements, which allow the supplier of capital to participate, either as equity holder or through profit sharing, in the financing of the undertaking, and to be repaid by the borrower through a amortization of his equity over time or through the share of the profits of the borrower;

- A greater involvement of financial intermediaries in the financial performance of the borrower. As can be expected, when the repayment of the debt depends on the outcome of the project, a better selection of highly productive ventures will take place, and more tranfer of managerial and financial expertise will occur, leading to an improvement in the quality of project financed;

- The attractiveness of new financial instruments to savers who have religious inhibitions concerning conventional interest-bearing assets. This is not only applicable to Islamic countries, but also to all developing countries, since the increase in usable capital will be increased by the amount deposited in Islamic financial institutions, and thus a larger capital base will be available for financial intermediation.

Islamic contracts and financial instruments will be dealt with in greater detail in chapter 3, while the operations of existing Islamic financial institutions and their role in financing developing countries are discussed in chapter 4.

Table 2-I: Savings and Investment Rates: 1960-1983 Share of GNP.

[percentage]

Region and indicator	1960–70	1970–80	1981	1982	1983	1984(P)
All developing regions						
SHARE IN GNP						
Gross investment	20.5	25.5	25.6	24.7	24.0	n.a.
Gross national savings	18.4	25.4	25.1	23.3	21.8	n.a.
Africa, south of the Sahara						
SHARE IN GNP						
Gross investment	18.8	24.3	23.8	20.9	18.9	n.a.
Gross national savings	16.2	22.3	15.8	13.3	14.5	n.a.
East Asia and Pacific						
SHARE IN GNP						
Gross investment	19.0	28.6	28.6	28.0	28.8	28.3
Gross national savings	14.6	27.0	26.0	25.9	26.7	n.a.
Latin America and the Caribbean						
SHARE IN GNP						
Gross investment	21.4	24.7	23.7	22.0	17.1	17.5
Gross national savings	20.3	22.1	19.3	17.6	15.6	n.a.
North Africa and the Middle East						
SHARE IN GNP						
Gross investment	23.2	25.6	26.1	25.7	31.0	32.5
Gross national savings	26.7	44.4	47.1	39.5	30.7	n.a.
South Asia						
SHARE IN GNP						
Gross investment	17.2	19.8	22.7	22.9	22.7	22.7
Gross national savings	12.4	16.2	17.9	18.4	19.2	19.1
Southern Europe and other Mediterranean countries						
SHARE IN GNP						
Gross investment	24.5	27.5	28.2	27.2	24.8	22.8
Gross national savings	19.4	19.9	19.6	19.5	19.6	n.a.
Industrialized countries						
SHARE IN GNP						
Gross investment	22.8	22.7	21.6	19.8	19.5	19.5
Gross national savings	23.5	23.1	21.8	20.2	20.0	19.5

NOTE: All the countries listed below (excluding Lebanon) have been included for the estimates of the real rates of growth of GNP and population. For other indicators, some countries or other areas have been omitted because of lack of data.

Industrialized countries—Australia, Austria, Belgium, Canada, Denmark, Finland, France, Federal Republic of Germany, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, United Kingdom, United States.

Developing countries or other areas—Those listed in the "General Notes to Appendix Tables" (except Hungary and Romania) and those listed below:
Africa, south of the Sahara—Angola, Mozambique, South Africa.
East Asia and Pacific—China.
Latin America and the Caribbean—Grenada.
North Africa and the Middle East—Bahrain, Kuwait, Libya, Qatar, Saudi Arabia, United Arab Emirates.

n.a. Not available.
(P) Preliminary.
SOURCE: The World Bank.

Source: [World Bank 85a]

Table 2-II: External Debt and Debt Servicing

	1978	1979	1980	1981	1982	1983	1984	1985	1986[e]	1987[e]
All Indebted Developing Countries[a]										
External Debt ($bn)[b]	399.1	475.9	567.8	662.0	751.6	798.4	840.7	888.3	943.1	990.5
Debt/GDP (%)	25.6	25.6	25.7	28.9	33.2	35.9	36.6	38.1	38.7	37.9
Debt/Exports (%)	132.4	120.4	110.4	122.9	148.6	158.8	162.8	163.0	166.6	160.7
Debt-servicing ratio (%)[c]	19.0	19.1	17.1	20.5	23.6	22.0	22.9	24.1	24.2	22.6
Western Hemisphere										
External Debt ($bn)	155.9	188.1	230.7	287.0	328.6	340.6	355.9	368.3	381.8	391.5
Debt/GDP (%)	31.8	32.9	32.7	36.2	43.1	48.2	47.3	46.2	46.0	43.8
Debt/Exports (%)	217.2	197.8	182.8	208.8	267.2	287.5	273.3	295.0	311.1	296.0
Debt-servicing ratio (%)	37.9	39.2	33.3	41.1	49.6	43.0	42.4	44.1	43.5	39.7
Sub-Saharan Africa[d]										
External Debt ($bn)	29.5	36.0	41.7	45.8	50.7	52.8	55.5	60.7	66.5	71.9
Debt/GDP (%)	35.9	36.8	35.3	43.0	48.8	51.4	60.0	62.6	61.7	62.1
Debt/Exports (%)	141.2	143.3	138.4	167.3	201.3	215.8	216.3	240.3	236.0	242.8
Debt-servicing ratio (%)	15.1	14.6	15.6	17.9	20.2	21.3	23.3	29.8	28.4	30.2

NOTES

a. All indebted developing countries consists of all developing countries except for eight Middle Eastern countries, plus Greece, Portugal, Turkey, Hungary, and Romania.

b. Includes short-term as well as long-term debt.

c. Ratio of interest and amortization payments to exports of goods and services.

d. Excluding Nigeria and South Africa.

e. Estimated.

Source: [IMF 86]

Table 2-III: Total Net Resource Flows to Developing Countries.

	\$ billion at 1984 prices and exchange rates									Percentages		
	1975	1978	1979	1980	1981	1982	1983	1984	1985	1975	1980	1985
I Offical development finance (ODF)	37.3	36.4	37.5	42.1	44.3	43.8	41.2	47.3	47.8	44.8	35.3	60.7
1. Official development assistance (ODA)	30.9	30.5	31.8	34.7	35.5	33.3	32.8	34.6	36.0	37.1	29.2	45.7
A Bilateral[a]	25.4	24.5	25.5	27.5	28.0	26.0	25.4	26.8	27.7	30.5	23.1	35.2
a) OECD countries	12.0	14.8	16.6	16.8	17.6	18.2	18.3	19.7	21.7	14.4	14.1	27.6
b) OPEC countries	8.3	7.4	6.5	8.0	7.2	4.4	3.8	3.7	2.3	10.0	6.7	2.9
c) CMEA countries	2.2	1.8	2.1	2.5	3.0	3.1	3.1	3.2	3.5	2.6	2.1	4.4
d) Other countries	0.6	0.6	0.3	0.2	0.2	0.3	0.2	0.2	0.2	0.7	0.2	0.3
B Multilateral	5.5	6.0	6.2	7.2	7.5	7.3	7.4	7.8	8.3	6.7	6.0	10.5
2. Other ODF	6.4	5.9	5.7	7.4	8.8	10.5	8.4	12.7	11.8	7.7	6.2	15.0
of which: Multilateral	3.6	3.4	4.1	4.4	5.4	6.4	7.0	8.2	7.8	4.4	3.7	9.9
Bilateral	2.8	2.4	1.6	2.9	3.3	4.1	1.4	4.5	4.0	3.3	2.5	5.0
II Total exports credits	8.2	16.9	13.8	16.1	17.2	14.1	8.1	5.4	1.2	9.8	13.5	1.5
1. OECD countries	8.2	16.7	13.5	15.4	16.2	13.4	7.6	5.0	0.8	9.8	12.9	1.0
of which: short-term		2.9	2.0	2.2	2.5	2.9	0.3	-0.8		.	1.9	
2. Other countries		0.2	0.3	0.7	1.0	0.7	0.5	0.4	0.4		0.6	0.5
III. Private flows (Excluding export credits)	37.8	67.9	56.1	60.9	70.9	57.0	45.9	30.2	29.7	45.4	51.1	37.7
1. Direct investment (OECD)	16.6	13.2	13.5	10.3	16.4	12.5	9.1	10.4	7.7	20.0	8.7	9.8
2. International bank sector	17.5	44.3	35.9	45.1	49.6	40.0	33.4	17.4	13.5	21.0	37.9	17.2
of which: Short-term	..	18.9	16.1	24.0	21.0	14.7	12.7	-6.0	10.0	.	20.1	12.7
3. Total bond lending	0.6	4.6	2.0	1.5	1.2	1.6	0.7	-0.6	4.5	0.7	1.2	5.7
4. Other private[a]	3.1	4.7	4.7	4.0	3.6	2.9	2.7	3.0	4.0	3.7	3.3	5.0
Total resource flows (I + II + III)	83.3	120.0	107.4	119.1	132.4	114.9	95.2	83.0	78.7	100.0	100.0	100.0
For information:												
ODA grants	16.9	16.8	18.8	20.5	20.2	19.8	20.4	22.8	22.7	20.3	17.2	28.9
Private grants by NGOs	1.9	1.8	2.0	2.1	1.9	2.2	2.3	2.6	3.1	2.3	1.8	3.9
IMF purchases, net	4.7	1.1	0.5	2.4	5.9	6.3	12.2	5.4	0.7	-5.6	2.0	0.9

a) Including grants by Non-Governmental Organisations (NGOs), shown for information below.

Source: [OECD 87]

Table 2-IV: Construction as a Percentage of GDP.

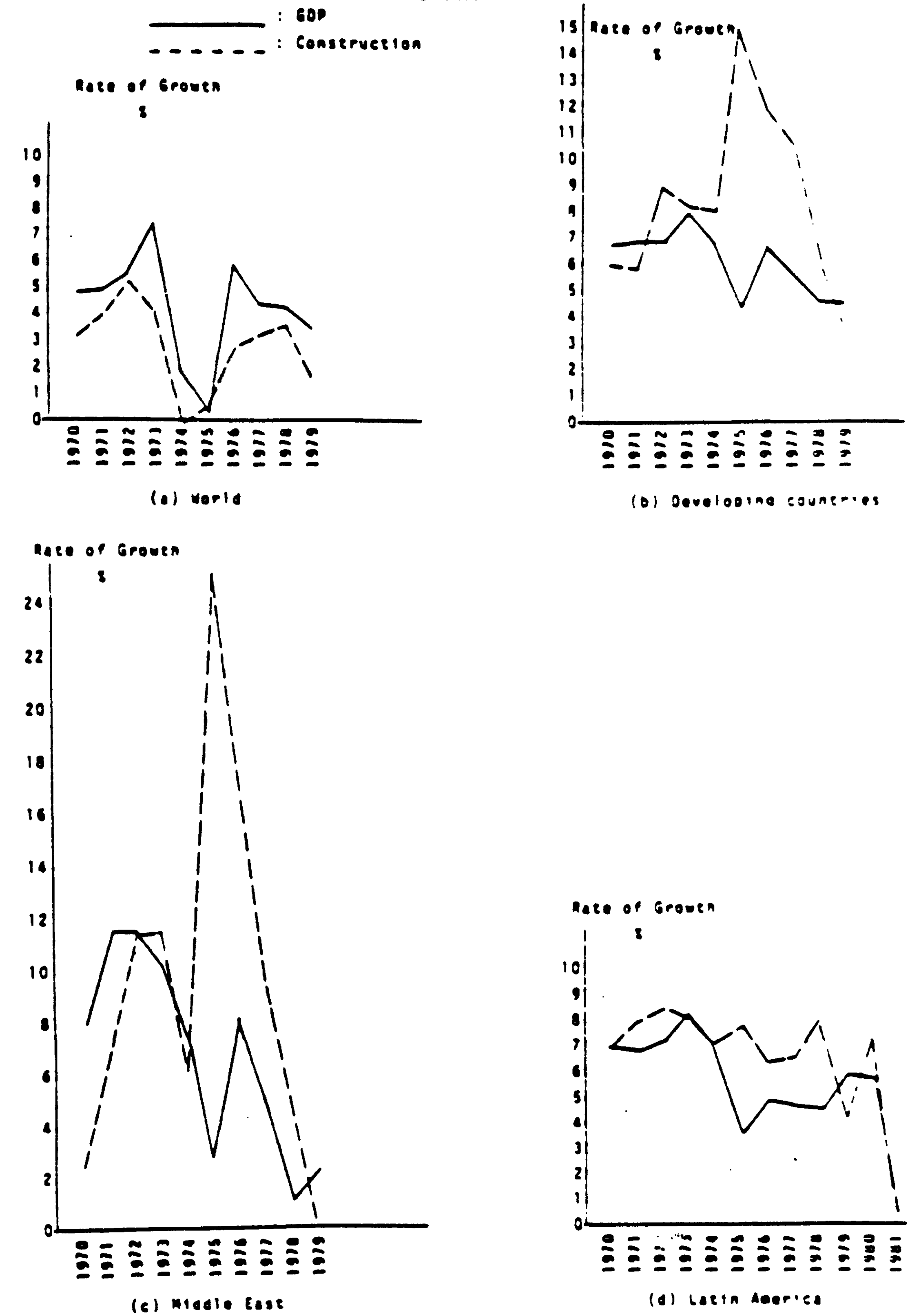
Developing Countries
1970-1980
(Averages)

Region	GNP per Capita US $		Construction Value Added/GDP (percent)		Annual Growth 1960-1970 (percent)		Annual Growth 1970-1980 (percent)		Construction as a Percentage of GDFCF
	1970	1980	1970	1980	GDP	Constr.	GDP	Constr.	
East Africa	180	325	4.6	3.6	4.5	13.6	2.4	1.0	41.8
West Africa	447	1009	4.8	6.3	4.0	5.2	3.7	8.4	59.8
Asia	190	558	4.0	6.0	5.2	9.9	5.7	8.8	49.6
Europe, Middle East and North Africa	1453	3017	7.8	8.0	9.1	5.1	5.7	8.3	53.7
Latin America and the Carribbean	722	1770	4.3	5.7	5.1	6.7	5.6	7.5	49.7

Note:GDFCF: Gross Domestic Fixed Capital Formation for 1978.

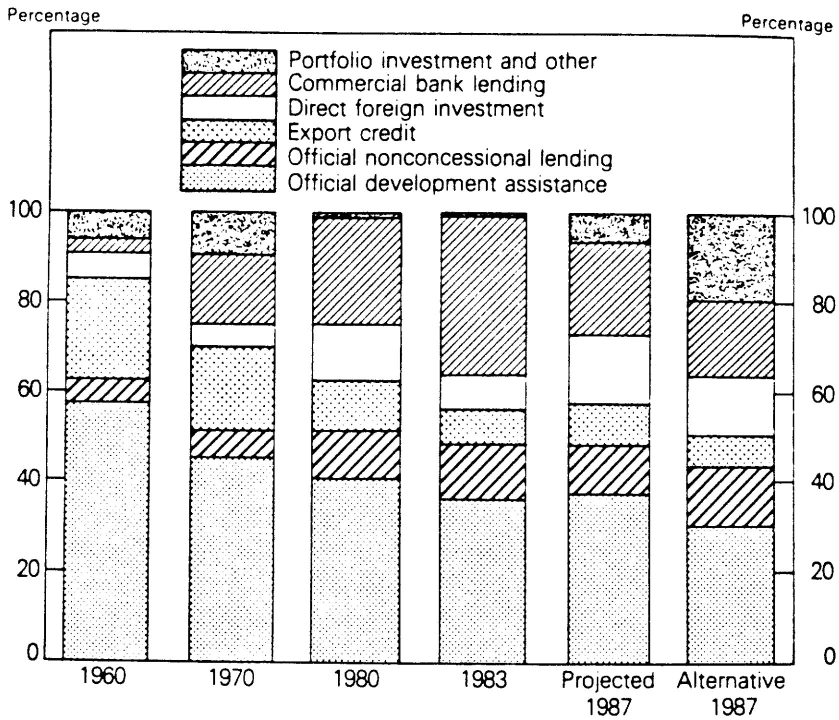
Source: [World Bank 84]

Figure 2-1: Annual Rate of Growth of Construction VS Annual Rate of Growth of GDP.



Source: [Demacopoulos & Moavenzadeh 85]

Figure 2-2: Composition of Net Capital Flows to Developing Countries.



Source: [Lessard & Williamson 85]

Table 2-V: Composition of the Net Flow of External Finance to Indebted Developing Countries.

		1977	*1978*	*1979*	*1980*	*1981*	*1982*	*1983*	*1984*
1	Official finance	22.1	24.5	29.8	36.6	40.6	43.4	42.2	42.6
2	Transfers	8.3	8.3	11.7	12.5	13.5	13.0	12.9	13.1
3	Bilateral loans	5.8	7.0	7.8	8.3	7.6	5.9	5.0	n.a.
4	Multilateral loans	5.7	6.5	7.1	9.3	9.6	11.9	10.2	n.a.
5	Export credits	2.3	2.8	3.9	5.4	5.7	−2.5	5.9	n.a.
6	Unallocated	0	−0.1	−0.7	1.1	4.2	15.1	8.2	n.a.
7	Direct investment	6.0	7.9	10.1	9.4	14.0	12.8	9.9	9.1
8	Private loans	28.2	44.8	52.4	69.7	84.1	48.1	19.1	13.6
9	Suppliers' credits	2.3	3.3	4.0	1.8	0.6	1.0	1.4	n.a.
10	Bank loans	23.7	38.6	47.7	66.8	82.4	45.9	16.5	n.a.
11	Medium-term	9.0	28.8	38.1	36.4	59.3	32.5	33.8	n.a.
12	Concerted	—	—	—	—	—	1.3	14.6	16.2
13	Short-term	14.7	9.8	9.6	30.4	23.1	13.4	−17.3	−10.9
14	Bonds	2.8	3.2	0.9	1.5	1.2	1.3	1.3	n.a.
15	Other	−0.6	−0.3	−0.2	−0.4	−0.1	−0.1	−0.1	n.a.
16	Reserves and miscellaneous	−19.4	−20.4	−30.5	−38.6	−26.1	−1.3	−11.8	−27.4
17	Change in reserves (increase = −)	−10.7	−13.5	−21.5	−18.4	1.6	14.4	−9.5	−22.3
18	SDR allocations, etc.[a]	0.6	1.4	2.9	2.5	0.5	2.9	0.1	0.5
19	Reserve creation[b]	2.0	1.4	−1.3	1.9	0.9	1.1	−1.3	−0.2
20	Export credit extended by developing countries, etc.[c]	−6.2	−4.9	−7.8	−7.8	−17.4	−12.9	−8.2	−5.8
21	Borrowing from IMF	−0.2	−0.4	0.2	1.5	6.0	7.0	11.0	5.3
22	Change in arrears (increase = +)	1.6	0.5	0.4	0.8	2.0	11.1	7.5	−1.3
23	Errors and omissions	−6.5	−4.9	−3.4	−19.1	−19.7	−24.9	−11.4	−3.6
24	Current account deficit on goods, services, and private transfers	36.9	56.8	61.7	77.0	112.6	102.9	59.4	37.9

— Negligible.
n.a. Not available.
Source: IMF, *World Economic Outlook*, appendix table 38, for lines 2, 7, 8, 13, and 17–24, and the sum of lines 3–6. World Bank's Debtor Reporting System for lines 3, 4, 5, 9, 14, and 15. Lines 6, 10, and 11 calculated as residuals. Institute of International Finance for line 12.
a. SDR allocations, valuation adjustments, and gold monetization.
b. Short-term borrowing by monetary authorities from other monetary authorities, excluding the IMF.
c. Described as "Asset transactions, net" in *World Economic Outlook*.

Source: [Lessard & Williamson 85]

Table 2-VI: Members of Major Donor Groups of Development Assistance.

OPEC **Organization of the Petroleum Exporting Countries**	**OECD/DAC** **Development Assistance Committee of the Organization for Economic Cooperation and Development**	**CMEA** **Council for Mutual Economic Assistance**
Algeria	Australia	Bulgaria
Ecuador	Austria	Czechoslovakia
Gabon	Belgium	German Democratic Republic
Indonesia	Canada	Hungary
Iran, Islamic Republic of	Denmark	Poland
Iraq	Finland	Romania
Kuwait	France	Union of Soviet Socialist Republics
Libyan Arab Jamahiriya	Germany, Federal Republic of	
Nigeria	Italy	
Qatar	Japan	
Saudi Arabia	Netherlands, The	
United Arab Emirates	New Zealand	
Venezuela	Norway	
	Sweden	
	Switzerland	
	United Kingdom	
	United States	
	Commission of the European Communities	

Source: [OPEC 86]

Table 2-VII: Long-Term Trends in Aid by Major Donors.

	Volume of ODA ($ million at 1984 prices & exch. rates)				Share in World ODA				ODA as per cent of GNP			
	1970-71	75-76	80-81	84-85	1970-71	75-76	80-81	84-85	1970-71	75-76	80-81	84-85
United States	7 313	7 304	7 745	8 907	32.5	23.2	21.2	24.2	0.31	0.26	0.23	0.24
EEC members combined[a]	6 592	7 636	10 069	11 409	29.3	24.2	27.6	31.1	0.42	0.45	0.49	0.52
EEC members excl. DOM/TOM	5 761	6 616	8 784	10 196	25.6	21.0	24.0	27.7	0.38	0.40	0.43	0.47
of which:												
France (incl. DOM/TOM)	2 288	2 483	3 183	3 833	10.2	7.9	8.7	10.4	0.66	0.62	0.67	0.78
France (excl. DOM/TOM)	1 457	1 463	1 898	2 620	6.5	4.6	5.2	7.1	0.46	0.38	0.40	0.53
Germany	1 541	1 966	2 704	2 880	6.9	6.2	7.4	7.8	0.33	0.38	0.45	0.46
United Kingdom	1 401	1 456	1 555	1 462	6.2	4.6	4.2	4.0	0.42	0.39	0.39	0.34
Netherlands	536	806	1 243	1 209	2.4	2.6	3.4	3.3	0.60	0.79	1.01	0.97
Italy	391	312	616	1 116	1.7	1.0	1.7	3.0	0.17	0.12	0.18	0.32
Belgium	275	373	414	435	1.2	1.2	1.1	1.2	0.48	0.55	0.54	0.56
Denmark	160	240	354	438	0.7	0.8	1.0	1.2	0.40	0.57	0.74	0.83
Ireland		12	27	36		x	0.1	0.1		0.14	0.16	0.23
Japan	1 577	1 805	3 221	4 037	7.0	5.7	8.8	11.0	0.23	0.22	0.30	0.31
Canada	865	1 317	1 301	1 646	3.8	4.2	3.6	4.5	0.41	0.50	0.43	0.50
Sweden	277	662	703	780	1.2	2.1	1.9	2.1	0.41	0.82	0.80	0.83
Australia	646	694	684	829	2.9	2.2	1.9	2.3	0.59	0.53	0.44	0.47
Norway	109	281	424	557	0.5	0.9	1.2	1.5	0.33	0.68	0.86	1.03
Switzerland	110	163	221	297	0.5	0.5	0.6	0.8	0.13	0.19	0.24	0.30
Austria	32	87	172	215	0.1	0.3	0.5	0.6	0.07	0.17	0.28	0.33
Finland	28	65	111	191	0.1	0.2	0.3	0.5	0.09	0.17	0.24	0.38
New Zealand	35	84	60	55	0.2	0.3	0.2	0.1	0.23	0.47	0.31	0.25
Total DAC	17 583	20 111	24 738	28 924	78.2	63.8	67.7	78.7	0.34	0.35	0.36	0.36
Spain	(15)	(52)	191	157	0.1	0.2	0.5	0.4	0.02	0.04	0.11	0.10
Iceland				2				x				0.10
Luxembourg	5	5	7	(8)	x	x	x	x		0.12	0.16	0.20
Portugal	176		(4)	(8)	0.8		x	x	1.05			
Total non DAC OECD	196	57	202	173	0.9	0.2	0.5	0.5	0.33	0.34		
OPEC countries												
Saudi Arabia	476	3 943	5 249	2 911	2.1	12.5	14.4	7.9	5.30	6.78	4.16	3.00
Kuwait	310	1 161	1 080	876	1.4	3.7	3.0	2.4	4.73	5.87	3.80	3.27
U.A.E.	72	1 406	902	76	0.3	4.5	2.5	0.2	3.11	9.67	3.32	0.27
Other	160	2 099	1 198	123	0.7	6.7	3.3	0.3	0.14	0.87	0.37	0.20
Total OPEC	1 018	8 609	8 429	3 986	4.5	27.3	23.1	10.8	0.78	2.61	1.66	0.75
CMEA countries												
USSR	1 983	1 731	2 242	2 840	8.8	5.5	6.1	7.7	0.15	0.16	0.22	0.28
GDR	109	96	192	157	0.5	0.3	0.5	0.4	0.13	0.11	0.20	0.13
Eastern Europe, other	449	285	337	363	2.0	0.9	0.9	1.0	0.15	0.08	0.11	0.11
Total CMEA	2 541	2 112	2 771	3 360	11.3	6.7	7.6	9.1	0.15	0.14	0.20	0.23
LDC donors[b]	1 149	636	387	300	5.1	2.0	1.1	0.8				
Total World	22 487	31 525	36 527	36 743	100.0	100.0	100.0	100.0				

a) Excluding Luxembourg
b) China, India, Israel, Yugoslavia

Source: [OECD 87]

Table 2-VIII: ODA from all Sources by Major Regions.

Commitments, current prices and exchange rates

	1979-80		*of which:* Bilateral from DAC	1984-85		*of which:* Bilateral from DAC
	$ billion	% of total	% of total	$ billion	% of total	% of total
Sub-Saharan Africa	4 472	21.9	29.3	10 683	30.3	28.1
Asia	7 348	36.1	31.7	10 889	30.9	29.1
North Africa and Middle East	5 414	26.6	15.9	7 301	20.7	19.7
Latin America and the Caribbean	2 252	11.0	14.4	4 700	13.3	16.5
Europe and Oceania	906	4.4	8.8	1 684	4.8	6.5
Total	20 392	100.0	100.0	35 257	100.0	100.0

Source: [OECD 87]

Table 2-IX: DAC Members' ODA Terms in 1984 & 1985.

	Grants as a share of ODA commitments[b] %		ODA loan terms							
			Interest rate %		Maturity (years)		Grace period (years)		Grant element %	
	1984	1985	1984	1985	1984	1985	1984	1985	1984	1985
Australia	100.0	100.0	..	..	..	..	..	..	..	..
Austria	71.1	85.3	4.3	3.6	16.8	21.1	6.7	6.5	36.9	46.3
Belgium	85.7	94.5	(0.1)	0.0	(30.0)	30.0	(10.0)	10.0	(83.5)	84.0
Canada	85.3	95.6	0.0	0.0	50.0	50.0	10.0	10.0	90.3	90.3
Denmark	88.2	80.9	0.0	0.0	31.6	27.1	9.3	7.6	82.6	78.1
Finland	85.7	95.1	0.8	2.1	24.5	(22.1)	7.4	6.0	69.1	58.3
France	79.2	78.1	3.1	3.3	23.7	23.6	8.3	8.2	50.0	50.4
Germany	63.8	76.9	2.8	2.9	36.7	32.4	5.7	5.9	57.4	52.8
Ireland	100.0	100.0	..	..	..	..	..	..	..	..
Italy	83.7	80.9	2.5	2.1	16.3	18.2	4.9	6.1	45.9	63.9
Japan	46.1	47.5	3.4	3.7	26.7	27.7	8.6	8.8	51.2	49.8
Netherlands	83.2	90.8	2.5	2.3	30.1	28.8	8.0	7.8	60.8	62.4
New Zealand	100.0	100.0	..	..	..	..	..	..	..	..
Norway	99.5	99.6	3.3	2.0	17.1	6.2	7.0	2.0	32.7	25.3
Sweden	100.0	100.0	..	..	..	..	..	..	..	..
Switzerland	90.2	93.2	0.0	0.0	22.3	24.1	12.8	14.6	80.3	83.6
United Kingdom	97.6	98.6	1.4	0.0	20.3	17.3	6.3	5.3	42.9	64.7
United States	82.4	88.9	2.8	2.8	34.6	35.6	10.0	9.4	64.2	63.9
Total DAC countries	77.0	80.8	2.9	3.1	30.4	(28.5)	8.3	(8.3)	57.1	55.1

a) Excluding debt reorganisation.
b) Including grants and capital subscriptions to multilateral agencies, which have been subject to fluctuations as explained in Chapter VI of the Report.

Source: [OECD 87]

Table 2-X: OPEC Members' ODA Terms Performance.

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Grants as share of commitments (%)	68.8	72.0	76.7	60.4	47.5	69.3	62.4	59.2	41.4	59.7	57.7
Grant element of loans (%)	44.6	50.9	49.3	44.1	46.9	46.9	45.9	51.9	50.2	49.2	52.4
Average interest rate of loans (%)	2.4	2.1	2.4	2.2	2.6	2.4	2.7	2.2	2.3	2.4	2.3
Average maturity of loans (years)	14.7	19.5	19.1	15.2	18.2	17.9	18.4	20.2	19.6	19.3	21.0
Average grace period of loans (years)	6.6	4.0	4.7	4.1	5.3	4.5	4.4	4.5	4.5	4.5	5.1
Overall grant element of commitments (%)	82.7	86.2	84.8	77.8	72.1	83.7	79.6	80.4	70.8	79.5	79.9

Source: [OECD 83]

Table 2-XI: Aid by Major Purposes.
[Commitments 1983-84 average]

Percentage

	DAC bilateral ODA		Multilateral finance (ODF)[a]	
Social infrastructure	20.2		15.6	
Education		11.0		4.3
Health		6.0		1.9
Other (including water and sanitation)		3.2		9.4
Economic infrastructure	21.4		31.1	
Transport and Communications		10.5		13.5
Energy		10.9		19.6
Production	25.4		38.1	
Agriculture		10.7		26.0
Other		14.7		12.1
Programme assistance	5.3		8.1	
Special country support	9.4		–	
Debt relief	1.4		–	
Food aid	7.4		5.5	
Other emergency assistance	1.5		–	
Contributions to NGOs	4.5		–	
Administrative expenses	3.5		n.a.	
Total	100.0		100.0	
of which:				
Technical Assistance	26.9			
Students and Trainees		3.9		
Other provided in donor country		0.7		
Experts (and related equipment)		15.9		
Other, including research		6.4		

a) Concessional and non-concessional loans plus EEC and WFP grants. No comparable end-use data are available for UN programmes.

Source: [OECD 87]

Table 2-XII: Representative Development Banks' Commitments.

(million US $)

BANK	1985	1986	1987	1988	1989
WORLD BANK					
IBRD	11000	12500	16500	18200	19430
IDA	2980	3200	3410	3125	3110
REGIONAL DEVELOPMENT BANKS					
African Development Bank	537	634	748	883	1042
African Development Fund	412	461	516	578	648
Asian Development Bank	1824	2125	2477	2402	2583
Asian Development Fund	650	600	650	700	800
Inter-American Development Bank (ordinary capital)	3520	4048	4655	5353	6156
Inter-American Development Bank (special capital)	400	550	600	650	700
SUBREGIONAL DEVELOPMENT BANKS					
Banque Ouest-Africaine	32	34	41	47	52
Caribbean Development Bank	40	44	48	53	57
Caribbean Development Fund	29	33	36	40	46
Central American Bank	334	239	255	225	235
East African Development Bank	19	23	28	33	40
ARAB DEVELOPMENT BANKS					
Abu Dhabi Fund	20	30	50	75	100
Arab Bank for Economic Development in Africa	93	97	102	107	112
Arab Fund for Economic and Social Development	400	457	514	571	628
Iraqi Fund for External Development	0	0	50	100	200
Islamic Development Bank	872	953	1034	1116	1197
Kuwait Fund for Arab Economic Development	300	400	500	600	700
OPEC Fund for International Development	150	200	250	300	350
Saudi Fund for Development	100	150	200	250	300
EUROPEAN AND JAPANESE DEVELOPMENT BANKS					
European Development Bank	900	995	1110	1225	1340
European Investment Bank	602	591	580	569	558
Overseas Economic Cooperation Fund, Japanese	2971	3191	3412	3632	3852
IFAD					
International Fund for Agricultural Development	150	225	215	250	300
Total of the above banks	28335	31780	37981	41084	44536

Source: Engineering News Record, May 2, 1985
(original source: Development Bank Associates, Inc., Washington, DC)

Source: [Demacopoulos & Moavenzadeh 85]

Table 2-XIII: Gross DFI Flows.

$ millions

Into the following regions:

	U.S.	W. Europe	All industrial countries*	LDCs	Global Total	Percent of total going to LDCs
1960	315	749	2.150	1.806	3.956	46
1961	311	1.573	2.815	1.839	4.654	39
1962	346	1.598	2.790	1.469	4.259	35
1963	231	1.819	2.836	1.659	4.495	38
1964	322	2.255	3.412	1.819	5.231	35
1965	415	2.652	4.227	2.488	6.715	37
1966	425	2.878	4.504	2.159	6.663	33
1967	698	2.893	4.791	2.103	6.894	30
1968	807	2.646	4.735	2.900	7.635	38
1969	1.263	3.300	5.928	2.804	8.732	32
1970	1.464	4.200	7.522	3.689	11.211	33
1971	367	4.892	7.523	3.307	10.830	31
1972	949	5.925	8.702	4.234	12.936	33
1973	2.800	8.054	11.688	4.719	16.407	29
1974	4.760	9.962	16.965	1.123	18.088	6
1975	2.603	7.244	11.153	10.494	21.647	49
1976	4.347	5.611	10.791	7.824	18.615	42
1977	3.338	8.972	13.851	9.500	23.351	40
1978	7.900	10.470	20.978	11.154	32.132	35
1979	9.730	9.403	22.098	13.491	35.589	38
						35**

Source: [The Group 84]

Table 2-XIV: Eurocurrency Credits 1978-80.
[million US $]

Category of Borrowing Country	1978 Amount	1978 %	1979 Amount	1979 %	1980 Amount	1980 %
Industrial	31314	42.5	19042	27.1	29868	42.2
Developing	38990	52.9	46651	66.4	38131	54.2
Non-Market	2960	4.0	4060	5.8	1639	2.3
International Organizations	182	0.2	310	0.4	530	0.8
Others	220	0.3	186	0.3	218	0.3
Totals:	73695	100.0	70249	100.0	70386	100.0

Source: [World Bank 81]

Table 2-XV: Eurocurrency Credits 1981-83.
[million US $]

Category of Borrowing Country	1981 Amount	%	1982 Amount	%	1983 Amount	%
Industrial	86000	64.0	42600	50.0	38700	52.2
Developing	45300	34.0	41500@49.0		32900	44.0
Non-Market	1800	1.0	800	1.0	1200	2.0
International Organizations	300	1.0	200	1.0	13000	2.0
Totals:	133400	100.0	85100	100.0	74100	100.0

Source: [Saini 86]

Table 2-XVI: Eurobonds Issues and Placements, 1978-84
(million US $)

Category	1978	1979	1980	1981	1982	1983	Jan-Jun 1984
Industrial Countries	9774	14212	17206	25210	42816	41013	30255
Developing Countries	3162	1885	1403	3185	3970	2382	1508
Oil Exporting	1110	329	132	170	470	288	50
Non-Oil Exporting	2052	1556	1271	3015	3500	2094	1458
Centrally Planned Economies	30	30	-	55	-	25	-
International Organizations	1820	2220	1710	2486	3280	6073	2193
Other	175	344	75	358	263	602	557
Total	14961	18691	20394	31294	50329	50095	34513

Source: [IMF 84]

Table 2-XVII: Foreign bonds Issues and Placements, 1978-84
(million US $)

Category	1978	1979	1980	1981	1982	1983	Jan-Jun 1984
Industrial Countries	10328	13421	11339	14129	16837	18624	11406
Developing Countries	2583	1431	746	1212	726	894	775
Oil Exporting	571	105	46	242	38	78	-
Non-Oil Exporting	2012	1326	700	970	688	816	775
Centrally Planned Economies	-	43	-	-	-	-	-
International Organizations	4906	5259	5714	5030	7461	7265	2756
Other	2896	154	125	159	191	323	125
Total	20713	20308	17924	20530	25215	27106	15062

Source: [IMF 84]

Table 2-XVIII: International bonds Issues and Placements, 1978-84
(million US $)

Category	1978	1979	1980	1981	1982	1983	Jan-Jun 1984
Industrial Countries	20102	27633	28545	39339	59653	59637	41661
Developing Countries	5745	3316	2149	4397	4696	3276	2283
Oil Exporting	1681	434	178	412	508	366	50
Non-Oil Exporting	4064	2882	1971	3985	4188	2910	2233
Centrally Planned Economies	30	73	-	55	-	25	-
International Organizations	6726	7479	7424	7516	10741	13338	4949
Other	3071	498	200	517	454	925	682
Total	35674	38999	38318	51824	75544	77201	49575

Source: [IMF 84]

Table 2-XIX: Sources of External Financing to Developing Coutries.

	1981	1982	1983	1984	1985	1986	Average 1987–88
				(Percent)			
Official	33	50	63	68	52	72	63
Transfers	4	6	10	14	19	21	22
Net long-term lending	21	25	31	45	33	47	45
Reserve-related transactions[1]	8	20	22	9	1	4	−3
Private	69	51	38	35	41	23	36
Net lending[2]	57	35	23	17	23	4	15
Direct investment	12	15	15	18	18	19	20
Other[3]	−2	−1	—	−3	7	5	1
Total	100	100	100	100	100	100	100
Memorandum				*(Billions of U.S. dollars)*			
External financing	160	132	99	79	75	68	69

[1] Includes arrears to private creditors.
[2] By private and unguaranteed creditors. May include short-term official credits.
[3] SDR allocations, valuation adjustments, and gold monetization.

Source: [IMF 87]

Table 2-XX: Potential Sources of Expanded Capital Flows to Developing Countries.

[billion US $]

	Amount
Innovative private sources	4–10
Equity investment	1–2
Quasi-equities	1–2
Stand-alone finance	1–2
Indexed bonds	1–2
Commodity-linked bonds	0–2
Traditional private sources	2–4
Direct investment	1–2
Real estate	1–2
Public sector	6–9
SDR allocations	3
Accelerated disbursements	2
Expansion of World Bank lending	1–4
Target	15–20

Source: [Lessard & Williamson 85]

Chapter 3

Islamic Finance

3.1 Review of Islamic Financial Principles

Before elaborating on Islamic financial instruments, a background of the Islamic philosophy and principles governing the economic activity is helpful.

The Islamic economic system is based on the Islamic canon law, the *Shari'a*. *Shari'a* is based on several principal sources. Primary sources, accepted by the major Islamic sects and schools of legal thoughts, include the Koran, Muslims' holy book, and the *Sunna*, which are the sayings, acts and allowances of the Prophet as recorded by reliable authorities in the traditions (*Hadith*). Secondary sources of *Shari'a* include *Ijma'*, usually defined as an historical consencus of qualified legal scholars, and *Qiyas*, or analogical reasoning, used for circumstances not provided for in other sources. The *Shari'a* specifies rules that relate to the allocation of resources, property rights, production and consumption, the workings of the markets, and the distribution of income and wealth. Similarly, rules and requirements have been specified that define the framework within which the monetary and banking system can operate.

The following sections describe some of the most relevant principles in Islamic economics. Although this is by no means a complete coverage of all the concepts introduced by the *Shari'a*, it represents basic information relevant to the discussion of later sections and chapters.

3.1.1 Underlying Concepts of Islamic Economics

In an ideal Islamic economy, ethics and economics are not only compatible but also inseparable. For Islam is not just a religion but a complete way of life, designed to cater for human welfare (*falah*) through the establishment of harmony between the moral and the material needs of human beings and the actualisation of socio-economic justice and brotherhood in society. Economic behaviour in such a society cannot be adequately explained without reference to the Islamic ethics which governs it.

The economic doctrine in Islam is closely related to, and is part of, the Islamic concept of life. This concept is based on a network of interrelated concepts of God, man's position in the Universe, and the relationship of man and his fellow man. The relevant values that delineate the economic framework prescribed in Islam include committment to God the creator and provider of all ecological resources and the appreciation of the wealth and all the ecological resources provided by God for the satisfaction of human needs.

Wealth is to be sensibly treated, not abused, destroyed, wasted or laid idle. Wealth is to be regarded as a means, not a final goal. Real ownership of wealth belongs to God. Man's temporal possession of wealth is limited and is granted by God. Man is merely a "trustee", entrusted with it to realise general human well-being and socio-economic justice. It is a duty of all muslims to adopt all available means to realise, not only necessities for sustaining life, but also comforts for making life more pleasant and less difficult. While no maxima is fixed, moderation in fulfilment of needs is emphasised and praised, and greed and avarice decried.

In addition to the above system demarcating the area of economic action, the Islamic economic framework is characterised by the call to uphold the Islamic virtues of truth, honesty in dealings, respect for the right of others, pursuit of moderation, sacrifice and hardwork, and to reject all forms of *zulm*, which is a comprehensive Islamic term referring to all forms of inequity, injustice, exploitation, oppression and wrongdoing. Thus, economic action in Islam is steered by the concept of a fair balance between the human and spiritual needs and between the individual and social obligations. [Ziauddin 83]

It is relevant to note that there is a consensus among Muslim scholars that the Islamic economic system is different from other contemporary economic systems, so much so that western concepts, notions and instruments are not applicable to an Islamic economic system without suitable modifications. For it has been recognized that the moral values and the ethical norms of Islam do significantly affect the mode of economic behaviour of muslims in an Islamic society.

Nevertheless, it is interesting to see an Islamic economy being conceptualized by some in a highly idealised form which clearly portrays an economic behaviour based strictly on Islamic ethics and which boldly assumes that all Muslims behave puritanically. Hence, Islamic economy is sometimes conceived to be so entirely different from all other economies that western concepts, tools of analysis and policy instruments are all in danger of being rejected as totally irrelevant and completely alien to an Islamic economic system.

This approach seems to symbolize the most conservative view. However, most of the scholars agree that what makes an Islamic economy different from other economies is its value system which influences its economic decisions and that the mechanics of the behaviour sciences are basically the same in all societies regardless of their underlying differences in the value systems. Therefore they say that Islamic economics provide no basis for rejecting the conventional tools of economic analysis which are neutral or value-free. Only tools in which interest rates play a crucial role, are unambiguously alien to the Islamic ideology and hence are totally unacceptable. [Ariff 82]

3.1.2 Prohibition of *Riba*

One often hears that Islamic finance is a system of interest-free lending, founded on the Koran's prohibition against paying or earning interest. This definition is both negative and too simple, and leads to misunderstandings. In order to avoid the pitfalls inherent in the above definition, it is important to have some familiarity with the fundamentals underlying this ban.

The abolition of *riba* in Islam is not an isolated injunction. It is part of a social and moral philosophy and an integral part of a set of interrelated values. Hence the problem is not merely that of removing *riba* from the conventional system, but of introducing a new system. Muslim scholars argue that the abolition of *riba* is only one of the several important values and institutions which together constitute the Islamic way of life. These are so well integrated that none can be dispensed with without weakening the system or making it less effective. They believe that it is not possible to conceive of a truly Islamic economy without the strength of individual and social character that Islam emphasises, the solidarity and mutual support system that Islamic brotherhood demands, the revival of the taxation systems of *zakat* and *'ushr* along with other relevant institutions, and the eradication of all kinds of injustice or *zulm* that Islam condemns. [Khan 83]

Nevertheless, among the most important teachings of Islam for establishing justice and eliminating exploitation in business transactions is the prohibition of all sources of 'unjustified' or 'wrongful' enrichment. The *Shari'a* has given principles whereby a muslim society can know or deduce what constitutes a 'wrongful' or 'unjustified' source of earning or aquisition of property from others.

The Koranic prohibition against *riba* is central to the establishment of the Islamic economic system. Of the references to *riba* in the Koran, some verses directly prohibit it, some describe the evil consequences resulting from its practice, and others do both. The Prophet also condemned, not only those who take *riba*, but also those who give *riba* and those who record the transaction or act as witnesses to it.(See Appendix I.)

However, there has been much argument about what exactly constitute *riba*. *Riba* used to be translated as usury, and those who supported this translation argued that interest should be prohibited only when money is loaned at exorbitantly high rates. Others argued that *riba* refers to the interest paid on consumption loans during the pre-Islamic period and that only this type of interest is prohibited [Esposito 80]. Nowadays, there is a consensus among most scholars to interpret *riba* as being all forms of interest.

Riba litterally means increase, addition, expansion or growth. The term is used in the *Shari'a* in two senses. The first is *riba al-nasi'a* and the second is *riba al-fadl*. (*Riba al-nasi'a* is also called *riba al-duyun* or *riba al-mubashir* or *riba al-jali*, while *riba al-fadl* is also called *riba al-buyu* or *riba al-ghayr al-mubashir* or *riba al-khafi*.)

Riba al-nasi'a

The term *nasi'a* comes from the root *nasa'a* which means to postpone, defer, or wait, and refers to the time that is allowed for the borrower to repay the loan in return for the 'addition' or the 'premium'. Hence *riba al-nasi'a* refers to the interest on loans. The prohibition of *riba al-nasi'a* essentially implies that the fixing in advance of a positive return on loan as a reward for waiting is not permited by the *Shari'a*. It makes no difference whether the return is a fixed or a variable percent of the principal, or an absolute amount to be paid in advance or at maturity, or a gift or service to be received as a condition for the loan. The point in question is the predetermined positiveness of the return. It is important to note that, according to the *Shari'a*, the waiting involved in the repayment of the loan does not itself justify a positive reward. However, if the return on principal can be either positive or negative depending on the final outcome of the business, which is not known in advance, it is allowed provided that it is shared in accordance with the principles of justice laid down in the *Shari'a*. There is no difference among Muslim jurists about the prohibition of *riba al-nasi'a* since it has been clearly stated and illustrated in the *Shari'a*.

Riba al-fadl

While *riba al-nasi'a* refers to interest on money loaned, *riba al-fadl* encompasses all forms of 'unjust' (as defined in the *Shari'a*) exchanges in business transactions. Although there exist some ambiguity in the definition of *riba al-fadl* and what it does include, the *Hadith* sheds some light on what is intented by this term. *Riba al-fadl* has been used by scholars in conjunction with the hand-to-hand purchase and sale of commodities. What is essentially being required is justice and fair play in spot transactions; the price and the countervalue should be just in all transactions where cash payment (irrespective of what constitute money) is made by one party and the commodity or service is delivered reciprocally by the other. Any additional enrichment received by one of the two parties to the transaction is *riba al-fadl.*

Thus, not only does the *Hadith* prohibit *riba al-fadl*, it provides some basic rules and regulations of the everyday investment activities of currency exchange and spot sales. It definately encourages spot sales, but there is still some ambiguity about the permissibility of forward contracts, the buying and selling in future contracts being considered unlawful by some jurists because the resulting conpensation involves elements of speculation. [Abdus-Shadid 84]

Several types of sales have been prohibited in the *Shari'a* with the objective of safeguarding the right of both buyers and sellers. Examples are : cheating of an unsophisticated entrant into the market, the rigging of prices in an auction with the help of agents, gambling, speculation, monopolistic or monopsonistic collusion or exploitation to lower or raise prices beyond what is justified by market conditions. Hence the injunction against *riba al-fadl* seems to be intended to insure a fair knowledge of the prevailing prices on the part of both the buyer and the seller, the elimination of cheating in trade, and the prohibition of unjust practices that leads to a restriction of fair competition. [Chapra 85]

While *riba al-nasi'a* has been defined in few words, *riba al-fadl*, interspersing a vast array of business transactions and practices, has not been easy to specify, and there is still uncertainty about a number of prohibitions. It seems that the interpretation of *riba al-fadl* will have to depend on the business environment in which transactions are performed, and on the conception of such transactions by Muslim jurists.

3.1.3 Profit and Loss Sharing

To appreciate the rationale of the replacement of interest by profit- and loss-sharing, it is necessary to understand the Islamic view of the relations between men, and men and the nature of the world in which men engage in productive enterprise. It is an uncertain world in which the outcome of a venture cannot be predetermined. To claim a predetermined positive return to money capital when capital and enterprise jointly engage in production runs counter to this reality. It amounts to injustice (*Zulm*), especially in the exploitation of the entrepreneur by the capitalist, as the entrepreneur is left alone to bear the uncertainty which in reality develops on both.

Profits are thus related to both the entrepreneurial decision making in face of uncertainty and to the subjecting of money capital to this decision making, thereby exposing it to risk. Profits belongs, therefore, to both enterprise and capital. Should both entrepreneurship and money capital come from one person, all profits go to him, should several parties jointly undertake entrepreneurial decision making as well as supply money capital, they may share profits in proportions agreed upon , should entreprise and money capital come from seperate parties, they share profits according to agreed proportions. Losses are regarded by *Shari'a* as diminution in money capital and are to be borne by the supplier or suppliers of money capital in proportion to the capital supplied. As the *Shari'a* sees it, the entrepreneur who prefers, in expectation of profits, to face uncertainty rather than sell his services for a salary, runs the risk of going unrewarded. Similarly, the capital which prefers exposing itself to uncertainties of productive enterprise in expectation of profits to lying idle or being lent with guaranteed repayment, runs the risk of being returned diminished to the extend of the loss. The Islamic principle of 'no gain without risk of loss' is applied to both entreprise and capital. [Siddiqi 81]

Hence, most of business financing in an Islamic economy would of necessity have to be equity-oriented where the financier shares in the profit or loss of the business being financed. Equity financing in an Islamic economy may thus have to be for either an indefinite period, as it is the case of stocks of joint stock companies or shares in partnerships, or a definite period (short, medium or long) as it is in the case of borrowed capital. Since borrowed capital would also be on the basis of profit-and-loss sharing and could not be interest-based, it would be in the nature of temporary equity financing and would mature on the expiry of the specified period.

Projects for funding through equity finance are expected to be selected primarily on the basis of their anticipated profitability rather than the creditworthiness or solvency of the borrower. Hence, Muslim economists claim that in an Islamic system, there is potential for (a) more varied and numerous investment projects for which financing is sought; (b) more cautious, selective, and perhaps more efficient project selection by the suppliers of funds; and (c) greater involvement of the public in investment and entrepreneurial activities. [Siddiqi 82]

3.2 Islamic Financial Instruments

In disallowing interest and permitting profits, Muslim economists, based on the *Shari'a*, have developed two specific forms of equity financing, *mudaraba* and *musharaka*. Recognizing that these types of contracts may not be applicable in all circumstances, muslim scholars have specified other modes of permissible transactions not necessarily based on profit-and-loss sharing principles.

However, one should not approach a discussion of specific transactions with an expectation that there are only certain rigid types of transactions that are Islamic. The financing techniques described in this section has been derived by the Islamic jurists directly or indirectly from the *Shari'a*. They are not unique and many other kinds of traditional financing forms can be modified to fit within the permissible limits specified by Islam. The allowed modes of financing can be grouped in three broad categories:

- First, there is financing by lending, that is loans not carrying any interest (also called *qard hasan*), on which the bank may recover a service charge covering administrative expenses. This type of loans will be discussed in greater detail in section 4.2.2.;

- Second, there is trade-related financing, including markup (also called *Murabaha*), leasing (*ijara* and lease-purchase (*ijara wa iktina*);

- Third, lending can take place under investment financing, including equity participation or partnership (*musharaka*) and profit-and-loss sharing (*mudaraba*).

3.2.1 Mudarabah Contract

This type of contract is called *mudaraba* by the *Hanafi*, *Hanbali* and *Zaydi* schools of Islamic thought and *qirad* or *muqarada* by the other schools. It has its roots in the pre-Islamic caravan trade. It is a contract whereby one or more investors (*rabb al-mal* or *sahib al-mal*) supply capital to an agent or manager (known as the *mudarib* or *amil* or *muqarid*). *Mudaraba* contracts can be unrestricted or restricted. In the unrestricted case, the *mudaraba* agreement does not specify the period, the place of business, the specific line of trade, industry or service, and the suppliers or customers to be dealt with. A restriction in terms of any of these renders the *mudaraba* a restricted one. In the case of unrestricted *mudaraba*, the *mudarib* has an open mandate and is authorised to do everything necessitated by the contract. In the case of a restricted *mudaraba*, the contract is dissolved when the particular trading venture or agreed period of time is over. In this case, the *mudarib* repays the capital to its owner or owners together with a share of any profit. The division is made according to a previously agreed upon formula, with permitted business expenses first deducted. The *mudarib* receives the rest of the profit as compensation for his work and expertise. If the venture is unsuccessful, the investor suffers the loss of capital and the *mudarib* receives no reward for his work. The liability of the investor is limited to the amount of his investment and there is a duty of trust on the part of the *mudarib* toward the investor, the former remaining liable for losses caused by his fraud or negligence. Thus, two main conditions must exist for a *mudaraba* agreement: a sharing of losses (be it capital or effort) as well as profits in proportion of the share in the enterprise, and a return on investment which is not predetermined.

When the principles of *mudaraba* are applied to the field of banking, three parties are recognized: (1) the user of capital or the entrepreneur, (2) the bank or Islamic financial institution, which is the managing trustee and also becomes the user of capital, and (3) the supplier of capital or the bank's depositors. A two stage relationship exists betwen the bank and the bank's depositors as to profit sharing. First, the entrepreneur and the bank share the profits according to an agreed upon percentage or ratio, then the bank shares its return with depositors to a certain percentage or ratio. Operations of Islamic banks are described in greater detail in chapter 4.

The form of *mudaraba* in Islamic banks differs from the *mudaraba* arrangements used in Islamic investment companies and Islamic solidarity companies.

The Islamic investment companies invite the public participation in defined investment trusts. The public participants become the beneficial owners in the investment trusts through generally negotiable *mudaraba* certificates. The terms and conditions of the *mudaraba* certificates are variable and are ultimately dependent on the economy in which the investment takes place. The net profits of the trust are divided between the trust and the owners of the certificates (See section 4.2.3).

The Islamic solidarity companies offer special types of insurance coverage, and they differ from investment companies only in their manner of distributing the assets and profits of the investment (See section 4.2.4).

3.2.2 Musharaka Contract

This is a form of business organisation where two or more persons contribute to the financing as well as the management of the business, in equal or unequal proportions. Profits may be divided in an equitable (but not necessarily equal) ratio agreed upon between the partners. The losses must, however, be borne in proportion to the capital.

Musharaka corresponds in many ways to its western counterpart. Broadly speaking, there are two kinds of *musharaka*: the *mufawada* and the *inam*. The *mufawada* or universal partnership is a long term arrangement in which all tangible capital of the partners as well as their commercial activities are committed by the contract. This means that the partners are fully liable for the actions and contracts of each other as agents and guarantors (*kafil*). The *inam* is sometimes described as a limited investment partnership, into which all other types of partnership fall. Under an *inam* arrangement each partner is the agent but not the guarantor of the other, and the agency applies only to the field of their joint capital. *Inam* contract exists in two forms, general and specified. The general *inam* allows partners to conduct multipurpose commercial trade, without restrictions as to commodities traded or transactions negotiated. The specified *inam* allows partners to trade in a particular class of goods or commodities defined and enumerated in the agreement. This arrangement is similar to a joint venture and is the form used by Islamic financial institutions today.

When applied to banking, there exist *Musharaka* contracts with either constant or decreasing participation. In the latter, the bank keeps the profit share of the customer or a portion of it to pay back the capital contribution. Also the bank may participate in the management of the enterprise, but may also waive this right.

3.2.3 Qard Hasan

It is a beneficial, straight interest-free loan, given either in conjunction with another contract, usually against a collateral, or in order to protect the institution's investment if cach-flow problems arise during the implementation of a project financed by a *mudaraba* contract, or to meet the consumption needs of the poor. The rationale behind the use of interest-free loans is discussed in section 4.2.2. and the justification of the collection of a fee on the manageemnt of the loans is discussed in section 4.4.1..

3.2.4 Murabaha Contract

When financing on a profit-and-loss sharing basis is not practically feasible owing to difficulties in determining profits or the short term maturity of funds required, Islamic financial institutions have been authorized to lend on the basis of markup.

The *murabaha* contract, variously translated as fixed profit sale or cost plus sale or markup, is suited to an entrepreneur who needs to finance the purchase of goods from the moment of his order until he receives them and can generate returns from them. It refers to an agreement whereby the financier purchases the goods and sell them to the entrepreneur at an agreed price which yields a specified margin of profit to the financier, the payments being settled by the entrepreneur within an agreed time frame either in lump or instalments (in the latter case the *murabaha* becomes undistinguishable from a lease-purchase or *ijara wa iktina* agreement).

The critical difference between a *mudaraba* financing and a traditional purchase financing, as stated by Muslim scholars, is that in the Islamic contract, the financier takes title to the goods in question and transfers it to the entrepreneur or purchaser upon delivery of the goods. The risk element that the financier is supposed to bear lies in the fact that the entrepreneur is theoretically not obliged to respect the contract until the possesion has been passed to him. A limitation of the *murabaha* is worth noting here and that is it is not acceptable to purchase goods from a party and sell them back to the same party at a profit. Moreover, while charging markup has been allowed, charging markup on the markup in the event of delays in repayment has been disallowed and is considered as interest.

This form of financing is being widely used by the Islamic Development Bank for its foreign trade financing operations and also by almost all Islamic banks established so far.

Murabaha, as most scholars claim, is a legitimate transaction according to the *shari'a*. However, it has been stressed that it would not be advisable to use it widely and indiscriminately since it can be wrongfully used as a financing arrangement with an agreed profit margin being no more than a camouflage for interest.

3.2.5 Ijara & Ijara wa Iktina

Ijara is tranlated as lease and *Ijara wa Iktina* as lease-purchase. There are practically little difference between the Islamic and the conventional operating lease contract. Leasing and lease-purchase are generally allowed by the jurists. They claim that even though the *Shari'a* does not allow a fixed return on financial capital, it allows a fixed charge on real capital. This is because by converting financial capital into real or non-financial assets, the financier has already taken upon himself the risk. In the lease-purchase operation, the bank aquires an asset and leases it to the client, which undertakes to deposit agreed capital payments-instalments over a definite time period, into a saving account held in the bank. The contract is terminated when the full price is paid and ownership is tranferred.

Chapter 4

Islamic Financial Institutions

4.1 Basic Principles

In practice, business organisations in an Islamic Economy would reflect a combination of sole proprietorship and *mudaraba* or a combination of *musharaka* and *mudaraba* or any other combination of acceptable contracts. Not all savers can participate, or are interested in participating as partners in the management of a business, and may be just looking for opportunities to invest their surplus funds for short-, medium-, or long-term periods. They could in this case make financing available to on-going or new businesses and share in the profits and losses according to agreed ratios. If, however, they wish to spare themselves the trouble of sharing as sleeping partners in other businesses, they could invest funds through financial institutions and investment trusts operating according to Islamic principles. In this case, they would also have the advantage of diversifying their investments, which would be difficult for them to achieve through direct equity financing of businesses. Hence, Islamic financial institutions should constitute the most convenient form of investment available to a majority of savers, who have neither their own businesses to invest in nor the ability to evaluate and become partners in running businesses.

Islamic Capital Market

Although the issue of capital markets does not appear in the classical discussions on the Islamic economic system, some scholars have briefly approached the subject. Basically, there seem to be no objections to the existance of capital markets in an Islamic economy similar to those existing in the capitalist system. Hence, scholars argue that firms in an Islamic economy should be able to raise capital by issuing shares. Shareholders are thus viewed as partners in the business of the firm. However, some amendments to the existing system are suggested. Corporate shares or certificates of deposits (in the case of banks) would have the same function than in the capitalist capital markets, but they will have to be based on profit and loss sharing, or *mudaraba*, principles. Thus, Muslim scholars agree that a capital market will be necessary in an Islamic economy, a capital market based primarily on equity financing. The development of an efficient capital market will necessitate also an efficient organisation of both primary and secondary capital markets to enable businesses to raise funds without undue difficulty and to provide liquididy to investors who cannot, or do not wish to hold the equity they have acquired.

However, scholars maintain that share prices should reflect underlying business conditions and expectations, and that they should be free from "erratic" fluctuations due to speculative activities. [Chapra 85]

4.2 Types of Institutions

The institutional framework within which the Islamic economic system is to function is conceptualised as being similar to the conventional one. It will broadly consist of: a Central Bank, commercial banks, non-bank financial institutions and solidarity or Islamic insurance funds.

4.2.1 Central Bank

It is agreed upon among Muslim economists that the Central Bank in an Islamic ecomomic system would have to play a similar role than that of a Central Bank in a capitalist system. It should be an autonomous government institution responsible for the issue of currency, the coordination with the government for the internal and external stability of the economy, the stabilisation of the value of the currency and the promotion, regulation and supervision of all financial institutions.

It should also be responsible for the correct application of the Islamic law in the economic sector, the laying down of rules to ensure the safety of depositors' funds in loan (or interest-free or current accounts), and it should act as lender of last resort for commercial banks and other financial institutions.

As far as taxation is concerned, the Central Bank is to be responsible for the collection of the Islamic taxes of *zakat* and *ushr*, and the disbursment of these funds for the well being of the society.

4.2.2 Commercial Banks

Of all the countries where Islamic financial institutions operate, only Iran and Pakistan have changed their entire banking system into an interest free one. They have done this following different paths. Several rules and regulations have been set to implement the transition. These rules were devised based on muslim scholars and economists thoughts and interpretations of the *Shari'a*.

Among the most complete studies on the operation of Islamic banks was the one done by M.N. Siddiqi in his book *Banking Without Interest* [Siddiqi 83]. In what follows, some of the theoretical issues concerning the formation and operation of an Islamic bank will be presented. The actual practices of currently existing Islamic banks might be different and will be discussed later in this chapter.

Sources of Funds for the Bank :

The two main sources of financing of an Islamic bank would be the paid-in capital of the shareholders and the deposits of individuals in the different bank accounts. Other sources such as fees for services rendered or borrowing from the central bank will also be discussed.

Paid-in Capital :

The bank would be established on the principles of *musharaka* of the *inam* type, as described in section 3.2.2. That is, a number of persons provide a share of the capital to be jointly invested , and hence are called shareholders of the bank. If the number of partners is large, the decision making process for routine business matters could be delegated to a salaried managers constituting a Council of representatives. As explained in the description of *musharaka* of *inam*, the financial liability of the partner should not be limited to the extent of his share in the capital of the bank, but should in priciple be unlimited. However, partners are not liable to any losses incured by a partner in business transactionss not related to the business line of the partnership.

Bank Accounts :

The bank will accept deposits from the public through two types of accounts. The *mudaraba* account and the loan account. (these types of accounts are some times refered to as investment accounts and current accounts).

- *Mudaraba* Account :

  When depositors place their capital in *mudaraba* accounts, the bank will invest their capital along with its own. The aggregate profit earned on the total capital of the bank will be divided over it. After such a division , an agreed percentage of the profit, determined with the mutual consent of the parties concerned, will be given to the bank and the rest will be given to the depositors. If the bank suffers a loss, the loss will be spread over the entire capital, and then divided according to the share in the capital, and the total liability of the depositor, unlike the share holder of the bank, will be limited to his deposit.

  The deposits in *mudaraba* accounts are similar to contracts, which are renewable every predetermined business or accounting cycle, or can be withdrawn with a agreed upon notice period, and profits and losses can be calculated according to determined business cycles. The money in *mudaraba* accounts can be neither drawn upon nor transferred to other persons through cheques.

- Loan Account :

The loan account would operate as current or demand accounts operate in convenitonal banks, and would have the same facilities as are normally available to holders of current accounts. Thus, persons depositing amounts in loan accounts, for security or convenience in making payments, have the right to draw cheques, transfer money and would have a guarantee, endorsed by the Central Bank, that their money will be returned on demand.

On the other hand, the bank has the right to invest the capital deposited in loan accounts, and any profit or loss in such investments will return to or be born by the bank's shareholders alone.

Since a large proportion of the amounts deposited in loan accounts will not be withdrawn totally and at the same time, these amounts are viewed by Muslim scholars as interest-free loans given by the public to the bank. Hence, they propose that the bank should reciprocate the receipt of loans without interest by issuing interest-free loans to the public according to a specific criteria. (These criteria will be discussed in the following section on interest-free loans.)

Investment Activities of the Bank :

There seem to be a consensus over the activities that an Islamic bank should in principle engage in. Hence, the bank's activities have been distinguished into three categories:

- Services which the bank renders on fee, commission, or on fixed charges.
- Investment of capital according to the principles of partnership or *mudaraba*.
- Free or uncharged services, or interest-free loans.

These three categories will be described in the following sections.

Charged Services :

These services are similar to those offered by conventional banks. They include safe deposits, transfer of money, consulting, brokerage and other services offered by conventional banks for a fee.

Investment through partnership or *mudaraba* :

The bank can engage in a partnership contract with an entrepreneur. In this case both the bank and the entrepreneur share in the investment and the management of the business, and they both share the profits according to predetermined ratios and share the losses according to the share of capital invested.

Although modern banking shows that in most countries, most commercial banks have refrained from investing in businesses on the principles of partnerships, direct bank participation in businesses has played a tremendous role in the industrial development of Europe [Siddiqi 83].

The bank can also offer financing on the basis of *mudaraba* contracts. In that case, the bank will not intervene in the management of the business, although it will be allowed to audit account and inspect the transactions of the business. Here also profit and loss sharing follows the rules set in the *mudaraba* contract.

Although these investment schemes seem fairly uncomplicated, they do present several major problems in their implementation.

In the case of a new enterprise, there are practically no problems in determining the profit or loss for the different parties involved. The corresponding contract would specify the nature of the business to be conducted, the limits within which it is to be run, the length of the agreement and the proportions of the profits to be distributed. However, in the case of financing of an already established and running business, the problem of determining the amount of capital contributed by each party, and the amount of profit attributable to the part of the business being financed may cause a tremendous amount of trouble. In this case, scholars have suggested that both the entrepreneur and the bank should agree on a method for assessing the amount of capital already invested in the business before any investment from the part of the bank.

Another problem may arise regarding the length of the term of agreement. While this is simple in the case of short term business transactions or operations, it gets more difficult in the case of a indefinately continuing enterprises.

Hence, in order to make the study of the business to be financed more convenient, there should be a universally agreed upon accounting system to be used by all Islamic Banks and the businesses that need to be financed.

Siddiqi suggests in his book that Islamic banks can also invest in the stock market by buying and selling shares of enterprises. He mentions that the value of shares would be greatly dependent upon the existing or expected profitability of the firm, but raises many questions to be addressed before such practices could be used, namely issues related to the financial liabilities of the shareholders, their right of interference in the joint enterprise and the speculative actions in current stock markets. [Siddiqi 83]

Interest-Free Loans :

It has been recognised that the need for short term loans cannot be met by the system of partnership or *mudaraba*. This is mainly due to the difficulty in keeping account of profit or loss for a short period of time and in allocating what part of the profit or loss is attributable to what party. To resolve this problem, muslim scholars had recourse to interest-free loans. These loans will be mainly given to entrepreneurs who already have *mudaraba* accounts with the bank, only for a determined short period and against a security or collateral. The rationale behind this type of loans is that, since the bank is profiting from interest free accounts consisting of deposits from the public in loan accounts, it should also extend this benefit back to the members of the community who are in need of short term financing. The Central bank is to promote this practice by giving commercial banks short term interest-free loans as needed.

This was in the case of businesses or entrepreneurs needing short term financing. As far as the members of society who need consumer loans are concerned, Siddiqi divides them into two categories. To the first category belong those who have neither assets nor sources of income with which they might repay the loan. Such people will not need loans as much as financial assistance, and this is the responsability of the Islamic State or the Central Bank who must accomodate them with the special *zakat* accounts. To the second category belong those who have assets and a source of income. Although it has not been clearly stated as to where should this category get its consumer loans, it has been recognised that since the banks are after all business institutions whose objective is to earn profits, the responsability for supplying interest-free loans to consumers cannot be placed on them. Specialised credit institutions, regulated by the state and the Central Bank and using *zakat* funds, are proposed for this purpose [Chapra 85].

4.2.3 Non-Bank Financial Institutions

This category encompasses investment banks, venture capitalists and all other financial institutions that would mobilise savings from the public through equity and *mudaraba* deposits and make them available for financing. Their role as financial intermediaries will be similar to their counterparts in the conventional system, except that under the Islamic system, they will have to issue shares or certificate of deposits on the basis of profit and loss sharing as specified by the *Shari'a*.

4.2.4 Solidarity Funds

The role, scope and operation of insurance companies in an Islamic system are different than those in the conventional one.

<u>Attitude Towards Risk</u>

Muslims see no virtue in risk taking. Those who seek risky businesses are associated with gamblers, and gambling is forbidden in Islam. However, there is a great sympathy in Islamic societies for those who fall on hard times through no fault of their own. Thus, sharing the risk through partnership or *mudaraba* is seen as completely legitimate and recommendable, since it serves to spread inevitable losses in business transactions instead of concentrating it on one party [Wilson 84].

<u>Insurance and Islamic Law</u>

Islamic Insurance companies operate practically in the same way as mutual funds. They are non-profit making insurance companies which exist for the benefit of their members, who are also owners.

The Islamic solidarity companies offer numerous types of insurance coverage and they differ from Islamic investment companies only in their manner of distributing the assets and profits of the investment to the members of the public. The solidarity company trusts assume indemnity payments to the participants in cases where stipulated risks occur to their detriment. Investment premiums, which are paid into the trust are reinvested in favor of the participants. These amounts are owned by the participants until they withdraw from the trust. The solidarity companies assume substantial risk of loss based on the reserves of a main pre-established solidarity trust.

4.3 Survey of Existing Islamic Financial Institutions

4.3.1 Historical Background

In the 7th century, when the Koran was revealed, the economy of the Arabian peninsula was that of trading city-states living in a hostile environment. The lack of stability meant, in business terms, illiquidity and scarcity that resulted in the widespread of usury and hoarding. In most cases, it was the poorer classes which relied on money-lenders and which were heavily indebted. Furthermore, high interest charges discouraged trade, caused inflation and resulted in an overall loss for the whole community. By prohibiting the practice of receiving or paying *riba*, the objective of the Koran was a fairer economic life.

The first Islamic financial institution was *Bait al Maal*, or the public treasury that was created during the early years of Islam. In the first decades of Islam, the Islamic empire rapidly grew beyond the Arabian Peninsula, and this led to the establishment of *Bait al Mal*, which was a sort of a central state bank.

History provides examples of several non-Islamic financial institutions based on religious law. During the 15th century, Christian banks were formed by the Church in Italy to discourage and eliminate usurious lending to the poor. The *montes pietatis* were public, non-profit pawnshops which were financed by charitable donations and charged a fee for their care of pawns and administrative costs. They were approved by decree in 1467 by Pope Paul II and successive Popes until they began charging interest in 1493. Also, in the same period, the kings in Europe encouraged the creation of interest banks that requested relatively low interest rates, in order to have access to cheaper money and lessen the power of usurers [Abdus-Shadid 84].

4.3.2 Growth to Date and Current Status

In recent years, the growing sentiment for a return to an Islamic model of society produced and atmosphere in which an alternative banking system began to develop in certain Islamic states. In Pakistan, where it had been the sense of a seperate religious identity that had resulted in the formation of the state, real debate about the application of Islamic principles first took place in the 1950s. However, the issue was put aside because of "commercial considerations", although the question of interest was subsequently raised time after time in the national assembly in Islamabad [Wilson 83].

The first formal experience occured in 1963 when a local Islamic bank was established in Egypt, in the town of Myt Ghamr in the Nile Delta. While the bank was ultimately dissolved in 1977, it had gained a great notoriety among the Islamic countries as a successful profit-making alternative to western banks.

Since the early 1970's, the tremendous trade surplus accumulated by the Arab Opec countries spurred the growth and modernization of Arab-owned, international commercial banks, and most of the surplus money was recycled through the U.S. and European international banks. However, these banks did not reflect Islamic principles in their operations, and great concern grew about the use of these recycled funds. Hence, in 1973, an OIC (Organization of the Islamic Conference (see Table 4-I)) committee met to discuss the development of a viable financial and economic system that could best utilize the surplus capital in the Muslim world to achieve social justice in accordance to Islamic spiritual and social teachings. This resurgence of interest in Islamic economics led to the establishment of numerous Islamic financial institutions.

Chief among them is the *Dar al Mal al Islami*, founded in 1981, registered in the Bahamas but based in Geneva. It is followed by the Kuwait Finance House which was created in 1977 with considerable Kuwaiti government support and which looks to large scale project financing. The *Al Baraka* group, which began at the start of the 1980s, is the fastest growing Islamic banking group with interest in the Middle East, Africa and Europe. It is the only Islamic financial institution so far to be granted a licence as a licensed deposit taker by the Bank of England [ME 84]. The *Al Rajhi* group, which was developed by a group of Saudi money changers in 1978, is also expanding into the UK [Euromoney 84]. It, together with the *Al Baraka* group and the Kuwait Finance House, established the Islamic banking System International which has founded a separate Islamic bank in Denmark - the first such European-based bank - which is designed to encourage trade and development participation between Scandinavia and the Middle East [Nienhaus 85].

There is also a large and amorphous group of independent Islamic banks, such as the Dubai and Bahrain Islamic banks, together with similar institutions in Egypt, Malaysia, Turkey and other African, Asian and Middle Eastern countries. Perhaps the most important Islamic institution, however, is that founded in October 1975 as source of development funding and foreign trade financing, the Islamic Development Bank based in Jeddah. Tables 4-II, 4-III and 4-IV give greater detail of the existing Islamic Financial Institutions.

The speed with which Islamic financial institutions has spread in the 1980's has surprised many observers who initially dismissed it as a passing phenomenon (See Table 4-V). A recent survey conducted by the Islamic Research and Training Institute at the Islamic Development Bank showed that there are about 40 Islamic banks which have started functioning in the different parts of the world. In addition to these Islamic banks, there are about 20 Islamic Investment and Finance Companies which are conducting their business according to the *Shari'a*.

However, no common regulations exists to govern these autonomous and spontaneous developments. Each institutions tend to develop deposit or investment instruments which it deems consistent with Islamic law. Most of them have retained Islamic jurists or advisors to guide them on the acceptability to Islam of their respective operating policies and procedures, and as might be expected, the rulings of these experts have not always been uniform [Wohlers-Scharf 83].

From the view point of purpose of the banks, Islamic banks can be classified into the following groups : (1) Development Banks such as the Islamic Development Bank; (2) Special-Purpose Islamic Banks (e.g social banks, agricultural banks, industrial banks, etc.) such as the Nasser Social Bank of Egypt; and (3) Islamic Commercial Banks.

On the basis on ownership, Islamic banks may be classified into : (1) International Islamic Banks such as the Islamic Development Bank, DMI (*Dar al Mal al Islami*), *Al-Baraka* group, the Islamic Banking System and *Al-Rajhi* Investment Banking Corporation; (2) Government-Owned Islamic Banks such as the Nasser Social Bank; (3) Privately-Owned Islamic Banks under which most of the other banks fall; and (4) Cooperative Islamic Banks.

In terms of financial structure, existing Islamic banks reveal a diversified and complex pattern. Some of the large international Islamic banks such as DMI or *Al Baraka* have opened subsidiaries or branches in different parts of the world .Tables 4-VI & 4-VII give a detailed profile and information of the major Islamic banks and their subsidiaries.

4.4 Current Activities of Islamic Financial Institutions

4.4.1 Islamic Development Bank

The creation of the Islamic Development Bank dates back to a declararion of intent by a Conference of Finance Ministers of Islamic States in December 1973 in Jeddah. The inaugural meeting was held in July 1975, and the bank began work officially in October 1975.

The authorised capital stock of the bank is 2 billion Islamic Dinar (ID), (1 ID = 1 SDR of the IMF). Saudi Arabia, which had played a prominent role in the setting up of the bank, is by far its major contributor with over one-quarter of the subscribed capital. The largest contributors are Saudi Arabia, Libya, Kuwait, the United Arab Emirates and Turkey. (In 1985, Turkey raised its subscription from ID 63 million to ID 160 million, thus joining the other four largest subscribors with a permanent seat on the Board of Executive Directors.) Arab countries as a group hold approximately 80 percent of the voting power (See Table 4-VIII).

Legal Status :

The Islamic Development Bank is an independent international institution possessing a judicial personality. Its headquarters are in Jeddah, but it has been authorised to establish other agencies and branch offices.

Objectives and Development Strategy :

The pricipal purpose of the Islamic Development Bank has been to foster economic development and social progress of its members and of other Muslim communities, in accordance with the priciples of the *Shari'a*. The bank has also been designed to encourage research in Islamic economics and to assist member states to organize their economic sructure and planning on essentially Islamic principles. The

Islamic Development Bank's functioning has been characterized by a flexible and multifaceted development and operational strategy, and -in contrast to Arab institutions- a lesser degree of adherence to the traditional strategy of international institutions, such as the World Bank [Hunter 84]. As a result, the scope of the Bank's operations has been quite wide (See Table 4-IX). The bank has been empowered to :

- to participate in the equity capital of productive projects and enterprises in member countries,
- to invest in member countries' economic and social infrastructure projects by way of financial participation or other financial arrangements,
- to make loans to the private and public sectors for the financing of productive projects,
- to establish and operate special funds for specific purposes, including funds to finance research, training and relief assistance to Muslim communities in non-member countries,
- to operate trust funds,
- to accept deposits and raise funds in any other manner,
- to invest in a suitable way funds which are not needed for its operations,
- to assist in the promotion of foreign trade, especially in capital goods among member countries,
- to provide technical assistance and promote training for personnel angaged in development activities,
- to undertake research to enable the economic, financial and banking activities in Muslim countries to conform to the principles of the *Shari'a*.

Financial Operations :

Tables 4-X and 4-XI give a summary of the Islamic Development Bank (IsDB) activities from 1976 to 1986.

I. Project Financing:

Project Financing receives the greater amount of funding. It includes public and private sector loan financing, equity participation, leasing, Lease-purchase and profit-sharing financing.

- Loan financing is utilized primarily to assist in the long-term development of countries through infrastructure projects. The bank could only levy a service fee to cover its administrative expenses. The amount of the fee and the manner of applying it has been determined by the bank (See Figure 4-3).

- Equity Participation has had an important place in the bank's financing operations. In fact, the bank has been required to maintain a suitable ratio between equity investments made in, and loans granted to, member countries, preferably with the balance being in favour of equity investments (See Figure 4-4).

- Leasing has been a successful operation for the bank due to the simplicity and flexibility of this method of financing. These operations are less risky, have shorter repayment period and provide better return on investment. Under the Lease-Purchase agreement the lessee is responsible for the contract negotiations for the purchase of equipment. However, the actual purchase cannot be consummated without the bank's approval. The agreement also requires that the lessee submit to the bank a certificate of acceptance which evidences a satisfactory inspection of the equipment by the lessee prior to acceptance (See Figure 4-5).

- Though the concept of profit-sharing is basic to Islamic banking and finance, the bank has not been able to make much use of this category of financing. The bank has reported that various issues and problems will need to be sorted out before this method can be used effectively. The Islamic Development Bank has financed two profit-sharing projects, one in the United Arab Emirates and the other in Morrocco (See Figure 4-5).

By 1983, the bank had structured its sectoral distribution of project financing into the following categories: agriculture, industry and mining, transportation and communication, utilities, social services (including education and public health) and others (See Table 4-XII and Figure 4-2).

The bank's Policies and Procedures provide that the bank will finance projects/enterprises which are technically sound and economically and financially viable. The Policies and Procedures are based on currently accepted general principles and on the practices of investment and regional development institutions, with a special view toward adapting these principles and practices to the bank's stated Islamic objectives. In determining wheter to finance, the bank will conduct proposals and feasibility studies in order to choose projects which: (1) have a high financial and economic rate of return; (2) promote the economic development of local or regional economies; (3) have strong social orientations; and, (4) instill economic self-sufficiency.

In addition to economic considerations, the bank include certain closes in the contract, depending on the type of financing, in order to safeguard its own interest. Under all of the agreements, the recipient must provide the bank with several specific types of reports and data regarding investments and financing.

II. Technical Assitance:

Technical assistance is normally provided for in the form of a loan, grant or a combination of the two, primarily for feasibility studies, designs and consulting services. The recipient is obligated to assist its consultant in a number of specified ways, and to assist the bank in the negotiations with the consultant (See Figure 4-6).

Project Financing and Technical Assistance constitutes what the bank calls

Ordinary Operations. Other operations are Foreign Trade Financing and Special Assistance Financing (See Table 4-XIII).

III. Foreign Trade Financing:

The bank has introduced an Investment Deposit Scheme in the late 1980 to fund its growing short term Foreign Trade Financing Operations which utilizes funds not immediately needed for project financing to assist member countries in obtaining essential commodities for their development programs. Most trade financing operations of the Islamic Development Bank have involved the import of crude oil and other petroleum products (See Figure 4-7).

IV. Special Assistance Financing:

A Special Assistance Account has been in existence since March 1979 to (1) assist member countries in financing the Islamisation of Banking, (2) promote Islamic causes, (3) provide disaster relief for member countries, and (4) foster the growth of Islamic communities (See Table 4-XIV).

Islamic Development Bank and Interest :

The Islamic Development Bank charges no interest on its loans. Instead, a one time service fee is levied to cover administrative administrative expenditures. According to the bank's Policies and Procedures, the fee is fixed "according to the proportions which the administrative expenditures of the bank bear to its total resources".

One view concerning this fee is that since it is fixed and it is not related to profits and losses of the borrower, it is not in accord with the principles of *mudaraba* and hence is illegitimite. The mere fact of not being tied to the duration of the loan does not make it different from interest.

The other view, and the bank's, is that since the fee is not related to the amount borrowed, nor to the duration of the loan, it represent the allowance of commissions charged for actual work done. If the bank's service is fairly-earned income, it is lawful under *Shari'a*, in contrast to interest, which is unearned income in the Islamic view.

4.4.2 Other Commercial Banks

Islamisation of Commercial Banking :

Although the movement for the establishment of individual Islamic banks has come a long way, most Muslim scholars believe that the full benefits of the Islamic system cannot be obtained without the establishment of a *riba*-free economy within a whole frame of an Islamic society.

There are only two Islamic countries that have so far decided to implement such a policy: Iran and Pakistan.

The total Islamisation of the Iranian banking system started in the 1980 following the revolution of the previous year, and by 1984 the majority of internal transactions conformed to the spirit of the Koran. Most domestic lending and deposit taking are now based on profit sharing, although the banks still maintain an administrative fee for lending. Resale contracts and leasing arrangements are also used, although not as frequently as in the Arab Islamic banks (See Tables 4-XV & 4-XVI).

The Islamisation of the banking system in Pakistan seems to have been carefully planned and implemented. The Council of Islamic Ideology was charged in 1979 to draw up a report on how interest could be eliminated from the economy. A unique document was produced in 1980 advising the complete Islamisation of the banking system. The government of Pakistan decided to implement the report's recommendations in stages [Faruki 84]. The report also considered how central government finance could be made to conform to Islamic principles, and how insurance arrangements should be modified. At the start of July 1985, the banking sector turned over completely to Islamic banking and no more interest bearing deposits were accepted (See Tables 4-XVII & 4-XVIII).

Between Theory and Practice :

The existing Islamic banks perform a number of functions. Some of these functions are normally performed by the commercial banks and some functions have been modified by Islamic banks in order to conform with the *Shari'a*. There are differences in the performed functions amongst Islamic banks, especially in the forms and names of deposits each bank accept, and although they are all centered around the same principles, they might operate in different ways. This divergence is mainly due to the diversity of Muslim scholars advising such institutions.

For most of the independent Islamic financial institutions, there is some discrepancy between the theory or ideology of Islamic banking, centered on profit-and-loss participation, and the practice which shows the preference for transactions bringing set earnings. For most of the commercial Islamic banks, the greatest part of their earnings are not actually made, as one would expect, from profit-and-loss participation financing, based on the *mudaraba* or *musharaka* principles. The majority of Islamic banks' earnings are derived from leasing, mark-up and similar transactions, which in contrast to profit-and-loss participation, carry practically little risk to the bank. Thus, *murabaha*, which is still considered by many Islamic scholars to be the negative side of Islamic banking, accounts on average for more than 80 percent of Islamic banks' assets. The mark-up system is usually seen as close to interest, and some bankers admit that the criteria for the mark-up rate depend highly on the prevailing interest rate [Bracher 85]. Mudaraba, on the other hand, has a minimal place, while *musharaka* accounts for about 10 percent of assets (See Table 4-XXI).

The reasons for this discrepancy can be understood if we look at some factors affecting the operations of Islamic banks. Some of these are the increased uncertainty of the bank's future earnings due to the profit-and-loss participation contracts, the lack of outlets for diversification, the problem of identifying and judging market opportunities, problems of evaluation and profit assessment, supervision of the partner's management of the joint enterprise, etc. Moreover, another factor working against the engagement in *mudaraba* or *musharaka* contracts (which are usually medium to long-term contracts) and favoring *murabaha* (of a shorter term) may be the fact that Islamic banks, especially newly established ones, need to be able to show financial success as quickly as they can to their shareholders and depositors, in order to gain their confidence.

4.4.3 Problems and Prospects

Problems of Islamic Banks :

Expansion and Regional Diversification :

The number of Islamic banking institutions and their geographical spread (as shown in Tables 4-III, 4-IV and 4-V), show that there are about 35 Islamic banks all over the world. Out of these, eight banks are located in non-Muslim countries and provide banking service consistent with the *Shari'a* mainly to Muslims settled in those countries. The rest, which are located in the Muslim countries, could be divided into three categories, (i) Islamic banks which are located in the Gulf countries, (ii) Islamic banks located in the non-oil Arab countries, (iii) Islamic banks located in non-Arab Muslim countries.

In view of the size and diversity of the Islamic world, these banking institutions can make a begining but possibly cannot achieve any perceptible change. In terms of modern banking parameters, Islamic banks are still in their infancy. Compared to other interest-based Arab banks, Islamic banks are operating on a relatively small scale. Hence, expansion and development of Islamic banks is necessary if they are to serve as vehicules of social and economic change along the Islamic lines.

Moreover, at present, most of the Islamic banks are located in major urban centers. Regional diversification in rural areas might help to develop saving and banking habits among rural popullation and promote resource mobilization for economic development.

Investment Outlets :

Finding acceptable investment outlets conforming with the *Shari'a* remains the major challenge for Islamic institutions. Islamic banks are still stuck in the short term market with only few medium term deals. This was mainly due to the concentration on instruments, generating quick returns at low risks - so called "soft areas" of credit, such as trade, real estate etc. Few banks have undertaken equity participation in agriculture and industry, and there is an increasing awareness of the necessity to engage in socially desirable long-term projects.

In financing long term projects, Islamic banks has certain pre-requisites not required by interest-based banks. The Islamic banks will have to identify project, carry out technical feasibility studies, estimate expected stream of profits and only then they shall be able to invest in a project. Moreover, the Islamic banks are expected to show more social responsability by ensuring socially productive use of their resources. Conventional banks are not usually faced with these constraints.

Another related problem faced by Islamic banks is finding profitable use of surplus liquid funds. The growth in the resources of Islamic banks and the reduction in the demand for credit due to the recession in the Gulf region have contibuted to the intensity of this problem. Several proposals aiming at finding short-term solutions to the problem of excess liquidity have been made. The most successfull one has been the Investment Deposit scheme introduced by the Islamic Development Bank in 1980. The proceeds of the scheme are invested in the foreign trade financing which offered short-term returns. The investment deposit scheme became very popular and a number of Islamic banks deposited their surplus liquid funds in it.

Islamic Banks in Western Markets :

Islamic banking based upon profit-sharing was conceived under the assumption of operating in an interest-free environment. Since Islamic banks started to operate in economies based upon interest financing, the forms of co-operation, but also of competition have yet to evolve.

One study has shown in a mathematical model that Islamic banks, operating in a market dominated by conventional banks, cannot neglect the market rate of interest [Nienhaus 83]. The assumption here is that an entrepreneur will have two alternatives for borrowing. With the Islamic bank and based on his expected revenues, he will have to agree on a ratio of profit sharing. If his share of "Islamic" profit is equal to or larger than the "conevntional" profit (i.e. revenues minus expenses including interest costs), then he will borrow from the Islamic bank. However, theoretically, since both the borrower and the Islamic bank are looking for the highest profit, they are bound to agree on a ratio of profit sharing that will make "Islamic" profit equal "conventional" profit. This implies that the revenues of an Islamic bank from the profit-sharing financing would not exceed the revenues of an average interest bank out of its interest loan business. This is in the case of certainty, where the realized profit is equal to the expected one. In the case of uncertainty, the entrepreneur has an incentive to present to the Islamic bank an optimistic estimate of the profit when setting the profit-sharing ratio. Thus, the Islamic bank will have to rely on protective measures: on the one hand, it will have to investigate all the investments in order to assess their expected profits, and on the other hand, it will demand higher profit-sharing ratios. Hence, the Islamic bank will be under pressure, because unlike the conventional bank which can more easily investigate the creditworthiness of the borrower, it cannot standerdize its profitability investigations. moreover, in order for the Islamic bank to accurately examine each investment, it will have to accumulate a well founded knowlegde of the markets where its clients intend to invest. Because of the difficulty of concentrating too much knowledge in its staff, the bank will have to specialize in financing investment projects in specific sectors or categories. With the use of financial instruments such as *mudaraba* or *musharaka*, where the bank is engaged in joint ventures, the tendency for Islamic banks to monopolize certain markets and to become giant conglomerates is great.

Moreover, while an Islamic bank gives no direct or unconditional guarantee that the funds placed by depositors in investment accounts will be repaid, these funds being subject to profit-and-loss participation, western central banks give the higher priority to protecting depositor's accounts. Therefore, because of the risk pertaining to profi-and-loss sharing accounts, western central banks have been reluctant to give such Islamic financial institutions deposit-taking or primary banking licences. Hence, there is no question of Islamic banks being allowed to offer retail banking facilities in western countries. The Bank of England gave permission for *Al Baraka* group to open as a licensed deposit taker in London largely because *Al Baraka* had acquired control of a UK finance house. Hence, Islamic banks operating in the West merely function as investment companies, and are often involved in the western stock market and commodity market transactions [Wilson 84].

A further concern of western central banks, when faced with request for branch or subsidiary status from Islamic banks is the difficulty of determining the precise nature and the the supervision exercised over Islamic banks. This is also likely to be a problem for western commercial banks seeking a proper basis for assessing the standing of an Islamic bank as a preliminary to entering into mutually beneficial trading relations with such institutions.

On the other hand, a theoretical model of the workings of the Islamic banking system, on the basis of equity participation, has shown that such system may well turn out to be better suited than the interest-based, or traditional, banking system to adjust to shocks that can lead to banking crises [Khan 86]. In an equity-based system, shocks to asset positions are immediately absorbed by changes in the nominal values of shares (deposits) held by the public in the bank. Therefore, the real values of assets and liabilities of banks would be equal at all points in time. In the traditional banking system, since the nominal value of deposits is guaranteed, such shocks can cause a divergence between real assets and real liabilities, and it is not clear how this disequilibrium would be corrected and how long the process of adjusyment would take. The study concludes that from an economic standpoint, the principal difference between the Islamic and the traditional banking systems is not that one allows interest and the other does not. The most relevant distinction is that the Islamic banking system treats deposits as shares and accordingly does not guarantee their nominal value, whereas in the traditional system such deposits are guaranteed either by the banks or by the government.

Prospects for Islamic Banks :

With about 20 percent of the world's population being Muslims, Islamic banks can attract a large number of depositors. The recent rapid increase in the number of such institutions, the favorable response of the Muslim populations in terms of deposits and support and the trend towards the revival of Islam and its values throughout the Muslim world show the importance of Islamic banking and its potentials.

Perhaps the most important aspect of Islamic banking is the role they can play in financing the development of Third World countries. Many of the developing countries, with or without Muslim majorities, have welcomed Islamic banks and have been willing to modify their banking regulations to enable such institutions to operate within their boundaries.

Dar al Mal al Islami has been the most active in establishing Third World branches. It has wholly owned Islamic banking subsidiaries in Niger and Senegal, which both accept deposits and make advances, and in the Sudan it has a wholly owned susidiary investment company [ME 86a]. Saudi Arabian capital has also been largely responsible for the establishment of the Faisal Islamic Bank of Egypt and the Faisal Islamic Bank of the Sudan, both of which started operations in 1977. In the Far East, Saudi Arabian and Arab Gulf capital helped the founding of the Bank Islam Malaysia and the Saudi-Philippine Islamic Development Bank, while in South Asia, the International Islamic Bank of Bangladesh also received strong Arab backing.

The Islamic Development Bank, however, remains the most important player on the Third World scene (See Table 4-XXII). It has provided concessionary finance and has been prepared to cofinance development projects with multilateral aid agencies and international development banks (See Table 4-XXIII).

However, despite the favorable social and political situation, there are many constraints hindering the development of an Islamic financial system on an international level. The development of such a system cannot take place without the adequate manpower and logistic infrastructure, and without the proper tools required to create ties between the Islamic and other conventional financial institutions.

Several steps have been taken to overcome these constraints. The first Islamic Conference on Islamic Economics (Mecca, 1976) gave an important impetus to establishing and developing Islamic economics as a scientific discipline and as a new research field. One of the major recommendations of the conference was that the King Abdul Aziz University establish a center for the study of Islamic economics.

The International Center for Research in Islamic Economics (ICRIE) was founded in 1979 at King Abdul Aziz University. Its major objectives are to conduct and support theoretical and applied research in various fields of Islamic economics. The Islamic Center for Research in Islamic Economics (IRTI) was established within the IsDB at Jeddah in 1981. Its main functions are to organise and co-ordinate basic and applied research with a view to developing models and methods for the application of *Shari'a* in the fields of economics, finance and banking and to provide training in Islamic economics for personnel in development activities in the Member State.

Table 4-VI: Profile of Islamic Banking Institutions (Cont

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Table 4-I: Some Basic Statistics for the Oraganization of the Islamic Conference [OIC] Members.

COUNTRY GROUPS	Area Sq.Km. (Thousand)	Population Mid-1982 (Million)	Average Annual Population Growth % 1970-1981	G.N.P. at Market. Million ($) 1981	GNP per capita (%) 1981	Average Annual Growth of Real GNP per capita (% 1970-1981	Growth Rate of Real GDP (%) 1980-1981	Gross Domestic Investment as % of GDP 1981	Gross Domestic Saving as % of GDP 1981
ARABIAN PENINSULA									
BAHRAIN	(620Km^2)	0 33	2.8	3.240)	8.960	5.7	—	—	—
KUWAIT	18	1.56	6 3	30.600	20.900	2.7	—	17	46
OMAN	212	0 95	3.1	5.440	5.920	2.8	—	—	—
QATAR	11	0 26	5.4	6.540	27.720	0 2	—	—	—
SAUDI ARABIA	2.150	9 68	4.5	117.240	12.600	9.0	—	26	59
UNITED ARAB EMIRATES	84	0 79	16 6	26.910	24.660	0 2	—	28	72
YEMEN ARAB REPUBLIC	195	6.06	3 0	3.310	460	6 1	1.2	44	-21
YEMEN PEOPLE'S REPUBLIC	333	2 09	2.5	910	460	10.7	—	—	—
MIDDLE EAST GROUP									
EGYPT	1.001	44 67	2 5	28.160	650	5.6	6.1	30	17
IRAQ	435	14.00	3 4	—	—	—	—	—	—
IRAN	—	—	—	—	—	—	—	—	—
JORDAN	98	3 49	3.5	3.880	1.620	5.8	6.1	41	-16
LEBANON	10	2 74	0.6	—	—	—	—	—	—
SYRIA	185	9 66	3.7	14.660	1.570	6.0	3.5	24	9
TURKEY	781	46 31	2.3	70.210	11.540	3.0	4 1	25	19
MAGHRIB GROUP									
ALGERIA	2.382	20 29	3.3	42.010	2.140	3 1	4 5	37	39
LIBYA	1.760	3.22	4.1	26.080	8.450	-0.9	1.8	34	48
MAURITANIA	1.031	1.73	2 3	710	460	-1.0	3 9	38	9
MOROCCO	447	21 67	3.1	17.960	860	2.8	1.2	23	8
TUNISIA	164	6.67	2.3	9.300	1.420	5.4	6 5	31	23
EAST AFRICAN GROUP									
DJIBOUTI	22	0 41	6 6	180	480	—	4.4	—	—
SOMALIA	638	5 12	2 8	1.240	280	1 1	1 0	—	—
SUDAN	2.506	19 45	3 1	7.390	380	0 9	4 5	13	(-)
UGANDA	241	14 06	2 6	2.890	220	-4.1	0 4	3	3
COMORO ISL	2	0.38	2 9	110	320	-2 4	4.2	—	—
WEST AFRICAN GROUP									
CAMEROON	475	8 87	2 2	7.630	880	3 3	5.6	21	22
CHAD	1.284	4.64	2 0	490	110	-3.6	-7.3	—	—
GABON	268	0 56	1.1	2.550	3.810	3.2	3.7	—	—
GAMBIA	11	0.64	3.0	220	370	3 1	-4.1	—	—
GUINEA	246	5 29	2 9	1.660	300	0 4	3.3	11	14
GUINEA-BISSAU	36	0 59	1.6	150	190	—	2.8	—	—
MALI	1.240	7 34	2 6	1.340	190	2.3	4.4	16	-6
NIGER	1.267	5 65	3.3	1.890	330	-0.8	1 4	27	15
SENEGAL	196	5.97	2 7	2.530	430	-0 4	5.8	17	-5
SIERRA LEONE	72	3 67	2 6	1.140	320	-1.1	0 6	13	-2
UPPER VOLTA	274	6 36	2 0	1.490	240	1 6	7.0	16	-11
ASIAN GROUP									
AFGHANISTAN	648	16 79	2 5	—	—	—	1 5	—	—
BANGLADESH	144	92 62	2.6	12.840	140	1.4	7.3	17	2
INDONESIA	1.905	153 03	2.3	78.750	530	4.8	7.6	21	23
MALAYSIA	330	14 77	2.5	26.110	1.840	5 1	6.5	32	26
MALDIVE ISL	(300 Km^2)	0 16	3.1	—	—	—	—	—	—
PAKISTAN	804	87 13	3.0	29.800	350	1.9	6 7	17	7

- not available (-) less than 0.5

Source: [Satiroglu 87]

Table 4-II: Number of Islamic Banks in Muslim Countries.

S.No.	Country	Number of Islamic Banks
1	Bahrain	3
2	Bangladesh	1
3	Egypt	3
4	Guinea	1
5	Jordan	3
6	Kuwait	1
7	Malaysia	1
8	Mauritania	1
9	Niger	1
10	Qatar	1
11	Senegal	1
12	Sudan	5
13	U.A.E.	1
14	Iran	1
15	Saudi Arabia	1
16	Tunis	1
17	Turkey	2
	Total	**28**

Source: [Ahmad 87]

Table 4-III: OIC Member Countries Without an Islamic Bank.

S.No.	Country	S.No.	Country
1	Afghanistan	14	Maldives
2	Algeria	15	Mali
3	Cameroun	16	Morocco
4	Chad	17	Oman
5	Comoros	18	Pakistan*
6	Djibouti	19	Palestine
7	Gabon	20	Sierra Leone
8	Gambia	21	Somalia
9	Guinea Bissau	22	Syria
10	Indonesia	23	Uganda
11	Iraq	24	Upper Volta
12	Lebanon	25	Yemen A.R.
13	Libya	26	Yemen P.D.R.

* Whole banking system in Pakistan is being reorganized on the Islamic lines.

Source: [Ahmad 87]

Table 4-IV: Islamic Banks in Non-OIC Countries.

Country	Number of Islamic Banks
Switzerland	1
Luxembourg	1
Denmark	1
Philippines	1
England	2
South Africa	1
Bahamas	1
Total	**8**

Source: [Ahmad 87]

Table 4-V: Progress in the Establishment of Islamic Banks.

Year	Number of Islamic Banks established during the year	Names of Islamic Banks
1972	1	Nasser Social Bank, Cairo.
1973	1	Philippine Amanah Bank.
1975	2	Islamic Development Bank, Jeddah Dubai Islamic Bank, Dubai.
1977	3	Faisal Islamic Bank, Egypt; Faisal Islamic Bank, Sudan; Kuwait Finance House, Kuwait.
1978	2	Jordan Islamic Bank, Jordan; Islamic Finance House Universal Holding, Luxembourg.*
1979	2	Bahrain Islamic Bank, Bahrain; Iran Islamic Bank.
1980	1	Islamic International Bank, Cairo.
1981	4	Dar-Al-Mal Al-Islami, Switzerland; Islamic Finance House, England; Jordan Finance House, Jordan; Islamic Bank of Western Sudan, Sudan.
1982	3	Islamic Bank Bangladesh, Bangladesh; Kibris Islamic Bank, Kibris; Islamic Ivestment House, Jordan.
1983	10	Qatar Islamic Bank, Qatar; Tadamon Islamic Bank, Sudan; Faisal Islamic Bank, Bahrain; Bank Islami, Malaysia; Faisal Islamic Bank, Guinea; Faisal Islamic Bank, Senegal; Islamic Bank International, Denmark; Faisal Islamic Bank, Niger; Sudanese Islamic Bank, Sudan; Bank Al-Baraka Al-Sudani, Sudan.
1984	5	Al-Baraka Bank, Bahrain; Islamic Finance House, Jordan; Bait-Al-Tamwil Al-Saudi Al-Tunisi, Tunis; Al-Baraka Turkish Finance House, Turkey; Faisal Finance Institution, Turkey.
1985	1	Al Baraka Islamic Bank, Mauritania.
Total	**35**	

Source: [Ahmad 87]

Table 4-VI: Profile of Islamic Banking Institutions.

Name of Bank and Head Office	Year of Establishment	Authorized Capital	Paid-up Capital	Shareholders	Management
1. Nasser Social Bank, Cairo	1972	E£ 14.4 million	Fully paid	100% Government owned	Chairman: Nassif Abdel Maksoud Tahoon
2. Dubai Islamic Bank, Daira, Dubai	1975	Dh.59,104,000	Fully paid		Chairman: Mr. Saeed Ahmed Lootah
3. Faisal Islamic Bank of Egypt, Cairo	1977	US$ 500 million	US$ 40 million	Dubai: 10% Kuwait: 10% Private Shareholders 80%	Governor: Dr. Mohamoud Mohamed El-Helw
4. Faisal Islamic Bank of Sudan, Khartoum, Sudan	1977	S£100 million	S£58.4 million	Sudanese: 40% Private Saudis: 40% Other Arab (Private) 20%	General Manager: Mr. Bakir Yousif Mudawi
5. Kuwait Finance House, Safat, Kuwait	1977	KD18,750,000	KD18,701,274	Private Interest: 51% Kuwaiti Ministries: 49%	Chairman: Mr. Ahmad Bazih Al-Yassin
6. Jordan Islamic Bank, Amman, Jordan	1978	JD6 million	Fully paid	Housing Bank of Jordan: 1.3% Private Shareholders 98.7%	General Manager: Mr. Musa A. Shihadeh
7. Bahrain Islamic Bank, Manama, Bahrain	1979	BD23 million	BD5.75 million	Kuwait Govt. 13.4% Bahrain Govt. 10.4% IDB 13.0% KFH 8.7% Dubai Islamic Bank 4.4% Private 46.2%	Managing Director: Mr. Abdullatif Janahi
8. Islamic International Bank for Investment and Development, Cairo, Egypt	1980	US$12 million	US$8.7 million	Egyptian Private shareholders 100%	Chairman: Mr. Hassan Ahmad Naji
9. Qatar Islamic Bank, Doha, Qatar	1983	QR 200 million	QR 50 million	US$ 13.2 million	Managing Director: Mr. Qasim M. Qasim
10. Tadamon Islamic Bank Khartoum, Sudan	1983	US$ 50 million		Kuwait Finance House and Sudanese Public	Chairman: Mr. Khidir Hassan Kambal
11. Al-Baraka Bank of Sudan, Khartoum, Sudan	1984	US$ 200 million	US$ 50 million		General Manager: Mr. Ibrahim M. Ali Nimer
12. Faisal Islamic Bank Manama, Bahrain	1983	US$ 30 million	US$ 30 million	Dar-al-Mall Islami (major shareholder)	Managing Director: Mr. Nabeel Abdellah Nassief
13. Al-Baraka Islamic Investment Bank, Bahrain	1984	US$ 200 million	US$ 50 million	Al Baraka Investment Company 50% Private Businessman and A Number of Islamic Financial Institutions 50%	General Manager: Dr. Sami Hamoud
14. Islamic Bank for Western Sudan	1981	US$ 10 million	US$ 200,000	Faisal Islamic Bank Egypt Bahrain Islamic Bank Al-Baraka Investment & Development Co.	Chairman: Dr. Adam M. Musa Madibo
15. Bank Islam Malaysia, Kuala Lumpur	1983	M$500 million	US$ 79 million	Federal Govt. of Malaysia 30% State Religious Bodies 50% Private s. holder: 20%	Managing Director: Dr. Abdul Halim Ismail

Table 4-VI: Profile of Islamic Banking Institutions (Cont)

Name of Bank and Head Office	Year of Establishment	Authorized Capital	Paid-up Capital	Shareholders	Management
16. International Islamic Bank, Dhaka, Bangladesh	1982		US$ 13.2 million	Bangladesh Govt. 51% IDB, KFH, DIB and others 49%	Chairman: Mr. Mohammed Abdur Razzaque Laskar
17. Faisal Islamic Bank, Guinea	1983	US$ 20 million		Subsidiary of DMI	Director General: Mr. Mory Fode Conde
18. Faisal Islamic Bank, Niger	1983	US $ 20 million		Subsidiary of DMI	Chairman: H.E. Prince Mohammed Al Faisal Al Saud
19. Faisal Islamic Bank, Senegal	1983	US$ 20 million		Subsidiary of DMI	Director General: Mr. Assane Diop
20. Dar-Al-Mall-Al Islami, Geneva, Switzerland	1981	US$ 1,000 million	US$ 310 million		Ahmed Sani El Darwish
21. Islamic Finance House Universal Holding, Luxembourg	1978	US$ 100 million	US$ 26,070,450 million		General Manager: Dr. Galal Osman
22. Islamic Bank International, Denmark	1983	D.Kr. 50 million	D.Kr. 50 million		Managing Director:Dr. Gunner Thorlund Jepsen
23. Kibris Islamic Bank, Kibris (Turkish Cyprus)	1982	US $ 1 million	US $ 1.0 million	Private Sharehoders and others	
24. Islamic Finance House, Public Ltd. Co. England	1981	£ Stg. 510,000		Islamic Banking System International holding 100%	
25. Al-Baraka International Ltd., England	1983	£10 million	£ 5 million		Sheikh Saleh Kamil
26. Iran Islamic Bank, Tehran	1979	US$ 115 million		Ali Hajtar Khani Sayyed Mohammed Beheshti: 60%	
27. Islamic Investment House, Amman, Jordan	1982	J.D.4 million	J.D 4 million		Director General: Mr. Khairi Ayub Al Hamonry
28. Beit Et Tamwil Saudi Tounsai, Tunis	1984	US$ 50 million	US$ 25.0 million	Al Baraka 80% Central Bank of Tunis 20%	General Manager: Dr. Moncef Rouhou
29. Jordan Finance House Amman, Jordan	1981	J.D.6 million	J.D.5.6 million		Chairman: Mr. Ahmed Ali Merghani
30. Sudanese Islamic Bank, Khartoum, Sudan	1983	Sud.£ 20 million	Sud.£ 18.7 million		Chairman: Prof. Mohamed Hashim Awad
31. Islamic Cooperative Development Bank	1983	£ 200 million	£ 3.7 million		
32. Al-Baraka Turkish Special Finance Institution, Istanbul, Turkey	1984	TL10 billion	TL10 billion	Al-Baraka Investment & Development Co.: 50% Hak Investment & Trade Co.: 10% Islamic Development Bank	General Manager: Mr. Yalcin Oner
33. Faisal Finance Institution Istanbul, Turkey	1984	TL 5 billion	TL 5 billion	DMI: 51% Turkish Partner: 10%	General Manager: Fehmi Akin
34 Al-Baraka Islamic Bank Mauritania	1985	UM500 million	Al Baraka Group	Jeddah 50% Mauritanian Businessmen 40% Central Bank of Mauritanian 10%	Director General: Mr. M. Sidi Mohamed Elemine

Note: Wherever the information was not available, the space has been left blank.

Source: [Ahmad 87]

Table 4-VII: Addresses of Some Islamic Banks

Organization/ Institue	Name and Designation	Address	Telex	Cable	Telephone
1. Kuwait Finance House (Kuwait)	Mr. Ahmed Bazih Al-Yassin, Chairman	Ahmed Al-Jaber St. Imad Commercial Centre P.O. Box 24989, Safat Kuwait	23331 KUWAIT KT 46717 KUWAIT KT	BAITMAL KUWAIT	2445050-2445070 (Ten lines)
2. Islamic International Bank for Investment and Development (Egypt)	Mr. Ahmed Amin Fouad Chairman of BOD	4 Addy Street, Mesaha Sqaure, Dokki, Giza, Egypt, Cairo	94190-94248 IBID UN	ISLA-BANK	843936/846439/ 846439
3. Dubai Islamic Bank, (Dubai)	Mr. Saeed Ahmed Lootah, Chairman	P.O. Box 1080, Diera Dubai, U.A.E.	45889 ISLAMI 48772 EM	ISLAMI	281856/285535 233300
4. Faisal Islamic Bank (Egypt)	Dr. Mohamed F. El-Sarraf, Governor	1113 Corniche El-Nile St. P.O. Box 2446, Cairo	93877 FBANK	FAISAL BANK	753165/753109
5. Faisal Islamic Bank (Sudan)	Mr. Bakir Yousif Mudawi General Manager	P.O. Box 3415, Khartoum	22519 FIBS 22163	BANKISLAMI KM	
6. Jordan Islamic Bank for Finance and Investment (Jordan)	Mr. Musa A. Shihadeh General Manager	P.O. Box 926225, Aman, Jordan	21125 ISLAMI JO	ISLAMI BANK	666325/661220 661310
7. Tadamon Islamic Bank (Sudan)	Mr. Khidir Hassan Kombol Chairman of BOD	P.O. Box 3154, Khartoum, Sudan	22687/ 22688 DAMAN 22158 SD	TADA-BANK	73640/73271 70417
8. Islamic Banking System International, (Luxembourg)	Dr. Gamal El-Din Attia General Manager	25, Cote D'Eich P.O. Box 1450 Luxembourg	1898 ISBAHO LU	—	474038/474037 474036
9. Naser Social Bank (Egypt)	Mr. Nassif Abed Maksoud Tahoun Chairman of BOD	35, Kasr El-Nil St. P.O. Box 277 Mohamed Farid, Post, Cairo, Egypt	92754 NASR BANK UN	NSRBK UN	741930/74484
10. Bahrain Islamic Bank (Bahrain)	Mr. Abdullatif Janahi Managing Director	P.O. Box 5240, Manama, Bahrain	9388 BESMEH BN	ISLAMI BANK	231402
11. Islami Bank Bangladesh Ltd. (Bangladesh)	Mr. Mohammed Abdur Razzaque Laskar Chairman of BOD	75, Motijheel C.A. P.O. Box 233, Dhaka Bangladesh	642525 IBANK BJ	ISLAMI BANK	235183/235184
12. Bank Islam Malaysia Berhad (Malaysia)	Dr. Abdul Halim Ismail Managing Director	Peti Suratl 1080 Bangunan Ibu Pejabat, Pernas, Jalan Raja Laut, Sambungan, Kuala Lumpur	31785 MA	BANK-ISMA KUALA LUMPUR	935569/935566
13. Islamic Bank International of Denmark A.S. (Denmark)	Mr. Erik Trolle Schultz Managing Director	7, Jernbanegade-1608 Copenhagen-V. Denmark	16478 ISBANK	ISLAMIC BANK	01-114777
14. Massraf Faysal Al-Islami (Guinea)	Mr. Mory Fode Conde Directeur General	P.O. Box 1247, Conakry, Guinea			
15. Massraf Faysal Al-Islami (Niger)		P.O. Box 12754 Niamey, Niger	5440 NI	DMI-NIGER	735719/735720
16. Massraf Faysal Al-Islami (Senegal)	Mr. Assane Diop, Directeur General	B.P. 3381, Dakar, Senegal	MASSARAF 5440		
17. Qatar Islamic Bank (Qatar)	Mr. Kaseem M. Kaseem Managing Director	P.O. Box 599, Doha Qatar	5177-5176	ISLAMI	438000 Operator 439339 Private
18. Al-Baraka Bank of Sudan, (Sudan)	Mr. Ibrahim M. Ali Nimer Managing Director	P.O. Box 3585, Hashim Hajju Building, Near Medical College, Khartoum, Sudan			73056/73043 76621/80688

Table 4-VII: Addresses of Some Islamic Banks (Cont)

Organization/ Institute	Name and Designation	Address	Telex	Cable	Telephone
19. Dr-Ul-Mal Al-Islami (Switzerland)	Prince Mohamed El Faisal	84, Avenue Louis-Casai, 1216 Cointrin, Geneva, P.O. Box 42 Switzerland			(022) 984040
20. Massraf Faysal Al-Islami of Bahrain	Mr. Nabil Abdellah Nasif Managing Director	P.O. Box 20492 Chamber of Commerce Bldg. King Faysal Rd. Manama, Bahrain	9270 FAISBK BN MASFA-9411 FAIFX BN SLAM TELEFAX 277305		
21. Islamic Finance House Public Ltd. Company (England)		England			
22. Al-Baraka International Ltd. (England)	Sheikh Saleh Kamel	32, Seething Lane London EC 3R 5BA, England	8951057 BARAK AC		01-488 0948
23. Kibris Islamic Bank (Kibris)		Kibris Turkish Republic			
24. International Association of Islamic Banking & Economics (Kibris)		a) Jeddah, P.O. Box 4992 b) Turkish Federated State of Kibris	57256 FIBK TK		6724416
25. Al-Baraka Islamic Investment Bank (Bahrain)		P.O. Box 1882, Manama, Bahrain	8655 BCI BN		

Source: [Ahmad 87]

Table 4-VIII: Islamic Development Bank Capital Subscriptions and Amount Paid in as of Dec. 31, 1981.

(In ID millions)

	Subscribed capital					Subscribed capital			
	Original	As at 31.12.81	% of total	Of which paid in		Original	As at 32.12.81	% of total	Of which paid in
Saudi Arabia	200.0	506.4	27.8	200.0	Guinea-Bissau	2.5	6.3	0.4	1.5
Libya	125.0	315.3	17.3	125.0	Niger	2.5	6.3	0.4	2.5
Kuwait	100.0	252.2	13.9	100.0	Senegal	2.5	6.3	0.4	2.5
UAE	110.0	194.7	10.7	110.0	Uganda	2.5	6.3	0.3	2.5
Algeria	25.0	63.1	3.5	25.0	Upper Volta	2.5	6.3	0.3	2.0
Indonesia	25.0	63.1	3.5	25.0	Yemen AR	2.5	6.3	0.3	2.5
Pakistan	25.0	63.1	3.5	25.0	Yemen PDR	2.5	6.3	0.3	2.5
Turkey	10.0	63.1	3.5	10.0	"Palestine"	2.5	5.0	0.3	2.5
Malaysia	16.0	40.4	2.2	16.0	Tunisia	2.5	5.0	0.3	2.5
Iraq	10.0	25.2	1.4	6.0	Afghanistan(a)	2.5	2.5	0.1	2.5
Sudan	10.0	25.2	1.4	10.0	Chad	2.5	2.5	0.1	0.5
Egypt(a)	25.0	25.0	1.4	20.0	Comoros	2.5	2.5	0.1	0.25
Qatar	25.0	25.0	1.4	25.0	Djibouti	2.5	2.5	0.1	0.25
Bangladesh	10.0	20.0	1.1	10.0	Gambia	2.5	2.5	0.1	1.0
Morocco	5.0	12.6	0.7	5.0	Lebanon	2.5	2.5	0.1	2.5
Jordan	4.0	10.1	0.6	4.0	Maldives	2.5	2.5	0.1	0.25
Gabon	2.5	7.5	0.4	0.6	Mali	2.5	2.5	0.1	1.5
Bahrain	5.0	7.0	0.4	5.0	Mauritania	2.5	2.5	0.1	2.5
Oman	5.0	7.0	0.4	5.0	Somalia	2.5	2.5	0.1	2.5
Cameroon	2.5	6.3	0.4	2.0	Syria	2.5	2.5	0.1	2.5
Guinea	2.5	6.3	0.4	2.5					
					Total: 41 Members	792.5	1820.2	100.0	768.35

a) Membership has been temporarily suspended.
Note: 1 Islamic Dinar (ID) is equal to 1 SDR (= $1.18 at 1981 exchange rate).

Source: [OECD 83]

Table 4-IX: IsDB: Approved Projects by Type and Country, 1976-1986.

Country	Loan	Equity Partici-pation	Leasing	Lease-purchase	Profit sharing	Technical assistance	TOTAL
ALGERIA	23,64	-	-	11,75	-	-	35,39
BAHREIN	4,44	3,05	15,29	-	-	-	22,78
BANGLADESH	33,60	5,25	37,78	-	-	-	76,63
BENIN	4,70	-	-	-	-	2,32	7,02
BURKINA FASO	9,89	5,42	3,51	-	-	4,04	22,86
CAMEROUN	19,85	13,76	-	-	-	1,00	34,61
COMORES	6,75	-	-	-	-	1,41	8,16
DJIBOUTI	4,90	-	-	-	-	0,95	5,85
EGYPT	10,30	5.00	5.00	-	-	-	20,30
GABON	5,00	-	-	-	-	-	5,00
BAMBIA	-	-	-	-	-	0,60	0,60
GUINEA	19,20	4,07	6,15	-	-	1,24	30,66
GUINEA-BISSAU	-	-	-	-	-	0,46	0,46
INDONESIA	15,00	16,84	8,56	3,12	-	-	43,52
IRAQ	19,71	-	-	10,87	-	-	30,58
JORDAN	19,00	29,38	52,68	19,38	-	0,53	120,98
LEBANON	7,44	-	-	-	-	0,09	7,53
LIBIA	-	-	26,05	25,64	-	-	51,69
MALASIA	23,64	8,30	12,50	6,17	-	-	50,61
MALDIVES	1,67	-	5,34	-	-	0,09	7,10
MALI	27,41	2,66	-	-	-	2,37	32,44
MOROCCO	18,54	36,08	3,53	-	3,06	0,15	61,36
MORITANIA	27,63	7,67	18,89	-	-	1,35	55,54
NIGERIA	20,90	9,22	-	-	-	3,51	33,63
OMAN	14,55	7,01	28,66	7,01	-	0,24	57,47
PAKISTAN	13,25	20,16	70,83	14,60	-	-	118,84
PALESTINE	-	-	-	-	-	1,22	1,22
QATAR	-	-	7,80	-	-	-	7,80
SENEGAL	20,85	15,33	9,30	-	-	3,11	48,59
SIERRA LEONE	6,00	-	-	-	-	1,87	7,86
SOMALIA	13,00	2,00	2,00	-	-	0,90	17,90
SUDAN	13,00	7,25	-	-	-	-	20,25
SYRIA	14,65	-	32,00	-	-	-	46,65
TCHAD	13,85	-	-	-	-	0,24	14,09
TUNISIA	33,67	26,61	23,29	10,43	-	-	88,00
TURKEY	7,25	24,78	121,63	25,68	-	3,05	182,39
U.A.E.	-	17,52	5,00	-	4,27	-	26,79
UGANDA	8,76	-	6,00	-	-	1,34	16,10
YEMEN (A.R.)	21,90	1,70	24,53	-	-	2,85	50,98
YEMEN (P.D.R.)	17,30	-	-	-	-	0,72	18,02
TOTAL	**521,24**	**263,06**	**526,33**	**134,65**	**7,33**	**35,65**	**1.480,46**

Source: [IsDB 86]

Table 4-X: IsDB: Summary of Operations, 1976-1986.

Million ID

DESCRIPTION	1396H/1976 No.	Amount	1397H/1977 No.	Amount	1398H/1978 No.	Amount	1399H/1979 No.	Amount	1400H/1980 No.	Amount	1401H/1981 No.	Amount	1402H/1982 No.	Amount	1403H/1983 No.	Amount	1404H/1984 No.	Amount	1405H/1985 No.	Amount	1406H/1986 No.	Amount	Total Since 1396H/1976 No.	Amount
Loan	1	6,00	11	55,41	5	25,46	6	33,74	9	52,68	6	31,11	9	45,03	11	73,45	12	71,46	15	98,62	7	28,27	92	521,24
Equity Participation	1	7,45	8	35,73	5	26,86	8	39,79	10	37,04	10	45,98	8	28,72	5	15,61	1	6,00	4	9,88	1	10,00	61	263,06
Leasing	-	-	2	7,72	1	12,50	2	16,25	5	38,47	3	30,69	8	57,99	10	75,00	12	115,27	9	102,10	9	62,54	61	518,53
Lease-Purchase	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	7	53,00	10	81,65	17	134,65
Profit Sharing	-	-	-	-	1	4,27	-	-	-	-	-	-	-	-	1	3,06	-	-	-	-	-	-	2	7,33
Technical Assistance	-	-	3	0,84	3	0,82	5	1,37	3	3,38	10	6,83	8	4,44	12	5,99	7	2,96	13	6,63	13	2,41	77	35,65
Total Projects	2	13,45	24	99,70	15	69,91	21	91,15	27	131,57	29	114,61	33	136,18	39	173,10	32	195,69	48	270,23	40	184,87	310	1.480,46
External Trade Financing	-	-	5	43,60	14	127,45	25	262,46	33	350,75	32	367,89	28	377,55	28	460,46	47	671,61	38	667,27	58	572,84	308	3.901,88
Total Ordinary Operations	2	13,45	29	143,30	29	197,36	46	353,61	60	482,50	61	482,50	61	513,73	67	633,56	79	867,30	86	937,50	98	757,71	618	5.382,34
Special Assistance	-	-	-	-	-	-	1	0,71	7	8,46	9	5,33	8	9,25	7	7,85	14	62,65	11	63,90	9	8,35	66	166,50
TOTAL	**2**	**13,45**	**29**	**143,30**	**29**	**197,36**	**47**	**354,31**	**67**	**490,78**	**70**	**487,84**	**69**	**522,98**	**74**	**641,41**	**93**	**929,95**	**97**	**1.001,40**	**107**	**766,06**	**684**	**5.548.84**

Source: [IsDB 86]

Table 4-XI: IsDB: Approved Financing, 1981-1986.

Million IsD

Type of Operations	1401H/ 1981 AD		1402H/ 1982 AD		1403H/ 1983 AD		1404H/ 1984 AD		1405H/ 1985 AD		1406H/ 1986 AD		Total 1396-1406H	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount
I. Project Finnancing	18	107,79	23	131.73	25	167.12	25	202,73	35	262,73	24	173,32	224	1,444.79
II. Technical Assistance	10	6.83	8	4,43	12	5,98	7	2,96	13	6,63	13	2,41	77	35,64
Sub-Total	**28**	**114,62**	**31**	**136,16**	**37**	**173,10**	**32**	**205,69**	**48**	**269,36**	**37**	**175,73**	**301**	**1,480.43**
III. External Trade Financing	31	367.73	27	357,19	28	480,61	42	671,68	38	668,21	58	572,84	294	3,901,73
Sub-Total	**59**	**482,35**	**58**	**493,35**	**65**	**653,71**	**74**	**877,37**	**86**	**937.57**	**95**	**748.57**	**595**	**5,382.16**
IV. Special Assistance	9	5,33	8	9,24	7	7,85	14	62,65	11	63,90	9	8,35	66	166.50
TOTAL	**68**	**487,68**	**66**	**502,60**	**72**	**661,56**	**88**	**940,02**	**97**	**1,001,47**	**104**	**756.92**	**661**	**5,548.66**

Source: [IsDB 86]

Table 4-XII: IsDB: Distribution by Sector of Financed Ordinary Operations, 1982-1986.

IsD Million

Sector	1402H/ 1982 AD		1403H/ 1983 AD		1404H/ 1984 AD		1405H/ 1985 AD		1406H/ 1986 AD		Total 1396H – 1406H	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Agriculture & Agro-industry	23.26	17.1	6.06	3.5	28.79	14.0	117.63	43.7	33.04	18.8	271.40	18.3
Industry & Mining	55.98	41.1	45.20	26.1	79.42	38.6	61.21	22.7	73.72	41.9	560.72	37.9
Transport & Communication	24.71	18.1	51.22	29.6	34.43	16.8	7.28	2.7	40.56	23.1	277.42	18.8
Public Services	25.50	18.7	21.08	12.2	21.20	10.3	45.43	16.8	12.84	7.3	188.47	12.7
Health, Education & Social sectors	5.00	3.7	39.33	22.7	41.37	20.1	35.48	13.2	15.57	8.9	160.09	10.8
Others	1.71	1.3	10.21	5.9	0.49	0.2	2.33	0.9	–	–	22.33	1.5
Total:	**136.16**	**100%**	**173.10**	**100%**	**205.70**	**100%**	**269.36**	**100%**	**175.73**	**100%**	**1480.43**	**100%**

Source: [IsDB 86]

Table 4-XIII: IsDB: Ordinary Operations by Type of Financing.

(IsD million)

Type of Financing	1404H/1984			1405H/1985			1406H/1986			Total 1396 – 1406H		
	Number	Amount	%	Number	Amount	%	Number	Amount	%	Number	Amount	%
Project Financing												
Loan	12	71,46	34,8	15	98,62	36,6	7	28,27	16,0	90	521,24	35,2
Equity Participation	1	6,00	2,9	4	9,87	3,6	2	10,00	5,7	62	263,04	17,8
Line of equity par- -ticipation	-	-	-	-	-	-	(2)	(10,00)	-	(19)	(91,61)	
Leasing	12	125,27	60,9	10	101,24	37,6	5	53,40	30,4	54	518,53	35,0
L/Leasing	(3)	(24,80)	-	(1)	(10,00)	-	(3)	(20,00)	-	(6)	(72,80)	
Lease-purchase	-	-	-	6	53,00	19,7	10	81,65	46,5	16	134,65	9,1
Profit sharing	-	-	-	-	-	-	-	-	-	2	7,33	0,1
Subtotal	25	202,73	98,6	35	262,73	97,5	24	173,32	98,6	224	1444,79	97,6
Technical Assitance	7	2,96	1,4	13	6,63	2,5	13	2,41	1,4	77	35,64	2,4
Total of ordinary operations	32	205,69	100	48	269,36	100	37	175,73	100	301	1480,43	100

Source: [IsDB 86]

Table 4-XIV: IsDB: Special Assistance Financing in Favor of Member Countries and Non-Member Muslim Countries.

Amount in 1000

Year	Member Countries			Muslim Communities in Non-member Countires			Total		
	No./Op.	Is.D.	$EU	No./Op.	Is.D.	$EU	No./Op.	Is.D.	$EU
1399H/1979	1	709	900	-	-	-	1	709	900
1400H/1980	6	7.682	10.050	1	776	1.000	7	8.458	11.050
1401H/1981	6	3.412	4.048	3	1.920	2.300	9	5.332	6.348
1402H/1982	6	7.480	8.442	2	1.772	2.000	8	9.252	10.442
1403H/1983	2	2.155	2.266	5	5.698	6.100	7	7.853	8.366
14o4H/1984	8	56.361	57.675	6	6.287	6.570	14	62.648	64.245
1405H/1985	4	23.534	23.633	7	40.366	38.695	11	63.900	62.328
1406H/1986	1	520	600	8	7.831	8.642	9	8.351	9.242
TOTAL	**34**	**101.853**	**107.614**	**32**	**64.650**	**65.307**	**66**	**166.503**	**172.921**

Source: [IsDB 86]

Table 4-XV: Islamic Republic of Iran: Modes of Permissible Transactions Corresponding to Types of Economic Activity.

Type of Activity	Permissible Mode
Production (Industrial, mining, agricultural)	*Musharakah*, lease-purchase, *Salaf* transactions, installment sales, direct investment, *Muzara'ah*, *Musaqat*, and *Jo'alah*
Commercial	*Mudarabah*, *Musharakah*, *Jo'alah*
Service	Lease-purchase, installment sales, *Jo'alah*
Housing	Lease-purchase, installment, *Qard al-Hasanah*, *Jo'alah*
Personal consumption	Installment sales, *Qard al-Hasanah*

Source: [Zubair 87])

Table 4-XVI: Islamic Republic of Iran: Breakdown of New Banking Facilities Extended According to Various Islamic Contracts.

Mode of Transaction	Amount	Share of Each Mode in Total Facility
	(In billions of Iranian rials)	*(In percent)*
Lease-purchase	27.9	3.7
Installment sale	247.5	32.8
Civil partnership	109.1	14.5
Mudarabah	134.6	17.8
Salaf transactions	26.8	3.5
Jo'alah	2.4	0.3
Legal partnership	37.0	4.9
Direct investment	4.4	0.6
Other	1.6	0.2
Total transactions affecting the profit of investment deposit	591.3	78.3
Debt purchasing	85.0	11.3
Qard al-Hasanah loans	78.4	10.4
Total transactions not affecting the profit of investment deposits	163.4	21.7
Total of transactions	754.7	100.0

Source: [Zubair 87]

Table 4-XVII: Pakistan: Growth of Profit-and-Loss-Sharing Deposits, 1981-85.

(In billions of rupees)

	End-December				End-June	
	1981	1982	1983	1984	1984	1985
Total deposits	70.0	82.8	106.9	111.7	117.9	138.0
Return-bearing deposits	54.7	66.4	86.3	91.0	98.0	. . .
PLS deposits	6.5	12.9	19.9	29.7	22.1	38.1
PLS deposits/total deposits (*in percent*)	9.2	15.4	18.6	26.3	18.7	27.6
PLS deposits/return-bearing deposits (*in percent*)	11.9	19.4	23.1	32.3	22.6	. . .

Source: [Zubair 87]

Table 4-XVIII: Pakistan: Investment of Profit-and-Loss-Sharing Funds by Commercial Banks, 1984.

Financing Technique	June 1984		December 1984	
	Value	Share	Value	Share
	(In millions of rupees)	*(In percent)*	*(In millions of rupees)*	*(In percent)*
Markup and markdown	17,318	86.7	16,263	83.0
Commodity operations	*14,687*	*73.6*	*11,426*	*58.3*
Trading operations	*727*	*3.6*	*2,755*	*14.1*
Documentary inland bills	*298*	*1.5*	*377*	*1.9*
Export bills	*705*	*3.5*	*953*	*4.9*
Import bills	*901*	*4.5*	*613*	*3.2*
Others	—	—	*139*	*0.7*
Musharakah	617	3.1	777	4.0
Hire purchase	132	0.7	130	0.7
Rent sharing (housing loans)	130	0.6	198	1.0
Investment (equity participation)	1,593	8.0	1,970	10.1
Others	176	0.9	249	1.3
Total	19,967	100.0	19,587	100.0
Memorandum items:				
Total PLS deposits	22,088		29,684	
PLS financing PLS deposits *(in percent)*	90.4		66.0	
Total bank credit and investments	140,206		147,928	
PLS financing total bank credit and investments *(in percent)*	14.2		13.2	

Source: [Zubair 87]

Table 4-XIX: Banking Operations of Islamic Banks.

	Faisal Islamic Bank Egypt	Islamic Bank Western Sudan	Tadamon Islamic Bank	Qatar Islamic Bank	Islamic Bank Intl. Denmark	Islamic Bank Bangla-desh	Sudanese Islamic Banks	Jordan Islamic Bank	Total
i. Accepting cash deposit									8
ii. Credit and loan inconformity with Shariah				—					7
iii. Purchase and sale of gold bullion		—	—	—	—	—	—	—	1
iv. Purchase and sale of foreign exchange									8
v. Issue of L/C									8
vi. Issue of L/G	—	—	—						5
vii. Short-term finance		—		—					6
viii. Collecting value of draft etc.						—	—		8
ix. Purchase and sale of certificate of investment etc.		—			—				5
x. Management of special funds		—		—	—				6
xi. Mudharabah		—							7
xii. Musharakah									8
xiii Decreasing participation		—							7
xiv. Specific invested A/C and funds			—			—			6
xv. Direct investment by the bank						—			7
xvi Leasing of machines etc.	—	—	—	—			—	—	2
xvii. Sale and purchase of real estate		—	—				—	—	5
xviii. Agency function	—	—	—	—			—		3
xix. Murabahah				—	—	—			5
xx. Leasing of real estate		—	—	—	—	—	—		3
TOTAL	**17**	**10**	**13**	**13**	**17**	**14**	**14**	**18**	

Note: A dash shows absence of the attribute.

Source: [Ahmad 87]

Table 4-XX: Types of Deposits Handled by Islamic Banks.

Type of Deposits	Faisal Islamic Bank Egypt	Islamic Bank Western Sudan	Tadamon Islamic Bank	Qatar Islamic Bank	Islamic Bank Intl. Denmark	Islamic Bank Bangladesh	Sudanese Islamic Bank	Jordan Islamic Bank	No. of Banks
a. Current Account									8
b. Saving Account with authorization to invest	—	—				—			5
c. Saving Account without authorization to invest		—	—						6
d. Investment Account with fixed period	—								7
e. Investment Account with unlimited period		—	—			—	—		4
f. Specified Investment Account	—	—	—			—	—		3
g. Charitable Investment Account		—	—	—	—	—	—	—	1
h. PLS short notice deposit Account	—	—	—	—	—		—	—	1

Note: A dash indicates absence of an attribute

Source: [Ahmad 87]

Table 4-XXI: Relative Significance of Mudaraba in Financial Operations of Selected Islamic Banks, 1984.

Name of the Bank.	Finance provided under Murabahah as percent of total finance provided.
1. Jordan Islamic Bank	72.0
2. Bangladesh Islamic Bank	65.3
3. Sudanese Islamic Bank	53.6
4. Tadamon Islamic Bank	61.4
5. Qatar Islamic Bank	97.7

Source: [Ahmad 87]

Table 4-XXII: IsDB: Approved Financing in Developing Countries, 1976-1986.

		Approved Amount		
	Number	ID Million	$ US Million	% of Total
Loan	53	271,30	300,76	52
Equity Participation	17	58,09	71,93	22,1
Leasing	16	113,51	125,62	21,9
Total of Projects	86	442,90	490,33	30,7
Technical Assistance	64	29,52	32,65	82,8
Total of Ordinary Operations:	150	472,42	530,98	31,9
External Trade Financing operations	115	1073,89	1253,57	27,5
Total of Ordinary Operations: External Trade Financing Operations	265	1546,31	1784,55	28,7
Special Operations	17	83,15	85,78	49,9
Total	**282**	**1629,46**	**1870,33**	**29,4**

Source: [IsDB 86]

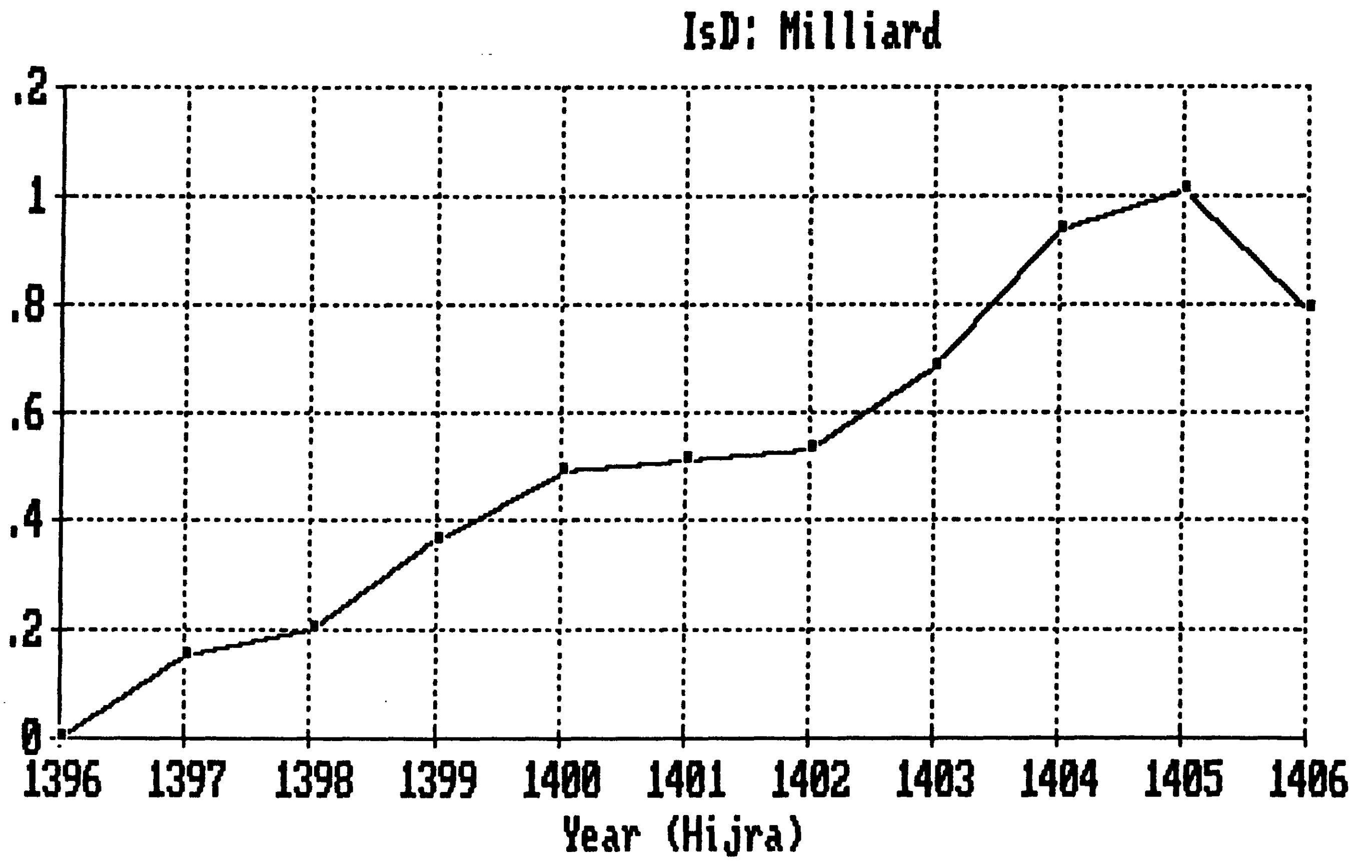
Table 4-XXIII: IsDB: Projects Co-financed in 1986 in $US.

Name of Project	Country	Total Cost	Participation of IsDB	Participation of Co-finan-ciers	Co-financiers
1. Basin of Zarqa River	Jordan	89,20	5,40	64,60	FADES, FKDEA, FSD KFW & GTZ (West Germany)
2. Development of the Abda Rural River	Morocco	40,00	6,30	22,60	FIDA, PAM, National Foundation of Agriculturl Credt
3. Textile Formation School	Mali (CEAO)	12,96	,5,00	7,96	Found. OPEP, FAC, (France), CEAO
4. Equipment for the Jordanian Steel Mill	Jordan	46,25	11,60	34,65	AEICO (Arab Society of Technical Industry)
5. Arab Society of Antibiotics	Iraq	115,00	12,00	19,95	ACDIMA
6. Arab Society of Pottasium	Jordan	17,38	8,00	4,80	BIRD
7. Sabah Paper & Putty	Malasia	506,00	5,30	238,00	Canada, Austria, West Germany
8. Fecto Cement Society	Pakistan	85,00	2,75	12,00	SFI
9. Plypropylene bags *	Somalia	4,75	0,49	1,51	SFI, Austrian
TOTAL		916,54	56,84	406,07	

* Financed by equity participation

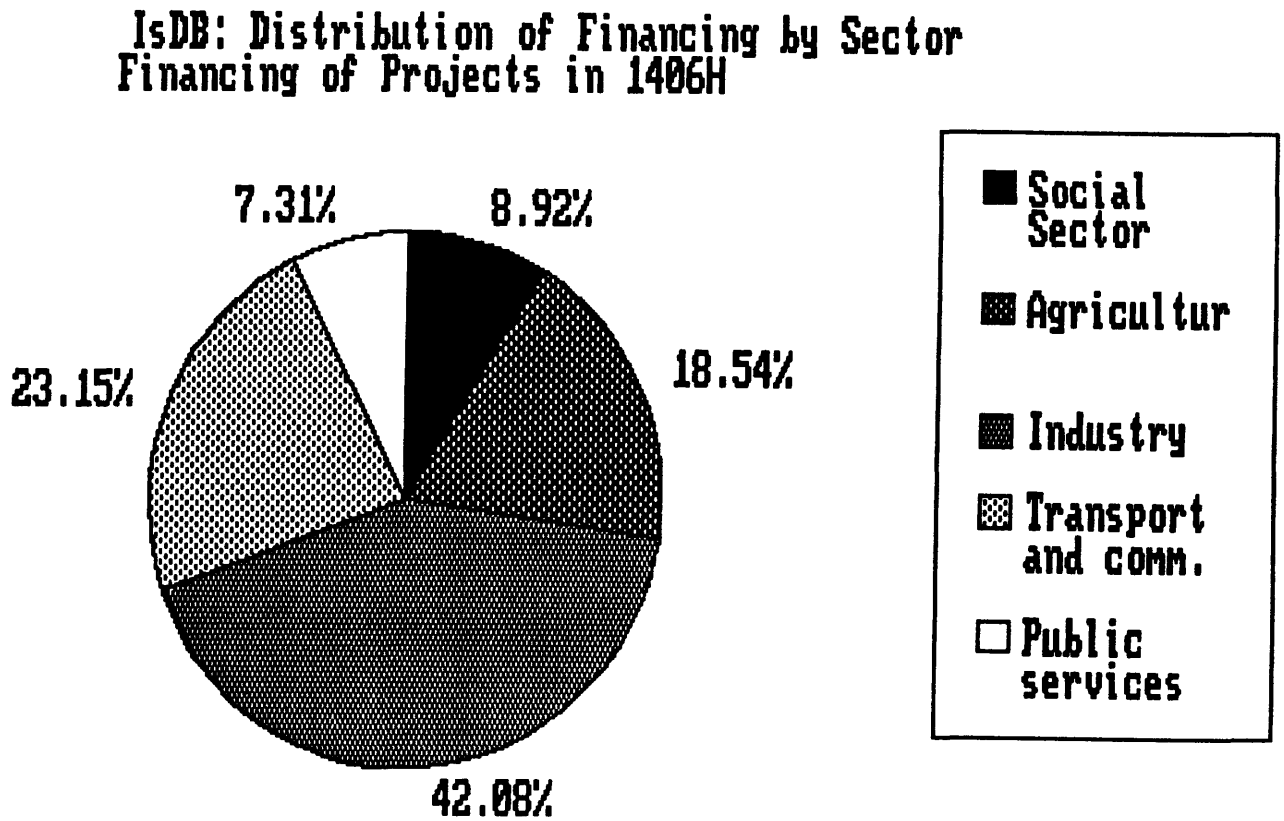
Source: [IsDB 86]

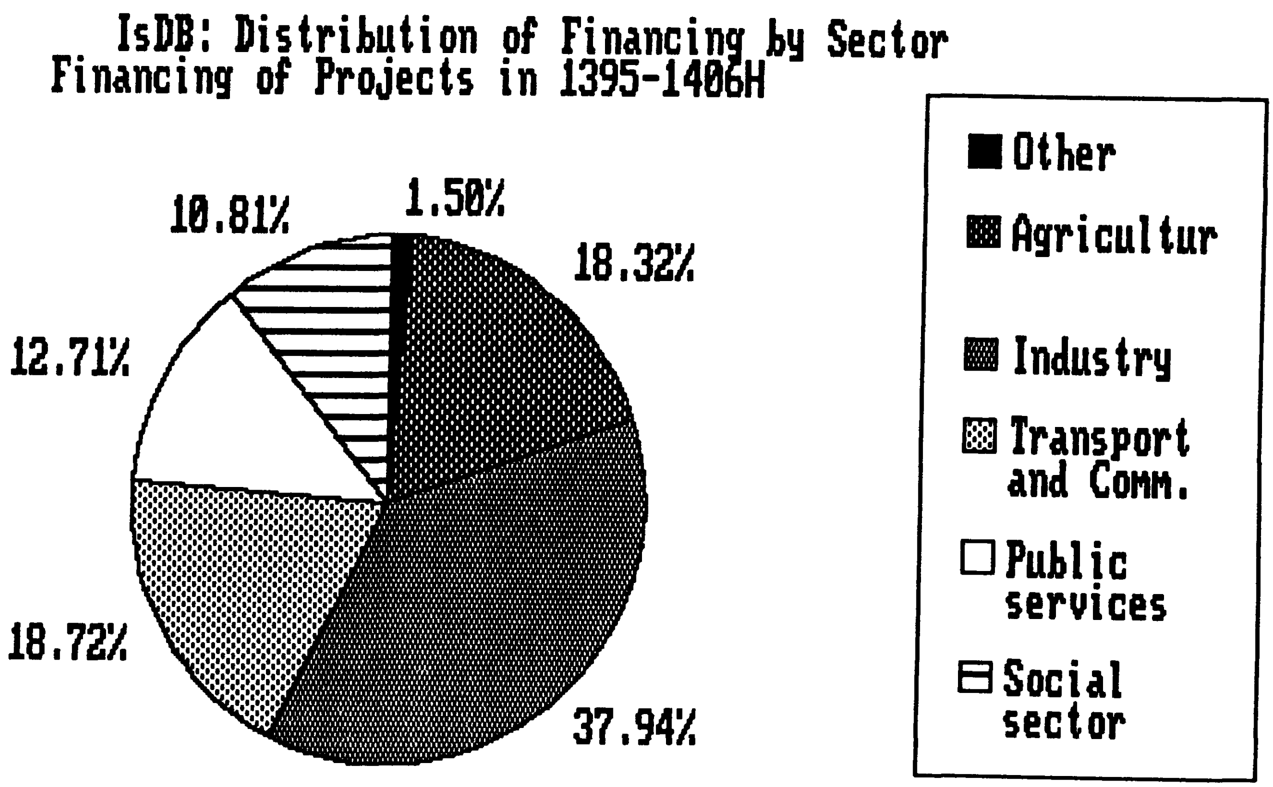
Figure 4-1: IsDB: Trend in Financing, 1976-1986.



Source: [IsDB 86]

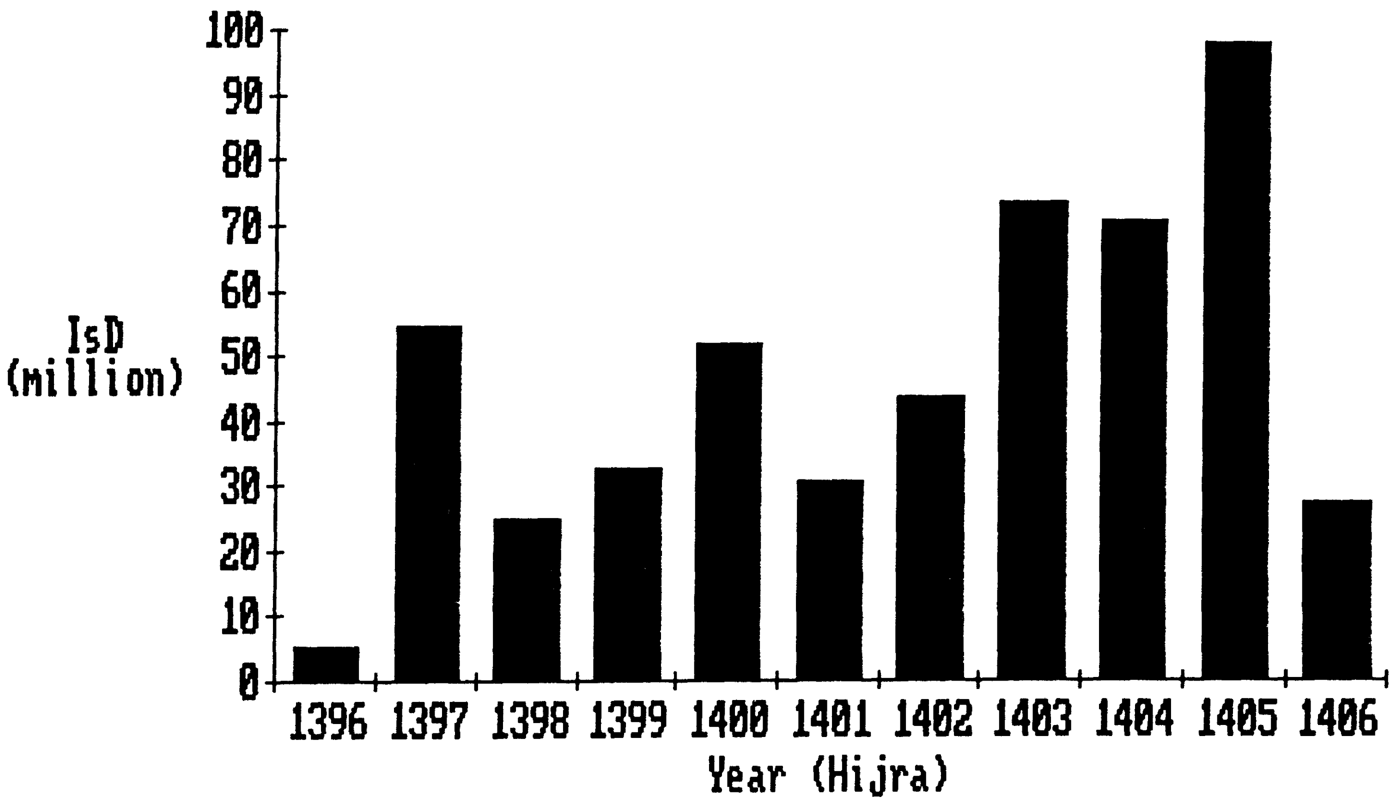
Figure 4-2: IsDB: Distribution of Financing by Sector.





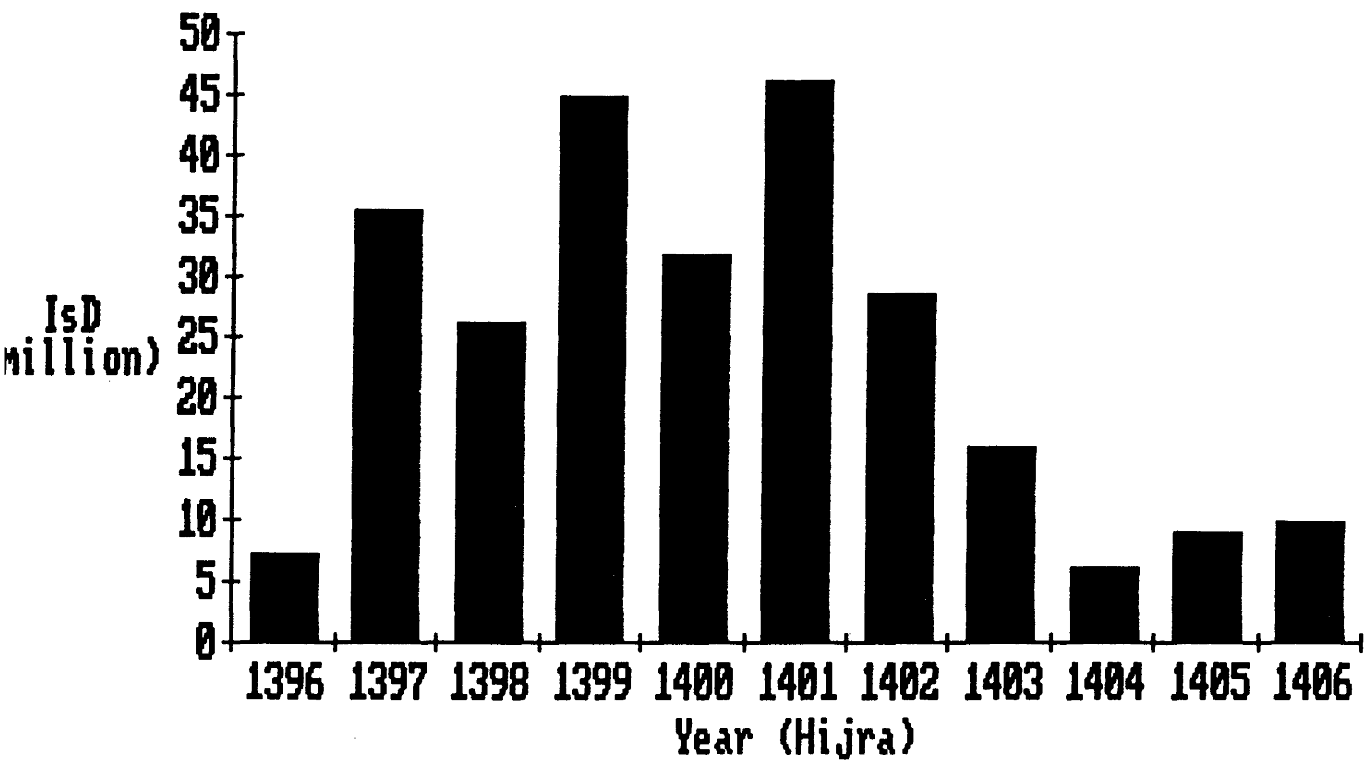
Source: [IsDB 86]

Figure 4-3: IsDB: Approved Loans, 1976-1986.



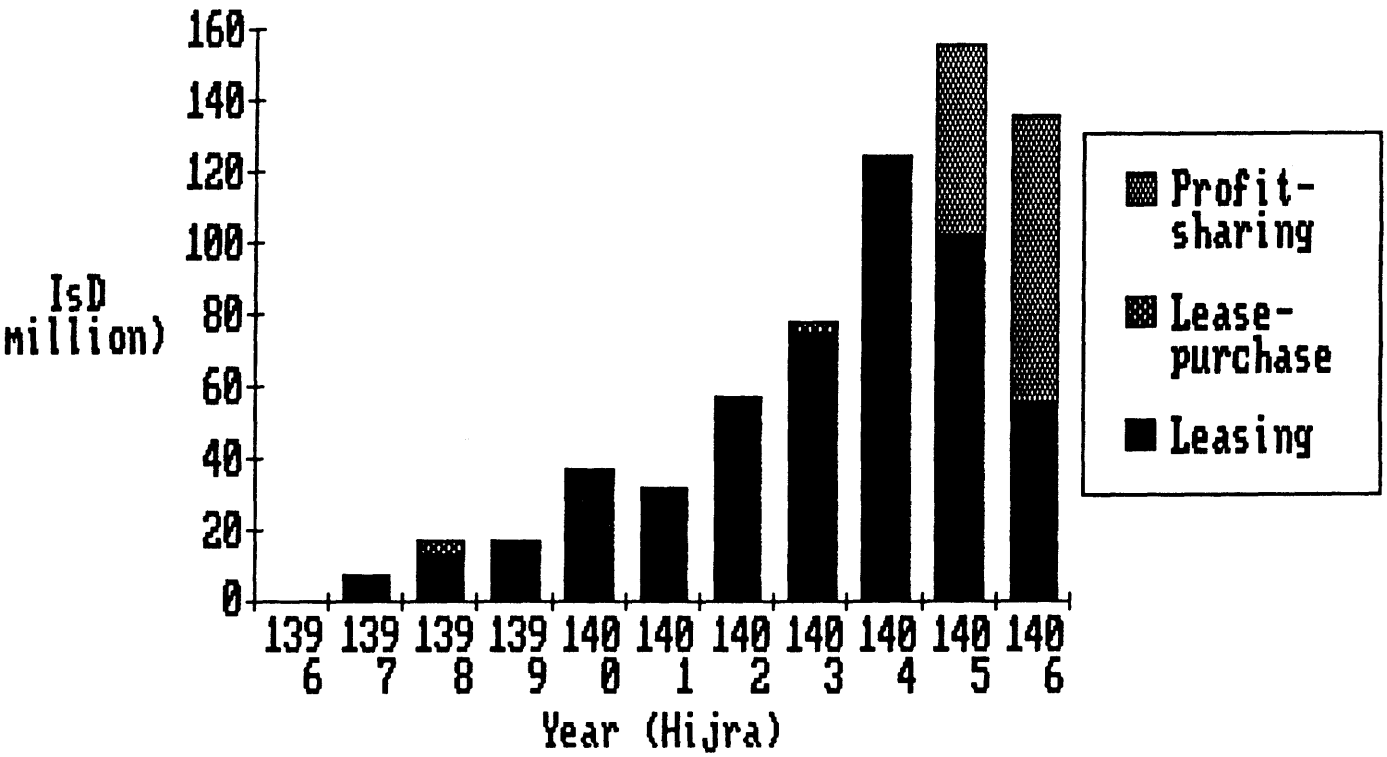
Source: [IsDB 86]

Figure 4-4: IsDB: Approved Equity Participation, 1976-1986.



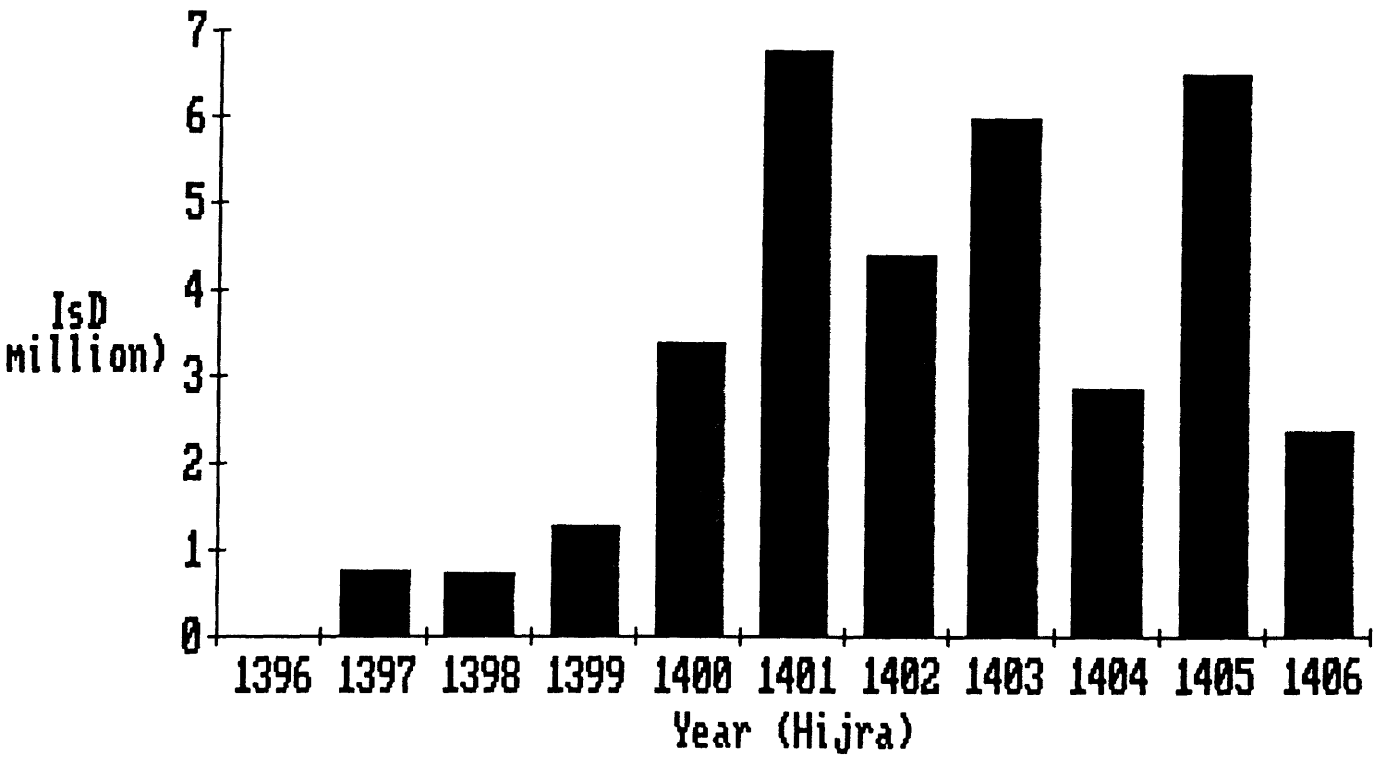
Source: [IsDB 86]

Figure 4-5: IsDB: Leasing, Lease-Purchase and Profit-Sharing, 1976-1986.



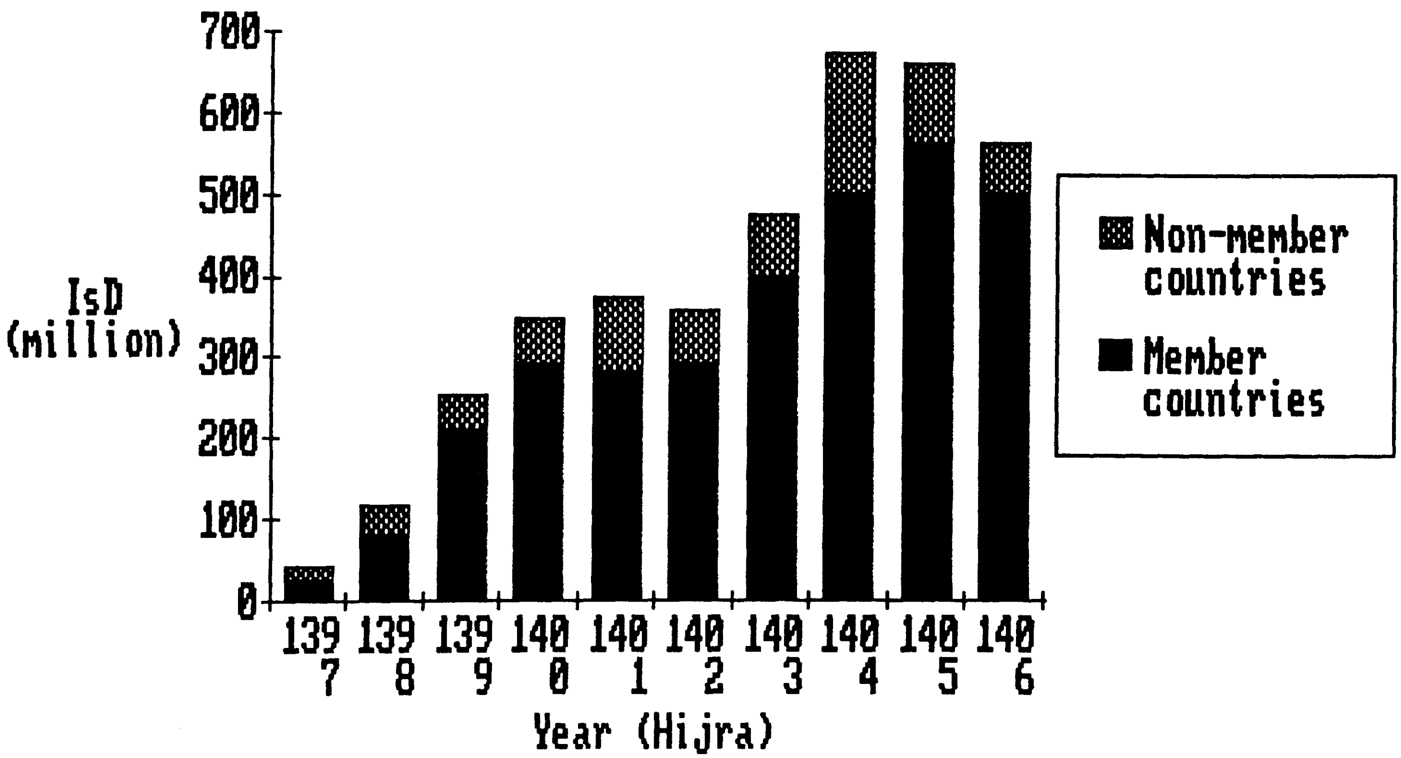
Source: [IsDB 86]

Figure 4-6: IsDB: Technical Assitance, 1976-1986.



Source: [IsDB 86]

Figure 4-7: IsDB: Foreign Trade Financing, 1977-1986.



Source: [IsDB 86]

Chapter 5

Comparison Between Islamic and Conventional Project Financing

Broad-based economic well-being, social and economic justice, and equitable distribution of income and wealth are some of the major socio-economic goals emphasized in Islamic teachings. It is considered essential that these goals form the cornerstone for the emergence of an Islamic economic system. It is widely believed by Muslim economists that the replacement of interest by a system of profit-sharing provides a viable alternative for achieving this objective. This belief is based on the notion that Islam prohibits *riba*, and interest has been viewed as constituting *riba*, since the lender gets a fixed return on a risky venture, in which the borrower assumes all the risks of failure. Moreover, in an interest-based transaction, the returns of a successfull venture are not proportionally redistributed since the borrower is only liable for a fixed interest on the debt outstanding. According to *Shari'a*, this is an injust transaction, and thus it should not be practiced and should be replaced by the concept of profit-and-loss sharing.

However, it is important to note that interest is not the only transaction that is, or should in principle be, disallowed in the Islamic economic system. As mentioned in chapter 3, *riba* interperse a vast array of business transactions and practices, and although some of these may not contain any element of interest, they may still be rejected on the grounds that they constitute unfair or unjustified means of enrichment.

Determining whether a transaction is in concordance with the Islamic teachings or the *Shari'a* is a complicated task which requires the help of Islamic scholars involved in the economic process. It is not surprising to see that most of the existing Islamic financial institutions retain Muslim jurists whose function is to check the conformance of business transactions with the Islamic law.

The comparison between the Islamic and the conventional project financing should in principle be an uncontroversial issue since the type of financing used by Islamic banks, which links the debt servicing requirements to the performance of the specific project being financed, exists also in one form or another in the conventional system. In fact, there exist in the conventional system a large number of projects that have been financed using profit-sharing principles, project and stand alone financing, or some other form of financing that ties the debt servicing to the payoffs of the project and spreads the risks among the different parties involved in accordance with their comparative advantage in bearing such risks.

Thus, as far as project financing is concerned, there seems to be common grounds between the Islamic instruments and their Western counterparts, namely stand alone financing, profit or revenue sharing or direct equity investments. The prohibition of *riba*, under all its recognized forms, renders most of the other conventional financing techniques, namely those based on interest, unacceptable under the Islamic law.

Consequently, the analysis of economy-wide replacement of interest by the profit-sharing schemes in a fully established Islamic economic system remains a complex task which, at the present time, has not been completely resolved, and constitutes one of the major challenges facing Islamic economists. The experience of some of the Islamic countries that have attempted to transform the whole economic system into an Islamic one will be discussed later in this chapter. The following section will address several issues concerning the similarities and differences of project financing under both the Islamic and the conventional systems.

5.1 Project Evaluation and Feasibility Study

5.1.1 Bank's Participation in Project Appraisal

Equity participation or profit-and-loss sharing financing schemes induce greater participation from the part of the bank in the evaluation of the profitability and the feasibility of the project, as compared with the general obligation interest-based financing.

In general, most, if not all, development banks are involved in the evaluation of the prospective projects to be financed. For example, the projects approved by the World Bank normally pass through a common project evaluation cycle whose objective is to ensure the soundness of the project and provide feedback for future projects. This cycle has six phases: identification, preparation, appraisal, negotiations, implementation and supervision, and evaluation. Most of the other development banks also have similar cycles. However, conventional commercial banks seldom worry about the use of the funds and concentrate more on the credit worthiness of the borrower and his assets' worth, in case of default.

Islamic commercial banks differ from conventional commercial banks in that they are more involved in project evaluation and feasibility study. This stems from the fact that their returns are tied, by the Islamic contractual arrangements, to the outcome of the project financed, and hence, unless the project's returns are large enough to repay the debts, the bank will suffer capital losses. Moreover, greater incentive exists to select highly profitable projects, since, theoretically, the bank should also share in the profits of the venture. In addition, the bank will have to supervise and monitor the performance of the project, during and after its implementation, in order to insure the quality and efficiency of its management.

However, although greater involvement in project evaluation may lead to better project selection and higher performance of the selected projects, appraisal, feasibility studies and supervision by the bank require a highly qualified staff with a great diversity in specialization. This is rarely the case in most commercial banks, and namely the existing Islamic commercial banks. For the sake of comparison, the World Bank employs almost three quarters of its staff in its project cycle, including experts from all professional fields.

Not having the necessary man power, Islamic commercial banks will tend to specialize in certain types of projects where the requirements for project evaluation fit the skills of their available personnel. Conventional commercial banks can have a greater flexibility in chosing projects to be financed since their main criteria for selection is the credit worthiness of the borrower, and hence may have an advantage over Islamic banks in handling a wider range of investments opportunities.

Indeed, the performance of the existing Islamic financial institutions has shown that finding appropriate investment outlets remains the major challenge of these institutions. The difficulty in project appraisal for most of the relatively small institutions has forced them to be active in the short term financing market, with few medium to long-term project financing undertakings.

5.1.2 Discount Rate in Project Evaluation

Discounting future flows of benefits and costs is important analytically in capital and investment theories, and practically in project evaluation. Discounting is often presumed to be based on, or at least intimately connected with, the rate of interest. Since Islam advocates the complete abolition of *riba*, almost universally translated by Muslim economists as interest, the concept and practice of discounting have given rise to several questions in the minds of Muslim economists.

Discounting is viewed by some as an application of the concept of opportunity cost of investing resources over time. Those defending this view argue that Islam favours efficiency and to ignore discounting leads to loss of efficiency, since discounting allows for a better selection of the most rewarding among different investment alternatives.

According to the same view, since Islamic transactions are based on equity financing, the proper discount rate of cash flows of such investments is the opportunity cost of venture capital invested in equally risky equity investments.

However, the issue of discounting is not completely resolved since no agreed upon convention has been devised regarding cash flow disconting in project evaluation under the Islamic financial system. It is still not shown in the existing literature in Islamic economics how the discount or capitalization rate should be determined in an economic system based solely on the principles of profit-sharing and equity participation. More studies need to be conducted regarding the valuation of different types of business and economic risks in an Islamic system, since the capitalization rate would probably depend on the required rate of return on investments and their associated risks.

What seem to be the main issues of debate among Muslim economists concerning the issue of discounting are the perception of risk and the questionability of the concept of time preference from the *Shari'a*'s viewpoint, the welfare function in an Islamic economy and the valuation of economic and non-economic or social returns to investments in an Islamic economy [Ziauddin 83].

5.2 Contractual Arrangements

Islamic financial principles are primarily based on the concepts of equity participation and profit-and-loss sharing. These principles have given way to a set of permissible contracts around which the economic activity in an Islamic system is to be geared. Western economists should in principle be familiar with these concepts, since they are also used in the conventional system of financing, although not to the same extent Islamic financial institutions intend to use them. Thus, at first sight, the Islamic financial instruments seem to be a subset of the financial instruments used in conventional capital markets, with the restriction that no interest should be paid or demanded on borrowed capital, and that the concept of interest should be replaced by the concept of profit-and-loss sharing.

However, as mentioned before, interest is not the only transaction that is disallowed, and many other pratices are considered to be constituting some form of the prohibited *riba*. The ambiguity that surrounds the definition of what constitutes *riba* has created some disparities in the interpretation of the law among the different Islamic financial institutions, which was reflected in the disparities among the contractual arrangements and operations of such institutions.

Hence, because of the non-uniformity of the allowed transactions, there has been an effort to codify them in a set of predefined contracts, namely those discussed in chapter 3. A strict requirement in Islamic law is that the object and content of any contract be clearly determined and defined. This is because uncertainty in the terms of the contract leads to dispute, and dispute leads to discord, and a fair economic life in Islam should avoid discord among members of society, thus avoiding weakening the social fabric.

The main two contracts that have been devised for the purpose of replacing interest in transactions are the *Mudaraba*, or profit-and-loss sharing, and *Musharaka*, or equity participation, contracts. These contracts have been presented in chapter 3, and the version of these contracts that is being used by *Dar al-Maal al-Islami* and its subsidiaries is contained in Appendix B.

5.2.1 Profit-And-Loss Sharing

The *Mudaraba* contract of *Dar al-Maal al-Islami* is presented in Appendix B, section B1.

In this contract, the bank credits to the project account, set for the purpose of the specific project, the amount of financing agreed upon. The borrowers obligations and responsabilities concerning the management of the project are presented in the first sections of this contract.

Concerning the participation of the bank in the profits of the project, section 16 states that "the Net Cash Flow of the project,..., shall be distributed quarterly within 30 days of the end of each calendar quarter to MFI until MFI shall have received an amount equal to the sum originally invested. Thereafter Net Cash Flow shall be distributed as follows" : to the client in respect of management services x %, to MFI in respect of sums invested y % (where x+y=100). "However, in all events, MFI shall cease to participate in the Net Cash Flow of the project when MFI has received funds distributed with respect to its participation equal to its investment in the project plus an internal rate of return to MFI on such investment equal to __ % per annum computed in accordance with standards set forth in the Information Booklet".

Concerning the participation in the losses, section 17 states that " to the extent that Net Cash Flow of the project ... shall be insufficient to return to MFI the amount originally invested, the loss will be born by MFI", however, "any losses in excess of the amount invested by MFI" shall be born exclusively by the borrower.

And finally, concerning the duration of the contract, section 18 states that the termination date of the contract shall occur on the earliest of any of a set of events, the most relevant ones being : the "receipt by MFI of funds distributed with respect to MFI's participation in the project equal to the credit made by MFI to the project plus an internal rate of return on such credit equal to __ % per annum"; a certain date specified by the contract; or on notice of demand given to the borrower by MFI "in the event that MFI has reasonably determined that the object of the Project cannot be realised".

There are several issues that need to be addressed concerning this contract.

Although this contract is based on profit participation, section 16 puts a limit to the share of the bank in the profits. The bank will cease to participate in the profits whenever an annual internal rate of return on investment is reached.

Mathematically, this can be represented in the following formulation:

$$-I + \sum_{t=a}^{b} R_t + \sum_{t=b+1}^{n} P_t / (1+IRR)^t$$

where :

- 'I' is the initial capital investment or the amount of the debt (it is assumed here that debt is to be extended as a lum sum, but 'I' can also represent any other scheme of payments).

- 'R_t' is the annual net profits of the project from year 'a' to year 'b', where the period 'ab' is the necessary time needed for the project to generate profits that will completely be used to amortize the principal value of the debt. Period 'ab' is not fixed, and will depend on the value of 'R' for each year. According to the contract, the R_t is captured entirely by the bank.

- 'P_t' is the annual net profits of the project that will be shared by the lender and the borrower according to an agreed upon ratios, and from which the bank is to derive its profits. While the value of the 'IRR' is pre-determined in the contract, the value of 'n' is not. 'n' will be the year in which the total value of the 'P_t's, discounted at the 'IRR', will set the above equation equal to zero.

Theoretically, the bank will keep on participating in the profits of the venture until the contractual internal rate of return on investment is attained. This type of contract can be called profit-and-loss sharing in the sense that the bank will share in the risks corresponding to the expected returns of the project, by linking the debt service obligations to the outcome of the specific undertaking. The bank will not share in the profits of the venture no matter what their value is, but will be satisfied with a pre-determined upper limit to its share in the returns. The sharing of the losses, however, is undoubtly there, since the bank will be completely exposed to the downside risks associated with the project, and might lose its entire capital participation in the event of the failure of the undertaking to produce net profits.

What is being offered here by the bank is a very close form of stand alone or project finance. This type of financing links the return to the lender to the success of the project, but only to the promised contractual rate of return required by the supplier of capital, which, in the conventional project finance scheme, is the interest rate required by the lender. The bank, however, continues to participate in the losses, as specified in section 17, but also to the extent of its capital participation in the project.

According to the *Shari'a*, sharing in the downside of the financial undertaking is only one part of the agreement, the other being the sharing in the upside part too. The way it is written, this contracts underminds the second part in the sense that it limits the sharing of the profits from the part of the bank to a contractual pre-determined upper value.

Looking back again at the mathematical formulation presented above, the way the contract works in its present form is that the required 'IRR' of the bank is stated in the contract, and depending on the values of R_t and P_t, representing the returns during the life of the project, the values of 'a', 'b' and 'n', representing the relevent repayment schedule, are determined. The value of 'n', which represents the termination date of the contract, is determined when the equation has the value of zero, ie when the annual required 'IRR' is reached, a point beyond which the share of the bank in the profits of the venture is truncated.

Profit sharing can be achieved through different payoffs functions, not necessarily similar to the above mathematical formulation, and with different contractual term structures. Nevertheless, the main variables in any contract would still be the termination date of the contract, the ratios of profit-and-loss sharing, and the payoff function of the bank. Hence, there can be a large number of combinations of these variable that would yield an acceptable contract from the Islamic viewpoint and that would fit the needs of both the supplier and the user of capital.

For instance, if the bank is to participate in the upsides of the outcome with no upper bound, the 'IRR' should not be pre-determined in the contract. Instead, if the same payoff function described in the above formulation is to be used, only the value of 'n' should be specified, and no 'IRR' should be specified as a measure of the returns to the bank. The value of the arbitrary 'IRR' required by the bank would be used in the feasibility study phase of the project as only one of many other tools of determining the profitability of expected future returns. Depending on the outcome of the undertaking, ie the values of R_t and P_t, the internal rate of return to the bank can be calculated and compared to an arbitrary value of 'IRR' set as a bench-mark for determining the profitability of the projects undertaken by the bank. In such a contract, the critical value to be determined would be 'n', the termination date of the contract.

One might argue that in such a contract where the duration of the contract is pre-determined, and therefore finite, and although the returns to the bank can take any value before the end of the contract, there will always be a truncation of the bank's share in the profit at the termination date. Moreover, in such a contract, the lender might have the incentive to defer any profits or revenues until after the termination date, or incur as much expenses, as early as possible before the termination date, therefore increasing its returns at the expense of the bank's.

Hence, it seems that there can exist a large number of variations in the contractual forms, each having different payoff functions to the bank, and each fixing some variables while allowing others to vary depending on the outcome of the venture. Most of these contracts may be acceptable to the *Shari'a*, and numerous project financing schemes can be designed in a way that satisfies the lender, the borrower and the Islamic principles.

However, it is hard to think of unlimited amount of profit-and-loss sharing without thinking of some form of equity financing, in which the supplier of capital becomes a partner in the business. This brings us to the next Islamic contract, the *Musharaka*.

5.2.2 Equity Participation

The *Musharaka* contract used by *Dar al-Maal al-Islami* is presented in Appendix B, section B2. In this contract, the bank is supposed to enter in a joint venture with the borrower. This type of equity financing requires that the bank supplies a certain percentage of the capital needed, the rest being contributed by the borrower himself. Both parties' obligations and liabilities are described in the first sections of the contract.

Concerning the participation in profit, section 16 of the contract states that " the Net Cash Flow of the Project, ... , shall be distributed quarterly within 30 days of the end of each calendar quarter in proportion to the sums originally credited for the Project" by the bank and the borrower, "until each shall have received an amount equal to the sum originally invested". Thereafter, Net Cash Flow shall be distributed as follows: to the borrower in respect of sums invested x%; to the borrower in respect of management services y%; and to MFI in respect of sums invested z% (where x+y+z=100). However, "in all events MFI shall cease to participate in the Net Cash Flow of the Project when MFI has received funds distributed with respect to its participation equal to its investment in the Project plus an internal rate of return to MFI on such investment equal to __ % per annum ...".

Concerning the participation in losses, section 17 of the contract states that "to the extent that the net Cash Flow of the Project shall be insufficient to return" to the borrower and the bank "the amount originally invested by each, the loss will be born by each in proportion to the sums" originally invested. However, the contract states an limit to the liability of the bank, the value of which is to be determined and stated in the contract.

Concerning the termination of the contract, the clauses of section 18 are similar to the ones of the previous section.

From the bank's point of view, and as far as the payoff function described in the mathematical formulation is concerned, there seems to be no difference between the *Mudaraba* and the *Musharaka* contracts described in Appendix B. Both contracts will yield the same pattern of returns to investment to the bank under all possible senarios of the outcome of the undertaking.

Indeed, in this contract also, the amount of profits to be disbursed to the bank is limited to a pre-determined internal rate of return specified in the contract. The same discussion of the previous section concerning the participation in profits applies here too. The equity participation is limited in time, and is amortized according to a rate of return on investment. The share of profits of the bank has a upper limit which, if reached, will cause the termination of the contract. Here again the bank shares in the downsides of the undertaking to the extent of its capital participation, and shares in the profits only up to the pre-determined internal rate of return. This type of contract can not even be called joint venture since the returns of the parties involved are not proportional to the amounts originally invested. The bank will always end up earning at most a fixed amount of profit equal to a contractual rate of return.

Equity financing, as described by Muslim economists, is a system similar to a joint venture, whereby the bank enters into a partnership for a limited period of time, and for a particular project. Both the bank and the client contribute to the capital , with the client maintainting the right to buy back gradually the bank's shares. Profits emanating from such venture are normally shared by the bank and the client in some agreed upon ratio, and even when the client buys back the bank's shares, the bank receives his share of the expected future profits of the venture in terms of the capital gains reflected in the price of the shares.

Here again, there can be a vast variety of contractual forms that fits within the framework of the *Musharaka* contract. One of the most challenging issues in the implementation of an Islamic financial system has been how to devise risky return-bearing instruments that can provide the investors a sufficient degree of liquidity. Proposals along this line rely on the development of instruments corresponding and parallel to the permissible forms of transactions. These include instruments such as *Musharaka* certificates or short-term profit-sharing certificates. Generally, any risk-bearing instrument reflecting a real asset and earning a variable rate of return tied to the performance of the asset is considered to be consistent with Islamic law.

In Pakistan, participation term certificates (PTCs) have been introduced as an alternative to a debenture (which typically carries a fixed rate of return) for raising medium-term financial resources. PTCs are transferable corporate instruments with a maximum maturity of ten years and which allow for temporary partnership or *Musharaka* between a financial institution and the business entity on the basis of profit-and-loss sharing. Funds under a typical PTC arrangement may be obtained either from a single financial institution or from a consortium. The business entity is expected to pay to the financial institution or bank, provisionally on a semiannual basis, an agreed percentage of anticipated profits with a provision for final adjustments at the end of the financial year. In the event of loss, the financial institution shall refund the share of profit that it had received on a provisional basis. However, the loss sustained by an entity in any accounting year will first be adjusted against the reserves of the business entity, and the remaining loss, if any, shall be covered in subsequent years by the two parties in agreed proportions. Lending is generally secured by a legal mortgage on the fixed assets of the business entity. PTCs can also be traded on the capital market.

Conceptually, since the financial relationship envisaged under the PTCs is that of partnership, different issues concerning the appropriate accounting of profits of the business entity and the required level of knowledge and experience of the bank in the business venture need to be addressed.

Nevertheless, it has been recognized that there should be a variety of financial instruments, which are traded on a capital market, and which will satisfy the needs of a vast array of users and suppliers of capital. For this reason, Muslim writers have pointed out the desirability of primary, secondary, and money markets in which, given that a proper securities underwriting function is performed by Islamic financial institutions, firms can directly raise the necessary funds for their investment projects within the stock market, and savers can invest in liquid, flexible and profitable financial instruments.

In conclusion, both contracts, ie *Mudaraba* and *Musharaka*, that are used by DMI and which are described in Appendix B, are similar as far as the bank is concerned. They are a form of the stand-alone or project finance that exist in the conventional system. Their advantage in terms of the flexibility of the debt servicing is explained in chapter 2 in the discussion on the desirable attributes of financing developing countries.

There is a great potential for the development of a wide range of permissible contracts that comply with the restrictions of the *Shari'a*. Indeed, Islam permits any arrangement based on the consent of the parties involved so long as the shares of each are contigent upon uncertain gains. This aspect of the arrangement is crucial, since the *Shari'a* condemns a guarantee by the working partner to restore the invested capital intact, not only because it removes the element of uncertainty needed to legitimize the agreed distribution of possible profits, but also because the lender will not be renumerated to the extent of the productivity of his financial capital in the resulting profit.

As far as project financing is concerned, there is still room for innovations in terms of the type of contracts that can be used and their term structure. Several versions of the *Musharaka* or the *Mudaraba* can be designed to accomodate a vast array of project financing. However, because it is not always obvious whether a transaction violates Islamic rules, it is advisable that an agency be created in order to regulate the contracts and check their conformance with the *Shari'a*. Existing Islamic banks usually retain a board of religious advisors which guides them in the analysis of financial operations, but this remains a dispersed and non-uniform effort which needs to be more centralized. In an Islamic country, such role can be assumed by the central bank, as is the case in Iran and Pakistan. On the international level, it seems that the large Islamic financial institutions are setting their own rules concerning the interpretation of *riba*.

Nevertheless, there seems to be less ambiguity with the *musharaka* and the *Mudaraba* contracts when they are applied to project financing than when they are used to regulate the entire financial activities in an Islamic economy.

Many problems have faced the implementation of the Islamization of the economy in both the Islamic republic of Iran and Pakistan. Such problems can only be stated at this stage, and a full description and analysis of the Islamization of the whole economy would be beyond the scope of this study.

In both countries, bank lending based on Islamic principles has so far been concentrated on short-term trade financing rather than a shift toward profit-and-loss participation type assets, contrary to the intentions underlying the establishment of the new system. Similarly, owing to problems in devising appropriate modes of financing budgetary deficits that would be consistent with the *Shari'a*, government borrowing requirements had to be met effectively on an interest basis. At the individual commercial bank level, difficulties have been encountered in lending to small-scale enterprises, owing to increases in perceived risks, consequently shifting the distribution of credit in favor of large-scale enterprises.

Apart from these common issues, effective implementation of the new system in the two countries may have been constrained by particular economic and legal environments, namely the absence of precise legal definitions of various modes of financing pertinent to the diverse needs of the private sector, and the need for a uniform dispute settlement system that would ensure the rights of the banks and the borrowers and prevent the occurance of major defaults.

Consequently, even when a single project is being financed in some sort of

Islamic contract, issues related to the whole economic environment arise, especially when dealing with international operations that are undertaken in different economic systems and under different legal frameworks. Some of these issues will be discussed in the following sections in the context of international project financing.

5.3 Contractor's Financing Requirements

In international construction business, the contractor is usually responsible for arranging at least part of the financing. Some of his responsabilities are the procurement of plant and equipment, as well as working capital for the duration of the construction project.

It should be noted here that the main concern of Islamic economists lies in the relation between the supplier and the user of borrowed capital. Both the owner of the project and the contractor need financing. The owner needs financing for expenses ranging from the costs of design and implementation of the project to the fees and capital requirements of the contractor as specified in the construction contract. The contractor also needs financing for the procurements of plant and equipment, salaries of workers and any other related expenses for which he is responsible.

Hence, the principles of profit-and-loss sharing will be applied in the arrangements between the bank and the owner or the bank and the contractor. The terms of the contract and the distribution of risks and liabilities between the owner and the contractor remains a technical issue that is not directly related to the nature of the financing.

5.3.1 Construction Contracts

The relation between the contractor and the owner in a contruction project should remain the same under the Islamic system. The contractor renders a specific service for which he gets paid a certain fee. The selection of the contractor can still be carried out as usual either by competitive bidding or by direct negociations.

Nevertheless, several contracts are often used in construction projects, and some may fit more than others within the Islamic framework of economic justice and fair allocation of risks and returns. The terms of the construction contract may be negociated between the concerned parties, and the Islamic principles on business transactions may be taken into considerations. However, this process need not be directly related with the bank supplying the required capital.

The most common contracts in construction projects are :

- Lump sum or fixed price contract.

  In this contract, the contractor states an amount of money for which he can do the work. If costs turn out to be higher than anticipated, his profits will be smaller and he may even suffer losses. Alternatively, if costs are lower than anticipated, his profits will be higher. In this type of contract, the contractor carries the greater proportion of risk, while the owner carries very little, if any, risk since he has a fixed commitment toward the contractor.

- Unit price contract.

  In this type of contract, the contractor quotes the prices by units of items rather than by giving a single total contract price, and the low bidder is determined by the total amount of costs of all items. The main advantage for the contractor is its flexibility, within certain limits, in making changes in the amount of work at the quoted unit prices. The risks are fairly distributed between the owner and the contractor.

- Cost plus fee contract.

  In this type of contract, the contractor is paid for the costs of the project as they arise as well as a fee. The cost covers the direct costs of the project; the fee covers indirect costs and profits, and can be either a fixed amount or a percentage of the direct costs. The owner carries the greater portion of the financial risk, especially in the cost plus percentage fee type, since he will assume the risk of uncertainty in the final cost of the project.

- Target price plus profit contract.

  In this type of contract, the target price represents the highest amount of money that the contractor estimates is necessary to compensate for direct costs of the project. If the job is carried out for less than the target price, the savings are divided according to a sharing clause between the owner and the contractor. In this case, the owner has the potential advantage that the contractor may be more cost efficient, while the contractor does not have to make a commitment on the final cost of the project.

- Guaranteed maximum price contract.

  In this contract, in addition to the target price, the contractor guarantees a maximum price that will not be exceeded. Any overrun is to be absorbed by the contractor. The guaranteed maximum price is usually defined as the target price plus an additional percentage of it.

Under all of the above contracts, the risks involved in the project are allocated between the owner and the contractor according to the contract agreed upon by the two parties. The amount and types of risks to be allocated among the concerned parties is determined through negotiations. If Islamic economic principles are to be taken into consideration at this stage, both the contractor and the owner should agree on a formula that spreads the risks equitably among them, in the context of who has a comparable advantage in bearing them. It seems that the target price plus profit contract is the closest to the spirit of the Islamic economic principles.

In any case, our main concern is in the relationship between the supplier and the receivers of borrowed capital,ie the bank and the owner or the contractor.

Under the conventional system, ie interest-based financing, the supplier of capital gets a fixed return irrespective of the outcome of the project, and risk is only transfered to him through default.

Under the Islamic system, risk is shared by both the supplier of capital on one side, and the contractor and owner of the project on the other. The advantages of such financing have been discussed in chapter 2 in terms of the potential of Islamic finance in financing projects in developing countries. The Islamic financial instruments dealing with equity participation and profit-and-loss sharing have been presented in chapter 3 and in the previous section.

In the following sections, greater detail will be given on the contractor's financing requirements, namely working capital financing and plant and equipment financing. Although the Islamic financial instruments used in these cases may not be based on the principals of equity or profit participation, they have been recognized by Islamic jurists as being acceptable because of their fair allocation of risks and returns.

5.3.2 Working Capital Financing :

Working capital requirements are dictated by the pattern of cash flows of a specific project as well as by the pattern of cash flows of the total number of projects in which the contractor is involved. Cash flows may be negative for some time during the life of a project before the contractor reaches a breakeven point and starts having net cash inflows. Until then, the contractor needs some kind of working capital financing.

Under the conventional system, most contractors, especially large international construction companies, have arrangements with commercial banks providing lines of credit, with or without compensating balances, and at relatively low interest rates.

Under the Islamic system, such short term financing cannot be easily accomodated by profit-and-loss sharing contracts because of the difficulty at this early stage of the project to determine the relevant profits or losses of the contractor. To resolve this problem, Muslim scholars have proposed that such line of credit should be provided to the contractor on an interest-free basis, in conformance with the principles of the *qard hasan* contract described in chapter 3. This type of credit should be extended against a collateral and preferably to contractors who are already engaged in long-term profit-and-loss sharing arrangements with the bank. As far as medium- and long-term financing, they are supposed to be met by the other types of contracts, ie *mudaraba* or *musharaka*.

The use of short-term interest free loans have been discussed in chapter 4. It has been recognized that the use of such loans cannot be used efficiently on a wide scale, and several conditions for the eligibility to this type of credit have been set by Islamic financial institutions, namely compensating balances and collateral requirements. Unfortunately, there is still a lack of sufficient permissible contracts which deal with short term financing for small scale enterprises or businesses and which are based on the principles of profit-and-loss sharing.

Thus, when financing on a profit-and-loss basis is not feasible owing to difficulties in determining profits or the short-term maturity of funds required, Islamic banks have used lending on the basis of markup. The contract used in this case is the *Murabaha*, under which the bank arranges for the purchase of items requested by the client and sells them back to him on the basis of cost plus an agreed upon profit margin. The payment is usually deferred and is made either in lump sum or in installements over a specified period. This type of financing seems to be quite popular among existing Islamic banks, although the conformance of its application with the *Shari'a* has often been questioned.

5.3.3 Plant and Equipment Financing :

Construction firms usually buy most of their basic equipments new. However, a large portion of equipment needed is leased. Leasing is facilitated by a variety of financing packages offered by the equipment leasing industry. Conventional commercial banks have an active role in leasing operations. They provide leasing as an extention of their credit activities in order to capture the profits related to tax allowances related to leasing activities.

There are two major categories of leases: the operating lease and the financial (or non-cancelable) lease.

The operating lease enables the contractor (lessee) to make use of the asset for a period of time paying a rent at specified regular time intervals. Ownership remains with the lessor, who has the responsability for the maintenance and insurance of the equipment. Under this arrangement, the lease may often be cancelled by the lessee on short notice with minor or no financial consequences.

The financial lease is primarily used for costly or specialized equipment. Under the terms of this lease, the contractor agrees to make specified payments over the contract life, the sum of which usually exceeds the purchase price of the equipment. Service and risks are assumed by the contractor. The contract is non-cancelable, or cancelable only after the payment of a large penalty.

Depending on the contractual agreement, under both types of leases, the contractor may be able to purchase the equipment at the end of the contract life.

Operating lease is acceptable under the Islamic law. In fact, most Islamic financial institutions are active in leasing and lease-purchase acivities, as can be depicted in chapter 4. Islamic jurists state that, even though the *Shari'a* does not allow a fixed return on financial capital, converting the financial capital into real or non-financial asset justifies a fixed return on that asset since the owner of the asset has assumed reasonable risks in this transaction.

However, there should be disagreement concerning the financial lease. In fact, the financial lease is similar to the conventional debt financing in that it often involves a combination of borrowing and purchasing the asset. The reason the financial lease is often used for financing the purchase of an asset rather than through a bank loan is the tax savings that can be achieved under some tax systems. Hence, as far as the *Shari'a* is concerned, there should be no difference between a debt based on interest and a financial lease.

5.4 Risks Involved in International Financial Operations

Risks in construction projects, particularly in international ones, are numerous. These risks can be : (1) political, associated with governement actions and turmoil affecting international economic factors; (2) commercial or business related, associated with the operational side of the construction business; and (3) financial, associated with interest rates fluctuations, exchange rates exposure and insurance.

Our primary concern is with financial risks, and the way they are handled by the conventional and the Islamic systems.

5.4.1 Interest Rates Fluctuations

Because of the risks associated with largely fluctuating interest rates, banks have been reluctant in extending loans on a fixed-rate basis. The variable or floating rate loans pass most of the risk to the borrower in the case of large interest rates increase.

The debt crisis experience has shown that the wide use of floating interest rate loans to developing countries has been one of the major factors that caused debt servicing problems and trigered a large scale debt crisis. For most of the developing countries, and because macro- and internatinal economic factors, the increase in interest rates coincided with the worsening of their balance of payments. This created a mismatch between the debt service requirements and the borrowers' ability to pay.

Under the Islamic system, this risk is equitably distributed between the lender and the borrower, since debt repayment, under either the equity participation or the profit-and-loss sharing schemes, is linked with the outcome of the venture being financed or in the case of program financing, with the agregate revenues generated. The Islamic financial contracts provide the participation of the supplier of capital in the downturns that may face the project, and are similar to their counterparts in the conventional system, ie stand-alone finance, joint ventures and other forms of equity finance.

5.4.2 Exchange Risks

The utilization of human, capital and physical resources at a global level involves international construction firms in financial transactions denominated in a variety of currencies. Floating exchange rates expose international firms to currency fluctuation risks.

Exchange risks can be usually managed in different ways, either by including protective clauses in the contractual arrangements, or by using currency swaps, or hedging in the forward exchange and financial futures market, or by the use of other exchange risk management practices such as matching the currencies of cash outflows with those of cash inflows.

Under the Islamic system, forward and futures contracts are generally considered as constituting a form of *riba*, and thus are not acceptable. Theoretically, commercial banks are supposed to trade in currencies using only spot prices, and most of the exchange of goods, and especially financial assets, are expected to be conducted using spot prices.

Nevertheless, since under the Islamic system financial risks are distributed between borrower and lender, a great deal of the exchange rate exposure is passed from the contractor to the bank, the later having a comparative advantage in assuming such risks due to its greater ability to perform exchange risk management.

5.5 Construction Financing and Commercial Banks

Commercial banks have played a major role in supporting the international expansion of the construction industry around the world. Recently, as developing countries have encountered increasing difficulty in financing their projects, new approachs for financial intermediation have been sought to extend necessary funds to those countries. In general, although construction industry is a relatively risky industry, banks seek business with construction firms because of the large revenues construction projects produce.

Since most of the financial problems of developing countries have been debt servicing problems, Islamic banking has a promising potential as a new vehicule for financing projects in such countries. Islamic financial priciples allow greater linkage between the outcomes of projects and the debt servicing requirements. They provide a more spread of risks between the supplier and the user of capital, and a greater stake of the lender in issues concerning feasibility, profitability and management of the undertaking. The contracts that are used by existing Islamic financial institutions regarding project financing are very similar to stand-alone or project finance as practised in the conventional system. Nevertheless, there is still room for innovation in terms of new contracts that are in accordance with Islamic financial principles, and that serve a wider range of financial undertakings.

A potential draw back for Islamic finance might be the lower degree of freedom that is accorded to the lender in the use of the extended capital as compared to general obligation financing instruments. It is not clear to what extent this factor can affect the attractiveness of such type of financing for developing countries, however, with the existing debt crisis, it is likely that most forms of financing to those countries will be extended with more involvement from the part of the lender in the use of the borrowed capital.

Chapter 6

Conclusion

Increasing interest has been shown in the functioning of an Islamic banking system, particularly the implications of the absence of the interest rate mechanism from the operations of the economy and the financial sector.

At present, most Muslim countries practice Islamic banking to varying degrees, and Islamic financial institutions have been operating in some non-Muslim countries as well. In some cases, individual Islamic banks are operating on a non-interest basis, while in others, the entire financial system has been transformed into an Islamic one.

Conceptually, Islamic banking is intended to operate within a totally Islamic socio-economic system. Hence, a distinction should be made between Islamic banking operating within systems that lack essential characteristics and infrastructures of an entirely Islamic system and Islamic banking operating as an organic part of such a system.

No attempt has been made in this thesis to analyze an overall economic system based on Islamic principles. Instead, this study has focused on the implications of the most relevant features of an Islamic financial system on the methods of project financing in the absence of fixed interest rates.

The central requirement of an Islamic financial system is the replacement of the rate of interest with the rate of return on real activities as a mechanism for allocating financial resources.

Islam possesses its own paradigm of economic relations within the context of an entire Islamic system based on injunctions and norms, derived from the Islamic canon law, the *Shari'a*. The *Shari'a* specifies rules that relate to the allocation of resources, property rights, production and consumption, the working of markets, and the distribution of income and wealth. Similarly, rules and requirements have been specified that define the framework within which the monetary and banking system can operate. The core of this framework is the prohibition of *riba*, which has been defined to include the rate of interest, and which should be replaced, as a mechanism of allocating financial resources, with the rate of return on real activities.

To this end, a variety of methods and instruments based on the concept of risk- and profit-sharing have been devised by Muslim scholars and economists to satisfy the requirements of such a system. Indeed, Islam permits a wide freedom in business transactions and contracts, as long as they are not in violation with the percepts of the *Shari'a*. In particular, the *Shari'a* permits any arrangement based on the consent of the parties involved, in which the shares of each are contigent upon uncertain gains. This is so because Islam condemns the receipt by the supplier of capital of a predetermined fixed return irrespective of the outcome of the financial undertaking, not only because it shifts most of the risks of failure to the user of capital and hence removes the element of uncertainty needed to legitimize the return on investment, but also because the lender will not be renumerated to the extent of the productivity of his financial capital in the resulting profit. Indeed, the *Shari'a* does not justify the reward received through interest by the lender for his mere act of abstention from consumption.

Hence, in disallowing interest and permitting profit-and-loss sharing, Muslim scholars have developed two specific forms of business arrangements, *Mudaraba* and *Musharaka*, as means of financial intermediation. Recognizing that such instruments may not be applicable in all circumstances, they have specified other modes of permissible transactions, namely *Murabaha*, *Ijara*, *Ijara wa Iktina* and *Qard Hasan*.

Two main remarks should be mentioned concerning the permissible contracts.

First, it should be emphasized that the *Shari'a* has prohibited *riba* which has been defined as to interperse a vast array of financial transactions, the most important of which being the interest rate on borrowed capital. Consequently, some transactions may violate the principles of the *Shari'a* even if they do not contain any element of interest. In any case, the interpretation of *riba* has evoluted over time, and this task remains to be settled by Muslim jurists and economists.

Second, one should not approach a discussion of specific permissible contracts with the perception that there exist only certain rigid types of Islamic financial arrangements such as the ones mentioned earlier. There is a great potential for innovation in terms of the contracts that can be used in an Islamic system, and greater research should be conducted in devising and analysing different contractual arragments that would perform all the necessary transactions in a modern economy, and that would not violate the basic principles of the Islamic teachings.

The non-uniformity of Islamic contracts among different Islamic financial institutions, and their lack of diversity may be caused by the lack of a legal framework that unambiguously specifies the domain and limitations of the Islamic financial principles, and the lack of adequate financial infrastructure that serves as a medium for the transfer of information on Islamic finance and for the training and education in the fields of Islamic economics and finance. Nevertheless, substantial effort has been made in this direction through several international conferences and a number of research centers dealing with various fields in Islamic economics, on both the individual institutional and the governmental levels.

With about 20 percent of the world's population being Muslims, Islamic banks can attract a large number of depositors. The recent increase in the number of Islamic financial institutions, the favorable response and support from the part of the Muslim populations to such institutions, and the trend towards the revival of Islamic values throughout the Muslim world show the importance of Islamic finance and its potentials.

Perhaps one of the most important aspects of Islamic banking is the role it can play in financing development in developing countries. Indeed, it is interesting to note that the characteristics of the Islamic financing techniques are similar to the desirable attributes that have been recommended in financing developing countries. Conceptually, Islamic financing instruments allow for a more equitable distribution of risks among the supplier and the user of borrowed capital, a more efficient linkage of the debt servicing requirements with the ability of the borrower to meet the repayment schedule, a greater involvement of financial intermediaries in the performance of the project being financed, and a greater involvement of the public, especially in Muslim countries, in the investment activities through the mechanisms of partnerships and profit-and-loss sharing arrangements.

Appendix A

Riba in the Koran, *Hadith* and *Fiqh*

In the english versions of the Koran, different translations have been made for the term *riba*. Some have translated *riba* as 'usury', others as 'interest'. There has been much argument about what exactly constitute *riba*, and although it appears that there is a consesus among most scholars nowadays to interpret it as all forms of interest, it would be wiser to leave it as *riba* in any translation of the Koran. This is so because, as described in chapter 3, the term *riba* is used in *Shari'a* in two senses, ie *riba al-nasi'a* and *riba al-fadl*, and each term refers to a different and wide range of business transactions.

The following sections show where the term *riba* has been mentioned in the *Shari'a* (the Islamic canon law), namely in the Koran (Muslims' holy book), the *Hadith* (the sayings, acts and allowances of the Prophet), and the *Fiqh* (the interpretations of the *Shari'a* by qualified legal scholars).

A.1 *Riba* in the Koran

1. First Revelation (*Surah al-Rum*, verse 39)

> That which you give as *riba* to increase the peoples' wealth increases not with God; but that which you give in charity, seeking the goodwill of God, multiplies manifold.(30:39)

2. Second Revelation (*Surah al-Nisa'*, verse 161)

> And for their taking *riba* even though it was forbidden for them, and their wrongful appropriation of others peoples' property, We have prepared for those among them who reject faith a grievous punishment.(4:161)

3. Third Revelation (*Surah Al Imran*, verse 130-2)

O believers, take no doubled and redoubled *riba*, and fear God so that you may prosper. Fear the fire which has been prepared for those who reject faith, and obey God and the Prophet so that you may receive mercy.(3;130-2)

4. Fourth Revelation (*Surah al-Baqarah*, verse 275-80)

Those who benefit from *riba* shall be raised like those who have been driven to madness by the touch of the Devil; this is because they say "trade is like *riba*" while God has permitted trade and forbidden *riba*. Hence, those who have received the admonition from their Lord and desist may have what has already passed, their case being entrusted to God; but those who revert shall be the inhabitants of the fire and abide therein for ever.(275)

God deprives *riba* of all the blessing but blesses charity; He loves not the ungrateful sinner.(276)

Those who beleive, perform good deeds, establish prayer and pay *zakat*, their reward is with their Lord; neither should they have any fear, nor shall they grieve.(277)

O believers, fear God, and give up the *riba* that remains outstanding if you are believers.(278)

If you do not do so, then be sure of being at war with God and His Messenger. But, if you repent, you can have your principal. Neither should you commit injustice nor should you be subjected to it.(279)

If the debtor is in difficulty, let him have respite until it is easier, but if you forego out of charity, it is better for you if you realise.(280)

A.2 *Riba* in the *Hadith*

A. General

1. From Jābir: The Prophet, may peace be on him, cursed the receiver and the payer of interest, the one who records it and the two witnesses to the transaction and said: "They are all alike [in guilt]." (Muslim, *Kitāb al-Musāqāt, Bāb la'ni ākili al-ribā wa mu'kilihī*; also in Tirmidhī and *Musnad* Aḥmad)

2. Jābir ibn 'Abdallah, giving a report on the Prophet's Farewell Pilgrimage, said: The Prophet, peace be on him, addressed the people and said "All of the *ribā* of *Jāhiliyyah* is annulled. The first *ribā* that I annul is our *ribā*, that accruing to 'Abbās ibn 'Abd al-Muṭṭalib [the Prophet's uncle]; it is being cancelled completely." (Muslim, *Kitāb al-Ḥajj, Bāb Ḥajjati al-Nabī*, may peace be on him; also in *Musnad* Aḥmad)

3. From 'Abdallah ibn Ḥanẓalah: The Prophet, peace be on him, said: "A dirham of *ribā* which a man receives knowingly is worse than committing adultery thirty-six times" (*Mishkāt al-Maṣābīḥ, Kitāb al-Buyū', Bāb al-ribā*, on the authority of Aḥmad and Dāraquṭnī). Bayhaqī has also reported the above *ḥadīth* in *Shu'ab al-īmān* with the addition that "Hell befits him whose flesh has been nourished by the unlawful" (*ibid.*)

4. From Abū Hurayrah: The Prophet, peace be on him, said: "On the night of Ascension I came upon people whose stomachs were like houses with snakes visible from the outside. I asked Gabriel who they were. He replied that they were people who had received interest." (Ibn Mājah, *Kitāb al-Tijārāt, Bāb al-taghlīẓi fī al-ribā;* also in *Musnad* Aḥmad)

5. From Abū Hurayrah: The Prophet, peace be on him, said: "*Ribā* has seventy segments, the least serious being equivalent to a man committing adultery with his own mother." (Ibn Mājah, *ibid.*)

6. From Abū Hurayrah: The Prophet, peace be on him, said: "There will certainly come a time for mankind when everyone will take *ribā* and if he does not do so, its dust will reach him." (Abū Dāwūd, *Kitāb al-Buyū', Bāb fī ijtinābi al-shubuhāt;* also in Ibn Mājah)

7. From Abū Hurayrah: The Prophet, peace be on him, said: "God would be justified in not allowing four persons to enter paradise or to taste its blessings: he who drinks habitually, he who takes *ribā*, he who usurps an orphan's property without right, and he who is undutiful to his parents." (*Mustadrak al-Ḥākim, Kitāb al-Buyū'*)

B. *Ribā al-Nasī'ah*

1. From Usāmah ibn Zayd: The Prophet, peace be on him, said: "There is no *ribā* except in *nasī'ah* [waiting]." (Bukhārī, *Kitāb al-Buyū', Bāb Bay' al-dīnāri bi al-dīnār nasa'an;* also Muslim and *Musnad* Aḥmad) "There is no *ribā* in hand-to-hand [spot] transactions." (Muslim, *Kitāb al-Musāqāt, Bāb bay'i al-ṭa'āmi mithlan bi mithlin;* also in Nasā'ī)

2. From Ibn Mas'ūd: The Prophet, peace be on him, said: "Even when interest is much, it is bound to end up into paltriness." (Ibn Mājah, *Kitāb al-Tijārāt, Bāb al-taghlīẓi fī al-ribā;* also in *Musnad* Aḥmad)

3. From Anas ibn Mālik: The Prophet, peace be on him, said: "When one of you grants a loan and the borrower offers him a dish, he should not accept it; and if the borrower offers a ride on an animal, he should not ride, unless the two of them have been previously accustomed to exchanging such favours mutually." (*Sunan al-Bayhaqī, Kitāb al-Buyū', Bāb kulli qarḍin jarra manfa'atan fa huwa riban*)

4. From Anas ibn Mālik: The Prophet, peace be on him, said: "If a man extends a loan to someone he should not accept a gift." (*Mishkāt, op. cit.*, on the authority of Bukhārī's *Tārīkh* and Ibn Taymiyyah's *al-Muntaqā)*

5. From Abū Burdah ibn Abī Mūsā: I came to Madinah and met 'Abdallah ibn Salām who said, "You live in a country where *ribā* is rampant; hence if anyone owes you something and presents you with a load of hay, or a load of barley, or a rope of straw, do not accept it for it is *ribā." (Mishkāt, op. cit.*, reported on the authority of Bukhārī)

6. Faḍālah ibn 'Ubayd said that "The benefit derived from any loan is one of the different aspects of *ribā." (Sunan al-Bayhaqī, op. cit.)* This *ḥadīth* is *mawqūf* implying that it is not necessarily from the Prophet; it could be an explanation provided by Faḍālah himself, a companion of the Prophet, peace be on him.

C. *Ribā al-Faḍl*

1. From 'Umar ibn al-Khaṭṭāb: The last verse to be revealed was on *ribā* and the Prophet, peace be on him, was taken without explaining it to us; so give up not only *ribā* but also *rībah* [whatever raises doubts in the mind about its rightfulness]. (Ibn Mājah, *op. cit.*)

2. From Abū Sa'īd al-Khudrī: The Prophet, peace be on him, said: "Do not sell gold for gold except when it is like for like, and do not increase one over the other; do not sell silver for silver except when it is like for like, and do not increase one over the other; and do not sell what is away [from among these] for what is ready." (Bukhārī, *Kitāb al-Buyū', Bāb bay'i al-fiḍḍati bi al-fiḍḍah;* also Muslim, Tirmidhī, Nasā'ī and *Musnad* Aḥmad)

3. From 'Ubāda ibn al-Ṣāmit: The Prophet, peace be on him, said: "Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt – like for like, equal for equal, and hand-to-hand; if the commodities differ, then you may sell as you wish, provided that the exchange is hand-to-hand." (Muslim, *Kitāb al-Musāqat, Bāb al-ṣarfi wa bay'i al-dhahabi bi al-waraqi naqdan;* also in Tirmidhī)

4. From Abū Sa'īd al-Khudrī: The Prophet, peace be on him, said: "Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt – like for like, and hand-to-hand. Whoever pays more or takes more has indulged in *ribā*. The taker and the giver are alike [in guilt]." (Muslim, *ibid;* and *Musnad* Aḥmad)

5. From Abū Sa'īd and Abū Hurayrah: A man employed by the Prophet, peace be on him, in Khaybar brought for him *janībs* [dates of very fine quality]. Upon the Prophet's asking him whether all the dates of Khaybar were such, the man replied that this was not the case and added that "they exchanged a *ṣā'* [a measure] of this kind for two or three [of the other kind]". The Prophet, peace be on him, replied, "Do not do so. Sell [the lower quality dates] for dirhams and then use the dirhams to buy *janībs*. [When dates are exchanged against dates] they should be equal in weight." (Bukhārī, *Kitāb al-Buyū', Bāb idhā arāda bay'a tamrin bi tamrin khayrun minhu;* also Muslim and Nasā'ī)

6. From Abū Sa'īd: Bilāl brought to the Prophet, peace be on him, some *barnī* [good quality] dates whereupon the Prophet asked him where these were from. Bilāl replied, "I had some inferior dates which I exchanged for these – two *ṣā*'s for a *ṣā'*." The Prophet said, "Oh no, this is exactly *ribā*. Do not do so, but when you wish to buy, sell the inferior dates against something [cash] and then buy the better dates with the price you receive." (Muslim, *Kitāb al-Musāqat, Bāb al-ṭa'āmi mithlan bi mithlin;* also *Musnad* Aḥmad)

7. From Faḍālah ibn 'Ubayd al-Anṣārī: On the day of Khaybar he bought a necklace of gold and pearls for twelve dinars. On separating the two, he found that the gold itself was equal to more than twelve dinars. So he mentioned this to the Prophet, peace be on him, who replied, "It [jewellery] must not be sold until the contents have been valued separately." (Muslim, *Kitāb al-Musāqāt, Bāb bay'i al-qilādah fīhā kharazun wa dhahab;* also in Tirmidhī and Nasā'ī)

8. From Abū Umāmah: The Prophet, peace be on him, said: "Whoever makes a recommendation for his brother and accepts a gift offered by him has entered *ribā* through one of its large gates." (*Bulūgh al-Marām, Kitāb al-Buyū', Bāb al-ribā,* reported on the authority of Aḥmad and Abū Dawūd)

9. From Anas ibn Mālik: The Prophet, peace be on him, said: "Deceiving a *mustarsal* [an unknowing entrant into the market] is *ribā*." (Suyūṭī, *al-Jāmi' al-Ṣaghīr,* under the word *ghabn;* Kanz al-'Ummāl, *Kitāb al-Buyū', al-Bāb al-thānī, al-faṣl al-thānī,* on the authority of *Sunan al-Bayhaqī*)

10. From 'Abdallah ibn Abī Awfa: The Prophet, peace be on him, said: "A nājish [one who serves as an agent to bid up the price in an auction] is a cursed taker of *ribā*." (Cited by Ibn Ḥajar al-'Asqālanī in his commentary on al-Bukhārī called *Fatḥ al-Bārī, Kitāb al-Buyū', Bāb al-najsh;* also in Suyūṭī, *al-Jāmi' al-Ṣaghīr,* under the word *al-nājish* and Kanz al-'Ummāl, *op. cit.,* both on the authority of Ṭabarānī's *al-Kabīr*)

A.3 *Riba* in the *Fiqh*

1. The Four Schools

'Abd al-Raḥmān al-Jazīrī's *al-Fiqh 'alā al-Madhāhib al-Arba'ah*, is a compendium on the juristic opinions of the four predominant schools of Muslim jurisprudence. It is held in high esteem and considered to be an authority on the subject. Given below are some relevant excerpts from this book on the subject of *ribā*.

Definition and Classification

Ribā is one of those unsound (*fāsid*) transactions which have been severely prohibited (*nahyan mughallaẓan*). It literally means increase . . .

However, in *fiqh* terminology, *ribā* means an increase in one of two homogeneous equivalents being exchanged without this increase being accompanied by a return. It is classified into two categories.[1] First, *ribā al-nasī'ah* where the specified increase is in return for postponement of, or waiting for, the payment; for example, buying an *irdab* (a specific measure) of wheat in winter against an *irdab* and a half of wheat to be paid in summer. As the half *irdab* which has been added to the price was not accompanied by an equivalent value in the commodity sold and was merely in return for the waiting, it is called *ribā al-nasī'ah*. The second category is *ribā al-faḍl*, which means that the increase mentioned is irrespective of the postponement and is not offset by something in return. This happens when an *irdab* of wheat is exchanged hand to hand for an *irdab* and a *kīlah* (another measure) of its own counterpart, the buyer and the seller both taking reciprocal possession; or when ten carats of gold produce are exchanged for twelve carats of similar gold produce.

Ribā al-Nasī'ah

There is no difference among Muslim jurists about the prohibition of *ribā al-nasī'ah*. It is indisputably one of the major sins. This is established by the Book of God, the *Sunnah* of His Prophet, and the consensus of the *ummah*. The Qur'ān says: . . . (Verses 2: 275–9).

This is the Book of God which has prohibited *ribā* vehemently and has reprimanded the taker so severely that it makes those who believe in their Lord and dread His punishment tremble with fear. Can any reprimand be harsher than God equating the takers of *ribā* with those who have risen in revolt against Him and are at war with Him and His Prophet? What will be the state of that feeble human being who fights with the Almighty and Overpowering God, Whom nothing on earth or in the Heaven can frustrate. There is no doubt that by resorting to *ribā* such a person has adopted the course of self-destruction and deprivation.

The obvious meaning of *ribā* to be understood from this noble verse of the Qur'ān is the *ribā* known by the Arabs in the *Jāhiliyyah* period as explained by the commentators of the Qur'ān. More than one of them has mentioned that when a loan extended by an Arab matured, he would ask the borrower for the return of the principal or for an 'increase' in return for the postponement. This is also the 'increase' that is known to us. This increase was either in quantity, like postponing the return of a camel now for two in the future, or in age, like postponing the return of a camel aged one year against a camel aged two or three years in the future. Similarly, the Arabs were familiar with situations where a lender would advance money for a period and take a specified amount of *ribā* every month. If the borrower was unable to repay the principal when the loan matured, he would be allowed an extension in the time of repayment [rescheduling] with the continuation of the *ribā* he has been receiving from the borrower. This is the *ribā* which is prevalent now and charged by banks and other institutions in our countries. God has prohibited it for Muslims . . .

The noble verses have decisively prohibited *ribā al-nasī'ah* which involves, what is generally understood in our times, as the giving of a principal amount on loan for a given period against the payment of interest in percentage terms on a monthly or annual basis. Some people try to justify this kind of *ribā* in spite of its conflict with Islam. It is far removed from Islam and is in discord with its basic philosophy in form as well as meaning. Some of them claim that what is prohibited is the charging of *ribā* many times the principal amount as stated by the Qur'ān: "O believers! charge not doubled and redoubled interest, and fear God so that you may prosper" (3: 130). This claim is however absolutely wrong because the objective of the verse is to express a repulsion against interest . . .

Ribā al-Faḍl: Its Legal Position

Ribā al-Faḍl . . . is prohibited according to the four schools of jurisprudence. But some of the Prophet's companions, among them Sayyid 'Abdallah ibn 'Abbās (may God be pleased with him), allowed it. Nevertheless, it is reported that he recanted his opinion afterwards and talked abouts its prohibition. *Ribā al-Faḍl* does not have substantial effect on transactions because of the rarity of its occurrence; it is not the objective of people to buy or sell one thing in exchange for the same thing unless there is something extra from which each of the parties may benefit. Notwithstanding this, it has been prohibited because it might lead to the defrauding or deception of less sophisticated persons. For example, a shrewd trader may claim that the *irdab* of a specific brand of wheat is equivalent to three *irdabs* of the other kind because of the excellence of its quality, or this unique piece of gold ornament is equivalent in value to twice its weight in gold; in such transactions there undoubtedly is defrauding of people and harm to them.

The authority for the prohibition of *ribā al-faḍl* lies in what the Prophet, peace be on him, said:

Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt – like for like, equal for equal, and hand-to-hand; if the commodities differ, then you may sell as you wish, provided that the exchange is hand-to-hand.

This *ḥadīth* indicates that it is neither proper to sell these homogeneous commodities against themselves with addition nor is it proper to delay the reciprocal taking of possession. Hence it is not proper to sell a gold guinea against a gold guinea and ten *qurūsh*, neither on a hand-to-hand, nor on a deferred basis, just as it is not right to sell a gold bar weighing ten carats against a gold bar weighing twelve carats. Similar is the case with wheat and barley and other items mentioned in the *ḥadīth*.

And if such is the case, then does *ribā* enter into every commodity or is it confined to just the commodities mentioned in the *ḥadīth*, namely, gold, silver, wheat, barley, dates and salt? There is no difference of opinion among the four schools of jurisprudence that analogically *ribā* enters into other commodities not mentioned in the *ḥadīth*. If there is any difference it is in the analogy (*'illat*) used to arrive at the conclusion that the 'addition' [*ribā al-faḍl*] is prohibited for all commodities wherever the analogy holds. Only the *Ẓāhiriyyah* (a juristic school which was opposed to analogical reasoning) confined *ribā al-faḍl* to only the commodities specified in the *ḥadīth*. ('Abd al-Raḥmān al-Jazīrī, *Al-Fiqh 'Alā al-Madhāhib al-Arba'ah,* Cairo: Al-Maktabah al-Tijāriyyah al-Kubrā, 5th ed., n.d., vol. 2, pp. 245–8)

Even though the above exerpt is sufficient to convey the views of the four schools of jurisprudence, the reader may wish to go through the following sample of opinions from prominent Qur'ān commentators and/or jurists of the various schools, particularly the Jā'farī school, which is not covered in the above-quoted book. It may be seen that there is hardly any difference of opinion on the subject except in presentation and in certain minor details.

2. Fakhr al-Dīn al-Rāzī (Qur'ān commentator and philosopher)

Ribā is of two kinds: *Ribā al-nasī'ah* and *ribā al-faḍl*.

Ribā al-nasī'ah is what was well known and conventional among the Arabs in *Jāhiliyyah*. They used to give loans on the condition that every month they will receive a stipulated amount with the whole principal remaining outstanding. Then, when the loan matured and the borrower was unable to clear his obligation, the amount was raised and the period was extended. This is the *ribā* that was practised in the *Jāhiliyyah*.

> *Ribā al-naqd [al-faḍl]* is, however, the selling of one maund [a unit of weight] of wheat, or anything similar to it, against two maunds. (*Al-Tafsīr al-Kabīr*, Tehran: Dār al-Kutub al-'Ilmiyyah, 2nd ed., n.d., vol. 7, p. 85)

3. Abū Bakr al-Jaṣṣāṣ (Qur'ān commentator and Ḥanafī jurist)

> The literal meaning of *ribā* is increase . . . but in the *Sharī'ah* it has acquired a connotation that its literal meaning does not convey. The Prophet, peace be on him, termed the increase, [which is a condition] for waiting, as *ribā* as is evident from the *ḥadīth* narrated by Usāmah ibn Zayd in which the Prophet said: "*Ribā* is in waiting . . ." Hence God abolished the *ribā* which was being practised at that time. He also invalidated some other trade transactions and called them *ribā*. Accordingly, the Qur'ānic verse "God has prohibited *ribā*" covers all transactions to which the connotation applies in the *Sharī'ah* even though the indulgence of the Arabs in *ribā*, as mentioned above, related to loans in *dirhams* and *dīnārs* for a specified period with the increase as a condition. The term *ribā* hence signifies different meanings. One is the *ribā* prevalent in *Jāhiliyyah;* the second is the disparity or differential (*tafāḍul*) in the volume or weight of a commodity [in spot transactions] . . .; and the third is postponing (*al-nasā'*); this implies that it is not permitted to sell a commodity against future delivery of the same volume, weight or other measure of the given commodity. (*Aḥkām al-Qur'ān*, Cairo: Al-Maṭba'ah al-Bahiyyah al-Miṣriyyah, 1347 AH, vol. 1, pp. 551–2)

4. Muḥammad ibn 'Abdallah ibn al-'Arabī (Qur'ān commentator and Māliki jurist)

> *Ribā* literally means increase, and in the Qur'ānic verse (2: 275) it stands for every increase not justified by the return . . . (*Aḥkām al-Qur'ān*, Cairo: 'Isā al-Bābī al-Ḥalabī, 1957, p. 242)

It may be clarified here that the 'waiting' involved in a loan is not considered by the jurists to be a return justifying the increase (interest) on the principal amount.

5. Ibn Qayyim al-Jawziyyah

> *Ribā* is of two kinds: *Jalī* and *Khafī*. The *Jalī* has been prohibited because of the great harm it carries and the *Khafī* has been prohibited because it is an instrument for the *Jalī*. Hence prohibition of the former is deliberate while that of the latter is precautionary.
>
> The *Jalī* is *ribā al-nasī'ah* and this is what was engaged in during the *Jāhiliyyah*, like allowing the postponement of repayment of principal against an increase, and every time there was a postponement, there was an increase . . .

However, *ribā al-faḍl* has been prohibited to close the access to *ribā al-nasī'ah*. (*A'lām al-Muwaqqi'īn*, Cairo: Maktabah al-Kulliyyāt al-Azhariyyah, 1968, vol. 2, pp. 154–5)

6. Shāh Walī-Allāh Dihlāwī

Remember that *ribā* is of two kinds: One is primary (*ḥaqīqī*,[1] the other is subject to it. Primary *ribā* is only on loans. The other *ribā* is called *ribā al-faḍl* . . . and is akin to primary *ribā*. (*Ḥujjat Allāh al-Bālighah*, Lahore: Qawmī Kutub Khānā, 1953, tr. Mawlānā 'Abdul Raḥīm, vol. 2, pp. 474–5)

7. 'Abdallah ibn Aḥmad ibn Qudāmah al-Miqdasī (a Ḥanbalī jurist)

Ribā is of two kinds: *ribā al-faḍl* and *ribā al-nasī'ah*. The prohibition of *ribā al-faḍl* involves the exchange of one commodity against itself and covers all commodities which are exchanged by volume or by weight regardless of whether the quantity exchanged is small, like one date for two dates or one grain for two grains . . . (p. 64)

Ribā al-nasī'ah is involved in the exchange of two commodities one of which is not the price. (p. 73) (Al-Muqni', Qaṭar: Maṭābi' Qaṭar al-Waṭaniyyah, 1973, vol. 2, pp. 64–77)

8. Ḥasan ibn al-Muṭahhar (Ja'farī jurist)

Ribā literally means increase and, technically, it refers to the increase in the exchange of two commodities, one against its own kind . . . *Ribā* is of two kinds: *Ribā al-faḍl* and *Ribā al-nasī'ah* and the jurists are agreed on their prohibition. (*Tadhkirah al-Fuqahā'*, Najaf: Maṭba'ah al-Najaf, 1955, vol. 7, p. 84)

Appendix B

Dar al-Maal al-Islami Contracts

B.1 *Mudaraba* Contract

IN THE NAME OF ALLAH, THE MERCIFUL AND THE COMPASSIONATE

Massraf Faysal Al Islami of X Country
Address

Re : Financing Participation (Mudaraba)

Gentlemen :

May the peace, blessing and mercy of Allah be upon you.

I/we/(the "Client") understand that you wish to employ your assets for profitable investment in strict accordance with Islamic law. The Client wishes to obtain such financing from you for purposes consistent with Islamic law.

The Client acknowledges that the Client has received and read your Information Booklet entitled "Islamic Financing with Basic Forms". In this connection, the Client applies to you to furnish the sum of   on a joint venture basis (the "Project") with Participation in Profit and Loss (Mudaraba). The Project shall be managed by the Client and the Client will ensure that the Project is itself conducted in conformity with Islamic law.

The Client acknowledges that the Client has carefully examined the chapter of such Information Booklet entitled "Financing Participation (Mudaraba)" and the Basic Forms appearing in that Chapter and accepts such forms in principle subject to minor amendments to be negotiated between the parties.

For your information and to induce you to participate in the financing of the Project the Client encloses with this letter copies of the following which have been prepared in accordance with the instructions contained in the Information Booklet and which the Client represents to be true and correct:

1. A completed Client Information Form.

2. A completed Project Information Form.

3. Balance Sheets and Statements of Profit and Loss of the Client for the last three fiscal years.

4. A Cash Flow Projection for the Project.

5. A Cash Flow Projection for the Client consolidating the Client's participation in the Cash Flow Projection for the Project.

Items 1-5 above have been prepared by the Client on the basis of forms supplied by you in accordance with the instructions given in the Informational Booklet. The Client encloses with this letter the Client's cheque to your order in the amount of ______________ in conformity with your standard fee schedule for your services and expenses in reviewing this application. The Client understands that this fee will be refunded in the event that the Islamic Financing contemplated by this application is effected.

The Client hopes that you will be able to consider this application and the annexes expeditously and remains at your disposition to supply further information as required. The Client understands that you will use your best efforts to inform the Client of your decision in principle within 30 days of receipt of this letter. In the event that such decision is favourable, the Client will promptly proceed to the execution of the definitive contract in a form substantially conforming to the text contained in the Information Booklet. The Client acknowledges that all your obligations are subject to execution of the definitive contract.

Trusting that Allah will reward our mutual efforts when those are consistent with His Word, we remain,

Very truly yours

FinancngFrm4/DMI/BF/850/EB

Draft 9 Feb 1982

In the Name of Allah, The Merciful, The Compassionate

JOINT VENTURE WITH FINANCING PARTICIPATION IN PROFIT AND LOSS (MUDARABA)

Agreement between Massraf Faysal Al-Islami of X Country with its registered office at ______________________________ ("MFI") and ____
____
______________________________ (the "Client").

1 Client Information

The Client has furnished to MFI the information concerning the Client disclosed on the Client Information Form annexed as Exhibit A and represents that such information is true and correct and prepared in accordance with the instructions contained in the Information Booklet entitled "Islamic Financing with Basic Forms" (the "Information Booklet") a copy of which has been executed by the client for identification.

2 Project Information

The Client has furnished to MFI a description of a contemplated commercial project (the "Project") on the Project Information Form annexed as Exhibit B prepared in accordance with the Information Booklet and proposes that the Client and MFI realise and exploit the Project on a joint venture basis subject to the management and control of the Client and the terms of this Agreement.

3 Project Account

For the sole and exclusive purposes of the Project, the Client has opened an Islamic Current Account at MFI for the receipt and disbursement of all funds relating to the Project (the "Project Account") numbered ________________ bearing the sub-heading "________ Project".

4 Contributions to Project Account

For the sole and exclusive purposes of the Project, MFI will credit to the Project Account the sum of ___________ _, on the draw-down dates and subject to the express conditions specified in Exhibit C hereto.

5 Client Financial Statements

To demonstrate the Client's prior commercial experience and the ability of the Client to fulfill all obligations hereunder the Client has delivered to MFI a copy of the audited* balance sheet of the Client for the last three fiscal years of the Client and a statement of profit and loss for each of such 12 month periods. The foregoing are attached as Exhibit D. The Client represents to MFI that such balance sheets accurately reflect the financial position of the Client at the year then ended and such statements accurately reflect the results of operations for such 12 month periods.

6 Project Cash Flow Projection

The Client has prepared the Cash Flow Projection for the Project annexed as Exhibit E in accordance with the Information Booklet and the Cash Flow Projection for the Client annexed as Exhibit F and represents to MFI that the Cash Flow Projections incorporate or disclose all factors known to the Client or which in the exercise of reasonable prudence and diligence should have been known to the Client and represents to MFI that such Cash Flow Projections are generally prepared with due commercial diligence.

7 Project Expenses

The Client covenants that only capital investments or operating expenses of the type or character described in the Cash Flow Projection annexed as Exhibit E hereto shall be borne by the Project from the Project Account

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* delete if unavailable and waived by MFI.

or otherwise and that funds for any other unbudgeted capital investments or operating expenses (unless otherwise agreed by MFI in writing) shall be supplied solely by the Client promptly as reasonably required by the Project.

8 Zakat

Each party is separately responsible for Zakat due with respect to the party's interest in the Project.

9 Taxation

All customs duties, added value taxes and stamp taxes payable with respect to assets or services to be acquired for the benefit of the Project at the cost of the Project as set forth in Exhibit E shall be paid from the Project Account and any other such duties or taxes shall be borne by the Client. Any other license fees, franchise taxes, business taxes or other governmental payments of any nature unless appearing on Exhibit E shall be borne by the Client, except that the Client and MFI shall separately bear any individual or corporate income taxes imposed as a result of the profit participation set forth in Paragraph 16 of this Agreement.

10 Management Services

The Client, subject to the terms and conditions hereof, shall supply management supervision services for the Project ("Management Services") as described in Exhibit G at the exclusive cost and expense of the Client and not at the expense of the Project but in exchange for the profit participation set forth in Paragraph 16 of this Agreement.

11 Support Services

The Client shall supply in all events at the exclusive cost and expense of the Client and not at the expense of the Project, the overhead ancillary and support services (the "Support Services") as described in Exhibit H, in exchange only for the profit participation or other compensation set forth in such Exhibit H to be borne by the Project.

12 General Rights and Duties of Client

Subject to the terms of this Agreement, complete management and control of the Project is exclusively assumed by the Client. As manager of the Project for the benefit of MFI and the Client, the Client is obligated not to prefer the interests of the Client over the interests of the Project. The Client shall utilise all reasonable diligence and care to assure the success of the Project in accordance with the terms of Exhibit B and Exhibit E. The Client shall immediately disclose in writing to MFI any business factors coming to the attention of the Client which will, or reasonably might, adversely affect such success of the Project and consult with MFI concerning the business strategy to be adopted. The Client shall not permit transactions resulting in a debit or credit to the accounts of the Project to be effected with the Client (other than for Support Services as described in Exhibit H) or with a person who is a shareholder of the Client (directly or indirectly) in whom the Client or a shareholder is interested (directly or indirectly) without the written consent of MFI.

13 Operation of Project Account

Disbursements of cash for items to be debited to the Project rather than to the Client's separate funds shall be effected only by cheque or transfer on the Project Account. All invoices for items constituting gross revenue of the Project shall be payable to MFI "   Project". The Client shall assure that all cheques for any gross revenue items of the Project are so payable and that transfers for such items are payable only to the Project Account. The Client shall assure that in all events items constituting gross revenue of the Project are promptly credited to the Project Account.

14 The authorised signatories of the Project Account shall, without the written consent of MFI, continue to be only those persons appearing as such on the date hereof and in the capacities appearing on the date hereof.

15 MFI shall have the right (but not the obligation) to refuse to honour any cheque or other instruction to the debit of the Project Account for any

payment which MFI reasonably believes is not of a character to be borne by the Project (as opposed to the Client or others) according to the terms of Exhibit E or other provisions of this Agreement. MFI shall give immediate notice to the Client and consult with the Client in such event.

16 Participation in Profit

The Net Cash Flow of the Project, computed in accordance with the principles of Exhibit E and the Information Booklet but after providing for the Support Services as set forth in Exhibit G shall be distributed quarterly within 30 days of the end of each calendar quarter to MFI until MFI shall have received an amount equal to the sum originally invested. Thereafter Net Cash Flow shall be distributed as follows:

To the Client in respect of management services	%
To MFI in respect of sums invested	%
	100%

However, in all events, MFI shall cease to participate in the Net Cash Flow of the Project when MFI has received funds distributed with respect to its participation equal to its investment in the Project plus an internal rate of return to MFI on such investment equal to _____ % per annum computed in accordance with standards set forth in the Information Booklet.

17 Participation in Loss

To the extent that Net Cash Flow of the Project, computed as specified in Paragraph 16, shall be insufficient to return to MFI amount originally invested, the loss will be borne by MFI. As MFI has participated in the Project on the basis of the Client's various representations and relying on the Client's management, any losses in excess of the amount invested by MFI shall be borne exclusively by the Client and the Client shall hold MFI harmless from the claim of any third party for any loss in excess of such amount.

18 Duration of the Joint Venture

The Joint Venture shall in all events terminate (the "Termination Day") on the day when the objectives of the Project as set forth in Exhibits B and E hereto are realised. The Termination Date shall earlier occur on the earliest of any of the following events*:

(a) Receipt by MFI of funds distributed with respect to MFI's participation in the Project equal to the credits made by MFI to the Project plus an internal rate of return to MFI on such credits equal to % per annum computed in accordance with standards set forth in the Information Booklet;

(b) On 19 ;

(c) On the expiration of ______________ months following _________;

(d) On notice of demand given to the Client by MFI in the event that MFI has reasonably determined that the objects of the Project cannot be realised.

On termination of the Joint Venture, the Project Assets (as defined in Paragraph 19 hereof) shall be promptly liquidated with proceeds credited to the Project Account and appropriate expenses and liabilities paid from the Project Account. Profit and loss shall be allocated as in Paragraphs 16 and 17 provided.

19 Maintenance of Project Assets

The Client shall acquire and maintain all assets resulting from expenditures debited to the Cash Flow of the Project ("Project Assets") in accordance with Exhibit E in the name of the Client but physically segregated from other assets of the Client. The Client shall maintain all Project Assets free and clear from any mortgages, liens or other encumbrances except only liens to secure any indebtedness of the Client

* Some or all of which may be deleted with d

to MFI and any liens to secure the obligations of the Client to MFI hereunder. The Client shall not sell or otherwise transfer any Project Assets except for the purposes of the Project as set forth in Exhibits B and E hereof.

20 Financial Reporting

Within 30 days of the close of each calendar quarter, the Client shall submit to MFI the following in form and substance satisfactory to MFI:

(a) A Cash Flow statement of the Project prepared in conformity with the principles employed in Exhibit E hereto with a clear explanation of each variation from the Cash Flow Projection included in Exhibit E;

(b) A Cash Flow statement of the Client prepared in conformity with the principles employed in Exhibit F hereto with a clear explanation of each variation from the Cash Flow Projection included in Exhibit F;

(c) A balance sheet and income statement of the Client prepared in accordance with principles utilised in Exhibit D consistently applied, which annual balance sheet and income statement shall be audited by an independent firm of accountants approved by MFI.

21 Access to Information

At any time the Client shall supply to MFI any information, material or documents relating to the Project reasonably requested by MFI, and Client will grant access to MFI or accountants or agents appointed by MFI to all books and records relating to the Project and to all premises where Project Assets are located. The Client shall maintain true and correct books of account relating to the Project together with all underlying invoices, records, contracts and all other material documentation at __________ unless MFI shall in writing authorise such to be kept at another address.

22 Guaranties

As security for the due and prompt performance of all the obligations of the Client hereunder, the Client shall furnish to MFI the additional guaranties or collateral described in Exhibit I hereto and MFI will not be obligated to furnish any funds pursuant to this Agreement until executed completed documentation in form and substance satisfactory to MFI has been delivered to effectuate the transactions described in Exhibit I.

23 Liability of the Client

The Client shall hold MFI harmless and indemnify MFI from any loss:

(a) arising from the breach of any obligation of the Client under this Agreement;

(b) arising from any material misstatement contained in Exhibits A, B, or D of this Agreement;

(c) arising from any material misstatement in any financial statements or other document delivered by the Client to MFI hereafter;

(d) arising from the failure of the actual Cash Flow of the Project to conform in any material respect to the Cash Flow Projection prepared by the Client annexed as Exhibit E, except if such failure is attributable to an Act of Allah, circumstances not forseeable on the date hereof or risks appearing on Exhibit K hereof which are specifically assumed by MFI.

Except where the amount of any loss is otherwise clearly established, the loss of MFI shall be fixed at the excess of the distribution projected to MFI on Exhibit E over the amount actually distributed at the date of determination.

24 Assumption of Management

If any of the following events shall occur on notice given by MFI to the Client, the authority of the Cli[illegible] and such authority shall be assumed by DMI until otherwise agreed by the parties:

(a) If the Client shall materially breach any obligation under this Agreement;

(b) If the Client shall make any material misstatement in Exhibits A, B or D of this Agreement or in any financial statement or other document delivered by the Client to MFI hereafter; or

(c) If MFI shall reasonably determine that the Cash Flow Projection contained in Exhibit E has not been met in a material respect.

On such notice all power of the Client or agents of the Client to give instructions with respect to the Project Account shall terminate. Thereafter, the management services described in Exhibit G hereof shall be provided by MFI. Within 90 days of giving such notice, MFI shall by writing elect to provide such services in return for the management based profit participation described in Paragraph 16 hereof or charge the Client for out-of-pocket expenses, time cost and apportioned over-head costs of providing such services. Any such charges shall be invoiced quarterly and payable within 30 days of presentation of invoice.

If MFI shall elect to receive such management based profit participation distributions received by MFI with respect to the same from the Net Cash Flow of the Project shall not be considered in the rate of return computation referred to in Paragraphs 16 and 18. Restitution of management to the Client shall be at MFI's discretion but subject to terms and conditions agreed by the parties.

25 The assumption of management by MFI as in Paragraph 24 provided shall not discharge the Client of any obligation hereunder other than the obligation to render the management services specificied in Exhibit G hereto. Without limitation of the foregoing, assumption of management by MFI does not discharge the Client from the Client's obligation to provide the Support Services described in Exhibit H or from the liabilities described in Paragraph 23.

26 The assumption of management by MFI with respect to the Project shall in no event be deemed to effect the liability of the Client to MFI with respect to money borrowed or supplied under any other agreement between the Client and MFI whether or not the proceeds of such were employed in connection with the Project.

26 On assumption of management of the Project by MFI, the Client will on the written demand of MFI deliver to MFI all books, records, contracts and other documents relating to the Project and all Project Assets.

27 Disputes*

In the event of any dispute between the parties regarding this Agreement or the execution of this Agreement that is not amicably resolved, then the dispute shall be submitted to Arbitration in accordance with the rules of the ______________ . Each party shall name one arbitrator and the two so named can appoint a third. If they fail to so appoint a third, such third shall be appointed the Religious Supervisory Board of Dar Al-Maal Al-Islami, the direct or indirect parent of MFI. Any issue not settled by the text of this Agreement or any ambiguity in the text of this Agreement shall be determined or construed in accordance with Islamic law as set forth in the Glorious Shari'a.

29 Set-Off

MFI may set-off the balances of any account maintained by the Client at MFI or any other obligation of MFI to the Client against any obligation of the Client to MFI hereunder.

30 Formalities

Any notice shall be deemed to have been given to any party five days after posting in domestic mail addressed to the address given above or one day after actual delivery at such address.

* Where an Islamic Arbitration Council exists.

31 Waiver

No failure to act by either party hereunder shall be deemed to be a waiver of any right hereunder.

32 Amendments

This Agreement may be amended or any term or condition waived only in writing executed by persons duly authorised.

33 Counterparts

This Agreement has been executed in two original counterparts and each page of each Exhibit has been initialled for identification.

MFI:	The Client:
MASSRAF FAYSAL AL-ISLAMI OF X COUNTRY	
By ______________________ Duly Authorised	By ______________________ Duly Authorised
By ______________________ Duly Authorised	By ______________________ Duly Authorised
______________________	______________________
______________________ Printed Name(s) of Signatories	______________________ Printed Name(s) of Signatories

Dated: ______________________

B.2 *Musharaka* Contract

IN THE NAME OF ALLAH, THE MERCIFUL AND THE COMPASSIONATE

Massraf Faysal Al Islami of X Country
Address

Re : Mutual Financing Participation (Musharaka)

Gentlemen :

May the peace, blessing and mercy of Allah be upon you.

I/we/(the "Client") understand that you wish to employ your assets for profitable investment in strict accordance with Islamic law. The Client wishes to obtain such financing from you for purposes consistent with Islamic law.

The Client acknowledges that the Client has received and read your Information Booklet entitled "Islamic Financing with Basic Forms". In this connection, the Client applies to you to furnish the sum of   on a joint venture basis with Mutual Participation in Profit and Loss (Musharaka). The Client proposes to contribute   to the joint venture project (the "Project"). The Project shall be managed by the Client and the Client will ensure that the Project is itself conducted in conformity with Islamic law.

The Client acknowledges that the Client has carefully examined the chapter of such Information Booklet entitled "Mutual Financing Participation (Musharaka)" and the Basic Forms appearing in that Chapter and accepts such forms in principle subject to minor amendments to be negotiated between the parties.

For your information and to induce you to participate in the financing of the Project the Client encloses with this letter copies of the following which have been prepared in accordance with the instructions contained in the Information Booklet and which the Client represents to be true and correct:

1. A completed Client Information Form.

2. A completed Project Information Form.

3. Balance Sheets and Statements of Profit and Loss of the Client for the last three fiscal years.

4. A Cash Flow Projection for the Project.

5. A Cash Flow Projection for the Client consolidating the Client's participation in the Cash Flow Projection for the Project.

Items 1-5 above have been prepared by the Client on the basis of forms supplied by you in accordance with the instructions given in the informational booklet. The Client encloses with this letter the Client's cheque to your order in the amount of   in conformity with your standard fee schedule for your services and expenses in reviewing this application. The Client understands that this fee will be refunded in the event that the Islamic Financing contemplated by this application is effected.

The Client hopes that you will be able to consider this application and the annexes expeditiously and remains at your disposition to supply further information as required. The Client understands that you will use your best efforts to inform the Client of your decision in principle within 30 days of receipt of this letter. In the event that such decision is favourable, the Client will promptly proceed to the execution of the definitive contract in a form substantially conforming to the text contained in the Information Booklet. The Client acknowledges that all your obligations are subject to execution of the definitive contract.

Trusting that Allah will reward our mutual efforts when those are consistent with His Word, we remain,

Very truly yours

Financing Frml

Draft 9 Feb 1982

In the Name of Allah, The Merciful, The Compassionate

JOINT VENTURE WITH MUTUAL PARTICIPATION IN PROFIT AND LOSS (MUSHARAKA)

Agreement between Massraf Faysal Al-Islami of X Country with its registered office at ________________________________ ("MFI") and ____ ________________________ (the "Client").

1 Client Information

The Client has furnished to MFI the information concerning the Client disclosed on the Client Information Form annexed as Exhibit A and represents that such information is true and correct and prepared in accordance with the instructions contained in the Information Booklet entitled "Islamic Financing with Basic Forms" (the "Information Booklet") a copy of which has been executed by the client for identification.

2 Project Information

The Client has furnished to MFI a description of a contemplated commercial project (the "Project") on the Project Information Form annexed as Exhibit B prepared in accordance with the Information Booklet and proposes that the Client and MFI realise and exploit the Project on a joint venture basis subject to the management and control of the Client and the terms of this Agreement.

3 Project Account

For the sole and exclusive purposes of the Project, the Client has opened an Islamic Current Account at MFI for the receipt and disbursement of all funds relating to the Project (the "Project Account") numbered ________________ bearing the sub-heading "________ Project".

4 Contributions to Project Account

For the sole and exclusive purposes of the Project, MFI will credit to the Project Account the sum of _____________, on the draw-down dates and subject to the express conditions specified in Exhibit C hereto and the Client will credit from the Client's funds the sum of _____________ on the draw-down dates and subject to the express conditions specified in Exhibit C hereto. The Client has today paid to Islamic Participation Account _________ an equal sum and such amount shall remain blocked in favour of MFI to secure the Client's obligations under this Paragraph 4. MFI is irrevocably authorised to debit such Participation Account in the aggregate amount of such sum in compliance with the conditions of Exhibit C. Profit or loss of such Participation Account is for the account of the Client.

5 Client Financial Statements

To demonstrate the Client's prior commercial experience and the ability of the Client to fulfill all obligations hereunder the Client has delivered to MFI a copy of the audited balance sheet* of the Client for the last three fiscal years of the Client and a statement of profit and loss for each of such 12 month periods. The foregoing are attached as Exhibit D. The Client represents to MFI that such balance sheets accurately reflect the financial position of the Client at the year then ended and such statements accurately reflect the results of operations for such 12 month periods.

6 Project Cash Flow Projection

The Client has prepared the Cash Flow Projection for the Project annexed as Exhibit E in accordance with the Information Booklet and the Cash Flow Projection for the Client annexed as Exhibit F and represents to MFI

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* delete if unavailable and waived by MFI.

that the Cash Flow Projections incorporate or disclose all factors known to the Client or which in the exercise of reasonable prudence and diligence should have been known to the Client and represents to MFI that such Cash Flow Projections are generally prepared with due commercial diligence.

7 <u>Project Expenses</u>

The Client covenants that only capital investments or operating expenses of the type or character described in the Cash Flow Projection annexed as Exhibit E hereto shall be borne by the Project from the Project Account or otherwise and that funds for other capital investments or operating expenses (unless otherwise agreed by MFI in writing) shall be supplied solely by the Client promptly as reasonably required by the Project.

8 <u>Zakat</u>

Each party is separately responsible for Zakat payments due with respect to that party's interest in the Project.

9 <u>Taxation</u>

All customs duties, added value taxes and stamp taxes payable with respect to assets or services to be acquired for the benefit of the Project at the cost of the Project as set forth in Exhibit E shall be paid from the Project Account and any other such duties or taxes not set forth by the Client in Exhibit E shall be borne by the Client. Any other license fees, franchise taxes, business taxes or other governmental payments of any nature unless appearing on Exhibit E shall be borne by the Client, except that the Client and MFI shall separately bear any individual or corporate income taxes imposed as a result of the profit participation set forth in Paragraph 17 of this Agreement.

10 <u>Management Services</u>

The Client, subject to the terms and conditions hereof, shall supply management supervision services for the Project ("Management Services") as described in Exhibit G at the exclusive cost and expense of the Client and not at the expense of the Project but in exchange for the profit participation set forth in Paragraph 16 of this Agreement.

11 Support Services

The Client shall supply in all events at the exclusive cost and expense of the Client and not at the expense of the Project, the overhead ancillary and support services (the "Support Services") as described in Exhibit H, in exchange only for the profit participation or other compensation set forth in such Exhibit H to be borne by the Project.

12 General Rights and Duties of Client

Subject to the terms of this Agreement, complete management and control of the Project is exclusively assumed by the Client. As manager of the Project for the benefit of MFI and the Client the Client is obligated not to prefer the interests of the Client over the interests of the Project. The Client shall utilise all reasonable diligence and care to assure the success of the Project in accordance with the terms of Exhibit B and Exhibit E. The Client shall immediately disclose in writing to MFI any business factors coming to the attention of the Client which will, or reasonably might, adversely affect such success of the Project and consult with MFI concerning the business strategy to be adopted. The Client shall not permit transactions resulting in a debit or credit to the accounts of the Project to be effected with the Client (other than for Support Services as described in Exhibit H) or with a person who is a shareholder of the Client (directly or indirectly) in whom the Client or a shareholder is interested (directly or indirectly) without the written consent of MFI.

13 Operation of Project Account

Disbursements of cash for items to be debited to the Project rather than to the Client's separate funds shall be effected only by cheque or transfer on the Project Account. All invoices for items constituting gross revenue of the Project shall be payable to MFI " Project". The Client shall assure that all cheques for such items are so payable and that transfers for only gross revenue items of the Project are payable only to the Project Account. The Client shall assure that in all events items constituting gross revenue of the Project are promptly credited to the Project Account.

14 The authorised signatories of the Project Account shall, without the written consent of MFI, continue to be only those persons appearing as such on the date hereof and in the capacities appearing on the date hereof.

15 MFI shall have the right (but not the obligation) to refuse to honour any cheque or other instruction to the debit of the Project Account for any payment which MFI reasonably believes is not of a character to be borne by the Project (as opposed to the Client or others) according to the terms of Exhibit E or other provisions of this Agreement. MFI shall give immediate notice to the Client and consult with the Client in such event.

16 Participation in Profit

The Net Cash Flow of the Project, computed in accordance with the principles of Exhibit E and the Information Booklet but after providing to the Client his profit participation or other compensation for the Support Services as set forth in Exhibit G shall be distributed quarterly within 30 days of the end of each calendar quarter in proportion to the sums originally credited for the Project by the Client (and MFI) to the Project Account until each shall have received an amount equal to the sum originally invested. Thereafter Net Cash Flow shall be distributed as follows:

To the Client in respect of sums invested	%
To the Client in respect of management services	%
To MFI in respect of sums invested	%
	100%

However, in all events MFI shall cease to participate in the Net Cash Flow of the Project when MFI has received funds distributed with respect to its participation equal to its investment in the Project plus an internal rate of return to MFI on such equal to _____% per annum computed in accordance with standards set forth in the Information Booklet.

17 Participation in Loss

To the extent that Net Cash Flow of the Project shall be insufficient to return to the Client and MFI the amount originally invested by each the loss will be borne by each in proportion to the sums originally credited for the Project by the Client and MFI to the Project Account. As MFI has participated in the Project on the basis of the Client's various representations and relying on the Client's management, any losses in excess of ______________ shall be borne exclusively by the Client and the Client shall hold MFI harmless from the claim of any third party for any loss in excess of such amount.

18 Duration of the Joint Venture

The Joint Venture shall in all events terminate (the "Termination Day") on the day when the objectives of the Project as set forth in Exhibit B and E hereto are realised. The Termination Date shall earlier occur on the earliest of any of the following events*:

(a) Receipt by MFI of funds distributed with respect to MFI's participation in the Project equal to the credits made by MFI to the Project plus an internal rate of return to MFI on such credits equal to % per annum computed in accordance with standards set forth in the Information Booklet;

(b) On 19 ;

(c) On the expiration of ______________ months following __________;

(d) On notice of demand given to the Client by MFI in the event that MFI has reasonably determined that the objects of the Project cannot be realised or that losses in excess of _________ are threatened.

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* Some or all of which may be deleted with deletions initialled by the parties.

On termination of the Joint Venture if and so long as MFI shall be entitled to participate in Net Cash Flow according to Paragraph 16 of this Agreement, the Project Assets (as defined in Paragraph 19 hereof) shall be promptly liquidated with proceeds credited to the Project Account and appropriate expenses and liabilities paid from the Project Account. Profit and loss shall be allocated as in Paragraphs 16 and 18 provided. Termination shall not effect the validity of any Share Option Agreement with respect to the capital stock of the Client (if a corporation) annexed hereto as Exhibit I hereto.

19 Maintenance of Project Assets

The Client shall acquire and maintain all assets resulting from expenditures debited to the Cash Flow of the Project ("Project Assets") in accordance with Exhibit E in the name of the Client but physically segregated from other assets of the Client. The Client shall maintain all Project Assets free and clear from any mortgages, liens or other encumbrances except only liens to secure any indebtedness of the Client to MFI and any liens to secure the obligations of the Client to MFI hereunder. The Client shall not sell or otherwise transfer any Project Assets except for the purposes of the Project as set forth in Exhibits B and E hereof.

20 Financial Reporting

Within 30 days of the close of each calendar quarter, the Client shall submit to MFI the following in form and substance satisfactory to MFI:

(a) A Cash Flow statement of the Project prepared in conformity with the principles employed in Exhibit E hereto with a clear explanation of each variation from the Cash Flow Projection included in Exhibit E;

(b) A Cash Flow statement of the Client prepared in conformity with the principles employed in Exhibit F hereto with a clear explanation of each variation from the Cash Flow Projection included in Exhibit F;

(c) A balance sheet and income statement of the client prepared in accordance with principles utilised in Exhibit D consistently applied, which annual balance sheet and income statement shall be audited by an independent firm of accountants approved by MFI.

21 Access to Information

At any time the Client shall supply to MFI any information, material or documents relating to the Project reasonably requested by MFI and Client will grant access to MFI or accountants or agents appointed by MFI to all books and records relating to the Project and to all premises where Project Assets are located. The Client shall maintain true and correct books of account relating to the Project together with all underlying invoices, records, contracts and all other material documentation at __________ unless MFI shall in writing authorise such to be kept at another address.

22 Guaranties

As security for the due and prompt performance of all the obligations of the Client hereunder, the Client shall furnish to MFI the additional guaranties or collateral described in Exhibit J hereto and MFI will not be obligated to furnish any funds pursuant to this Agreement until executed completed documentation in form and substance satisfactory to MFI has been delivered to effectuate the transactions described in Exhibit J.

23 Liability of the Client

The Client shall hold MFI harmless and indemnify MFI from any loss:

(a) arising from the breach of any obligation of the Client under this Agreement;

(b) arising from any material misstatement contained in Exhibits A, B, or D of this Agreement;

(c) arising from any material misstatement in any financial statements or other document delivered by the Client to MFI hereafter;

(d) arising from failure of the actual cash flow of the Project to conform in a material respect to the Cash Flow Projection prepared by the Client and annexed as Exhibit E, except if such failure is attributable to an Act of Allah, circumstances not forseeable on the date hereof or risks appearing on Exhibit K hereof which are specifically assumed by MFI.

Except where the amount of any loss is otherwise clearly established, the loss of MFI shall be fixed at the excess of the distribution projected to MFI on Exhibit E over the amount actually distributed at the uate of determination.

24 Assumption of Management

If any of the following events shall occur on notice given by MFI to the Client, the authority of the Client to manage the Project shall terminate and such authority shall be assumed by DMI until otherwise agreed by the parties:

(a) If the Client shall materially breach any obligation under this Agreement;

(b) If the Client shall make any material misstatement in Exhibits A, B or D of this Agreement or in any financial statement or other document delivered by the Client to MFI hereafter; or

(c) If MFI shall reasonably determine that the Cash Flow Projection contained in Exhibit E has not been met in a material respect.

On such notice all power of the Client or agents of the Client to give instructions with respect to the Project Account shall terminate. Thereafter, the management services described in Exhibit G hereof shall be provided by MFI. Within 90 days of giving such notice, MFI shall by writing elect to provide such services in return for the management based profit participation described in Paragraph 16 hereof or charge the Client for out-of-pocket expenses, time cost and apportioned over-head costs of providing such services. Any such charges shall be invoiced quarterly and payable within 30 days of presentation of invoice. If MFI shall elect to receive such management based profit participation, distributions received by MFI with respect to the same from the Net Cash Flow of the Project shall not be considered in the rate of return computation referred to in Paragraphs 16 and 18. Restitution of management to the Client shall be at MFI's discretion but subject ot terms and conditions agreed by the parties.

25 The assumption of management by MFI as in Paragraph 24 provided shall not discharge the Client of any obligation hereunder other than the obligation to render the management services specificied in Exhibit G hereto. Without limitation of the foregoing, assumption of management by MFI does not discharge the Client from the Client's obligation to provide the Support Services described in Exhibit H or from the liabilities described in Paragraph 23.

26 The assumption of management by MFI with respect to the Project shall in no event be deemed to affect the liability of the Client to MFI with respect to money borrowed or supplied under any other agreement between the Client and MFI whether or not the proceeds of such were employed in connection with the Project.

27 On assumption of management of the Project by MFI, the Client will on the written demand of MFI deliver to MFI all books, records, contracts and other documents relating to the Project and all Project Assets.

28 Disputes*

In the event of any dispute between the parties regarding this Agreement or the execution of this Agreement that is not amicably resolved, then the dispute shall be submitted to Arbitration in accordance with the rules of the _______________ . Each party shall name one arbitrator and the two so named can nominate a third. If they fail to so nominate a third, such third shall be nominated by the Religious Supervisory Board of Dar Al-Maal Al-Islami the direct or indirect parent of MFI. Any issue not settled

* Where an Islamic Arbitration Council exists.

by the text of this Agreement or any ambiguity in the text of this Agreement shall be determined or construed in accordance with Islamic law as set forth in the Glorious Shari'a.

29 Set-Off

MFI may set-off the balances of any account maintained by the Client at MFI or any other obligation of MFI to the Client against any obligation of the Client to MFI hereunder.

30 Formalities

Any notice shall be deemed to have been given to any party five days after posting in domestic mail addressed to the address given above or one day after actual delivery at such address.

31 No failure to act by either party hereunder shall be deemed to be a waiver of any right hereunder.

32 This Agreement may be amended or any term or condition waived only in writing executed by persons duly authorised.

33 This Agreement has been executed in two original counterparts and each page of each Exhibit has been initialled for identification.

MFI:	The Client:
MASSRAF FAYSAL AL-ISLAMI OF X COUNTRY	
By ______________________ Duly Authorised	By ______________________ Duly Authorised
By ______________________ Duly Authorised	By ______________________ Duly Authorised
______________________ Printed Name(s) of Signatories	______________________ Printed Name(s) of Signatories
______________________ Printed Name(s) of Signatories	______________________ Printed Name(s) of Signatories

Dated: ______________________

B.3 *Murabaha* Contract

IN THE NAME OF ALLAH, THE MERCIFUL AND THE COMPASSIONATE

Massraf Faysal Al Islami of X Country
Address

Re : Financing Resale of Goods (Murabaha)

Gentlemen :

May the peace, blessing and mercy of Allah be upon you.

I/we/(the "Client") understand that you wish to employ your assets for profitable investment in strict accordance with Islamic law. The Client wishes to obtain such financing from you for purposes consistent with Islamic law.

The Client acknowledges that the Client has received and read your Information Booklet entitled "Islamic Financing with Basic Forms". In this connection, the Client applies to you to procure from third parties for the Client certain goods (the "Goods") to be resold to the Client (hereinafter "the Project") with a profit to you (Morabaha). The Client proposes to use the goods for certain commercial purposes (the "Project"). The Client estimates the cost of the Goods at approximately ______________________.

The Client acknowledges that the Client has carefully examined the chapter of such Information Booklet entitled "Financing Resale of Goods (Morabaha)" and the Basic Forms appearing in that Chapter and accepts such forms in principle subject to minor amendments to be negotiated between the parties.

For your information and to induce you to participate in this Project the Client encloses with this l tter copies of the following which have been prepared in accordance with the instructions contained in the Information Booklet and which the Client represents to be true and correct:

1. A description of the Goods.

2. A completed Client Information Form.

3. A completed Project Information Form.

4. Balance Sheets and Statements of Profit and Loss of the Client for the last three fiscal years.

5. A Cash Flow Projection for the Project.

Items 1-5 above have been prepared by the Client on the basis of forms supplied by you in accordance with the instructions given in the Informational Booklet. The Client encloses with this letter the Client's cheque to your order in the amount of ____________ in conformity with your standard fee schedule for your services and expenses in reviewing this application. The Client understands that this fee will be refunded in the event that the Islamic Financing contemplated by this application is effected.

The Client hopes that you will be able to consider this application and the annexes expeditiously and remains at your disposition to supply further information as required. The Client understands that you will use your best efforts to inform the Client of your decision in principle within 30 days of receipt of this letter. In the event that such decision is favourable, the Client will promptly proceed to the execution of the definitive contract in a form substantially conforming to the text contained in the Information Booklet. The Client acknowledges that all your obligations are subject to execution of the definitive contract.

Trusting that Allah will reward our mutual efforts when those are consistent with His Word, we remain,

Very truly yours

FinancngFrm2
DMI/BF/850

February 9, 1982

IN THE NAME OF ALLAH, THE MERCIFUL, THE COMPASSIONATE

FINANCING OF THE RESALE OF GOODS (MURABAHA)

Agreement between Dar Al-Maal Al-Islami of X-Country with its registered office at ("MFI") and (the "Client").

1. Client Information

The Client has furnished to MFI the information concerning the Client disclosed on the Client Information Form annexed as Exhibit A. The Client represents that such information is true and correct and has been prepared in accordance with the Information Booklet "Islamic Financing - Basic Forms" a copy of which has to be signed for identification by the Client (the "Information Booklet").

2. Description of Goods

The Client has furnished to MFI the description and specifications concerning the goods which the Client wishes to acquire (the "Goods") including the names of manufacturers or other suppliers approved by the Client and the location at which the Client will accept delivery of the goods together with date of delivery. The foregoing has led to the preparation of a contract (the "Supply Contract") annexed hereto as Exhibit B between MFI and one of such approved manufactures or suppliers (the "Supplier") which contract is approved by the Client.

3. Project Information

The Client has furnished to MFI a description of the contemplated commercial utilisation of the Goods (the "Project") in the Project

Information Form annexed as Exhibit C. The Client shall utilise the Goods only in accordance with the information disclosed in the Project Information Form.

4. Project Account

In the event that the Goods are to be acquired by the Client for resale to third parties according the terms of Exhibit C, the Client has opened an Islamic Current Account or Islamic Participating Account or Accounts (the "Project Account") designated "_____ Account" at MFI with the account number appearing on Exhibit D and the Client shall make or cause each third party purchaser to make the payments to such account described on Exhibit D at or prior to the transfer of any part of the Goods from the Client to any third party. Invoices utilised by the Client for the resale of the Goods to its customers shall be payable to MFI Project Account. Except to the extent that withdraws by the Client are specifically permitted by the terms of Exhibit D, all balances held in the Project Account shall be blocked or pledged to secure the obligations of the Client under this Agreement.

5. Client Financial Statements

To demonstrate the Client's prior commercial experience and the ability of the Client to fulfill obligations hereunder the Client has delivered to MFI a copy of the audited balance sheet of the Client for the last three fiscal years of the Client and a statement of profit and loss for each of such 12 month periods. The foregoing are attached as Exhibit E. The Client represents to MFI that such balance sheets accurately reflect the financial position of the Client at the years then ended and such statements accurately reflect the results of operations for such 12 month periods. So long as any part of the purchase price for the Goods shall be unpaid, the Client shall maintain a net worth equal to not less than   % of such unpaid balance.

6. Project Cash Flow Projection

The Client has prepared the Cash Flow Projection for the Project annexed as Exhibit F in accordance with the instructions of the Information Booklet and represents to MFI that the Cash Flow Projection incorporates or discloses all factors known to the Client or which in the exercise of reasonable prudence and diligence should have been known to the Client and represents to MFI that such Cash Flow Projection is generally prepared with due commercial diligence.

7. Agreement of Purchase and Sale

The Client promises to buy the goods and MFI promises to sell the goods upon the delivery of the Goods to the point of destination specified in the Supply Contract. Risk of loss with respect to the Goods shall pass to the Client when risk of loss passes from the Supplier pursuant to the terms of the Supply Contract.

8. Purchase Price

The price payable from the Client to MFI with respect to the Goods shall be as established on the price list annexed hereto as Exhibit G.

9. Payment Dates

The price payable with respect to the Goods shall be paid by the Client to MFI as follows:

% on the signature hereof;

% against notice of delivery to point of destination accompanied by any negotiable or other documents of title specified in the Supply Contract; and

the balance as specified in Exhibit H.

In the event of delivery of the Goods in installments as permitted by the Supply Contract or in the event of partial deliveries accepted by the Client, the partial payments referred to above are deemed to be apportioned to all Goods in proportion to the prices specified in Exhibit G.

10. Taxes

All customs duties, added value, sales or use taxes due on import of the Goods or on transfer of title shall be paid by the Client when due from the Client or MFI.

11. Default by Supplier

Non-performance by the Supplier of any of its obligations under the Supply Contract shall excuse MFI from performance of its obligations hereunder.

12. Waiver of Warranty

It is expressly agreed between the Client and MFI that the Goods are sold by MFI WITHOUT WARRANTY of condition or quality of any nature, made by MFI and that the Client in any question relating to the condition or quality of the goods shall look only to the Supplier under the terms of the warranties of the Supply Contract.

Client's Obligation to Pay

13. The terms of Paragraph 9 hereof notwithstanding, MFI may require the Client to pay any unpaid part of the purchase price of the Goods in cash against delivery in the event that the Client is in default in any obligation to MFI under this Agreement or under any other contract or agreement between the Client and MFI.

14. Islamic financing is based on continuing mutual trust between the parties. As a consequence, in the event that the Client shall be in default in any obligation to MFI to pay a sum of money on the date due under this agreement or under any other contract or agreement between the MFI and Client, MFI may by notice to the Client declare all sums due under this contract immediately due and payable.

15. In the event the Client shall fail to pay when due under this Agreement any sum, MFI shall be entitled to costs of collection, including attorneys fees borne by MFI.

16. Guaranties

As security for the due and prompt performance of all the obligations of the Client hereunder, the Client shall furnish to MFI the additional guaranties or collateral described in Exhibit I hereto and MFI will not be obligated to furnish the funds pursuant to this Agreement until executed completed documentation in form and substance satisfactory to MFI has been delivered to effectuate the transactions described on Exhibit I.

17. Absence of Liens

For so long as any indebtedness with respect to the Goods under this Agreement shall be outstanding, the Client shall not permit any liens or incumbrances to be outstanding on the assets of the Client other than those listed on Exhibit I or others, to secure any obligation in favour of MFI or others, except as listed on Exhibit J hereto.

Financial Reports

18. Within 30 days of the close of each calendar quarter, the Client shall submit to MFI the following in form and substance satisfactory to MFI:

(a) A Cash Flow statement of the Project prepared in conformity with the principles employed in Exhibit F hereto with a clear explanation of each variation from the Cash Flow Projection included in Exhibit F;

(b) A balance sheet and income statement of the Client, which annual balance sheet and income statement shall be audited by an independant firm of accountants approved by MFI and prepared according to accounting principles consistent with those used in the preparation of Exhibit E.

Access to Information

19. At any time the Client shall supply to MFI any information, material or documents relating to the Project or the financial status of the Client reasonably requested by MFI and the Client will grant access to MFI or accountants or agents appointed by MFI to all books and records relating to the Project or relating to the financial status of its Client. The Client shall maintain true and correct books of account relating to the Project and its financial status together with all underlying invoices, records, contracts and all other material documentation at unless MFI shall in writing authorise such to be kept at another address.

Disputes*

20. In the event of any dispute between the parties regarding this Agreement or the execution of this Agreement that is not amically resolved, then the dispute shall be submitted to Arbitration in accordance with the rules of the   . Each party shall name on arbitrator and the two so named can nominate a third. If they fail to so nominate a third, such third shall be nominated by the Religious Supervisory Board of Dar Al-Maal Al-Islami the direct or indirect parent of MFI. Any issue not settled by the text of this Agreement or any ambiguity in the text of this Agreement shall be determined or construed in accordance with Islamic law as set forth in the Glorious Shari'a.

21. Set Off

MFI may set-off the balances of any account maintained by the Client at MFI or any other obligation of MFI to the Client against any obligation of the Client to MFI hereunder.

Formalities

22. Any notice shall be deemed to have been given to any party five days after posting in domestic mail addressed to the address given above or one day after actual delivery at such address.

23. No failure to act by either party hereunder shall be deemed to be a waiver of any right hereunder.

24. This Agreement may be amended or any term or condition waived only in writing executed by persons duly authorised.

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* In any country with an Islamic Arbitration Counsel.

25. This Agreement has been executed in two original counterparts and each page of each Exhibit has been initialed for identification.

MFI:	The Client:
MASSRAF FAYSAL AL-ISLAMI OF X COUNTRY
By : ____________________	By : ____________________
By : ____________________	By : ____________________
Duly authorised	Duly authorised
____________________	____________________
____________________	____________________
Printed Names of Signatories	Printed name(s) of signatory(ies)

DATED

DEED OF SALE

MURABAHA

The Seller described below does hereby transfer all title and interest to the Goods described in the Murahaba Contract of Sale dated ________ 19 __ between the Buyer and the Seller described below and together with an executed copy of this Deed of Sale the Buyer does hereby deliver to the Seller the Goods or documents representing title to the Goods all as described in such Murahaba Contract of Sale.

Obligations of the Buyer and the Seller with respect to the Goods and the purchase price thereof shall be as set forth in the Murahaba Contract of Sale.

Dated:

Buyer	Seller
Name and address of Buyer	Name and address Massraf Faysal Al-Islami of X Country
________________________ Signature	________________________ Signature

B.4 Lease Contract

IN THE NAME OF ALLAH, THE MERCIFUL AND THE COMPASSIONATE

Massraf Faysal Al Islami of X Country
Address

Re : Lease Financing (Ijara)

Gentlemen :

May the peace, blessing and mercy of Allah be upon you.

I/we/(the "Client") understand that you wish to employ your assets for profitable investment in strict accordance with Islamic law. The Client wishes to obtain such financing from you for purposes consistent with Islamic law.

The Client acknowledges that the Client has received and read your Information Booklet entitled "Islamic Financing with Basic Forms". In this connection, the Client applies to you to procure from third parties certain goods (the "Goods") to be leased to the Client with a profit to you (Ijara). The Client proposes to use those goods for certain commercial purposes (the "Project"). The Client estimates the cost of the Goods at approximately ____________________. The term of the lease would be _________.

The Client acknowledges that the Client has carefully examined the chapter of such Information Booklet entitled "Lease Financing (Ijara)" and the Basic Forms appearing in that Chapter and accepts such forms in principle subject to minor amendments to be negotiated between the parties.

For your information and to induce you to participate in the financing of the Project the Client encloses with this letter copies of the following which have been prepared in accordance with the instructions contained in the Information Booklet and which the Client represents to be true and correct:

1. A description of the Goods.

2. A completed Client Information Form.

3. A completed Project Information Form.

4. Balance Sheets and Statements of Profit and Loss of the Client for the last three fiscal years.

5. A Cash Flow Projection for the Proposal.

Items 1-5 above have been prepared by the Client on the basis of forms supplied by you in accordance with the instructions given in the Informational Booklet. The Client encloses with this letter the Client's cheque to your order in the amount of ___________ in conformity with your fee schedule for your services and expenses in reviewing this application. The Client understands that this fee will be refunded in the event that the Islamic Financing contemplated by this application is effected.

The Client hopes that you will be able to consider this application and the annexes expeditiously and remains at your disposition to supply further information as required. The Client understands that you will use your best efforts to inform the Client of your decision in principle within 30 days of receipt of this letter and in the event that such decision is favourable, the Client will promptly proceed to the execution of the definitive contract in a form substantially conforming to the text contained in the Information Booklet. The Client acknowledges that all your obligations are subject to execution of the definitive contract.

Trusting that Allah will reward our mutual efforts when those are consistent with His Word, we remain,

Very truly yours

FinancngFrm3
DMI/BF/850

February 9, 1982

IN THE NAME OF ALLAH, THE MERCIFUL, THE COMPASSIONATE

FINANCING BY RENTAL OF GOODS
IJARA

Agreement between Dar Al-Maal Al-Islami of X-Country with its registered office at ("MFI") and (the "Client").

1. Client Information

The Client has furnished to MFI the information concerning the Client disclosed on the Client Information Form annexed as Exhibit A. The Client represents that such information is true and correct and has been prepared in accordance with the Information Booklet "Islamic Financing - Basic Forms" a copy of which has been signed for identification by the Client (the "Information Booklet").

2. Description of Goods

The Client has furnished to MFI the description and specifications concerning the goods which the Client wishes MFI to acquire for lease to the Client (the "Goods") including the names of manufacturers or other suppliers approved by the Client and the location at which the Client will accept delivery of the goods together with date of delivery. The foregoing has led to the preparation of a contract (the "Supply Contract") annexed hereto as Exhibit B between MFI and one of such approved manufactures or suppliers (the "Supplier") which contract is approved by the Client.

3. Project Information

The Client has furnished to MFI a description of the contemplated commercial utilisation of the Goods (the "Project") in the Project

Information Form annexed as Exhibit C. The Client shall utilise the Goods only in accordance with the information disclosed in the Project Information Form.

4. Client Financial Statements

To demonstrate the Client's prior commercial experience and the ability of the Client to fulfill obligations hereunder the Client has delivered to MFI a copy of the audited balance sheet of the Client for the last three fiscal years of the Client and a statement of profit and loss for each of such 12 month periods. The foregoing are attached as Exhibit D. The Client represents to MFI that such balance sheets accurately reflect the financial position of the Client at the years then ended and such statements accurately reflect the results of operations for such 12 month periods. So long as any part of the rental for the Goods shall be unpaid, the Client shall maintain a net worth equal to not less than % of such unpaid part.

5. Project Cash Flow Projection

The Client has prepared the Cash Flow Projection for the Project annexed as Exhibit E in accordance with the instructions of the Information Booklet and represents to MFI that the Cash Flow Projection incorporates or discloses all factors known to the Client or which in the exercise of reasonable prudence and diligence should have been known to the Client and represents to MFI that such Cash Flow Projection is generally prepared with due commercial diligence.

6. Agreement of Rental

The Client promises to accept the Goods and MFI promises to deliver the goods to the Client for rental upon the delivery of the Goods to the point of destination specified in the Supply Contract. Risk of loss with respect to the Goods shall pass to the Client when risk of loss passes from the Supplier pursuant to the terms of the Supply Contract.

7. Rent

The annual rental payable with respect to the Goods shall be as established on the rent list annexed hereto as Exhibit F and the annual rental shall begin to accrue when the Client receives notice of delivery of the goods to the point of destination named in the Supply Contract accompanied by any negotiable or other documents of title specified in the Supply Contract.

8. Term of Agreement

The term of this rental agreement shall be ____________ commencing from the date on which rent shall begin to accrue pursuant to Paragraph 7.

9. Date of Rental Payment

The Client shall pay as advance rent ______ on the date of signature of this agreement and ______ on the day the term of this rental agreement commences. The balance shall be payable as described Exhibit G.

10. Optional Purchase

On written notice given by the Client not less than 30 days prior to any date on which rent is payable pursuant to Exhibit G, the Client may elect to purchase the Goods (in entirety) on the rental payment date specified. In the event of such notice, the Client shall pay the Purchase Price (plus any sales or transfer taxes) to MFI (together with rent due on that date) specified in Exhibit H. On such payment title to the Goods shall vest in the Client and this Agreement shall terminate.

11. Default by Supplier

Non-performance by the Supplier of any of its obligations under the Supply Contract shall excuse MFI from performance of its obligations hereunder.

12. Waiver of Warranty

As the Client has approved the specifications of the Goods and the identity of the Supplier in the Supply Contract, it is expressly agreed between the Client and MFI that the Goods are rented by MFI WITHOUT WARRANTY of condition or quality of any nature, made by MFI and that the Client in any question relating to the condition or quality of the goods shall look only to the Supplier under the terms of the warranties of the Supply Contract. MFI shall reasonably assist the Client in any claim against the Supplier.

Client's Obligation to Pay

13. The terms of Paragraph 6 hereof notwithstanding, MFI may refuse to deliver the Goods except against immediate payment of all amounts specified on Exhibit H and the amount specified in Paragraph 9 as due on that date, in the event that MFI has the right to accelerate the due date for rental payments pursuant to Paragraph 14 of the Agreement. If the Client shall fail to pay against delivery, MFI may require the Client to pay damages. Damages shall be the excess, if any, of the sum of such amounts and amount over the then market value of the goods.

14. As Islamic finance requires mutual trust, in the event that the Client shall be in default in any obligation to MFI to pay a sum of money on the date due under this agreement or under any other contract or agreement between the MFI and Client, MFI may by notice to the Client declare all sums due under this contract immediately due and payable

15. In the event the Client shall fail to pay when due under this Agreement any sum, MFI shall be entitled to actual costs of collection, including attorneys fees borne by MFI.

16. Guaranties

As security for the due and prompt performance of all the obligations of the Client hereunder, the Client shall furnish to MFI the additional guaranties or collateral described in Exhibit I hereto and MFI will not be obligated to furnish the Goods pursuant to this Agreement until executed completed documentation in form and substance satisfactory to MFI has been delivered to effectuate the transactions described on Exhibit I.

17. Absence of Liens; Sign

For so long as any rent obligation with respect to the Goods under this Agreement shall be outstanding, the Client shall not permit any liens or incumbrances to be outstanding on the Goods, the assets of the Client other than those listed on Exhibit I or others, to secure any obligation in favour of MFI or others, except as listed on Exhibit J hereto.

The Client shall affix a notice of MFI's interest in the Goods to the Goods as specified in Exhibit K.

18. Financial Reports

Within 30 days of the close of each calendar quarter, the Client shall submit to MFI the following in form and substance satisfactory to MFI:

(a) A Cash Flow statement of the Project prepared in conformity with the principles employed in Exhibit E hereto with a clear explanation of each variation from the Cash Flow Projection included in Exhibit E;

(b) A balance sheet and income statement of the Client, which annual balance sheet and income statement shall be audited by an independant firm of accountants approved by MFI and prepared according to accounting principles consistent with those used in the preparation of Exhibit D.

Maintenance of Goods; Risk of Loss

19. The Client shall maintain the Goods in good working order, reasonable wear and tear excepted. The Client assumes the risk of loss, damage or destruction of the Goods. The Client shall use the Goods only in the manner for which the Goods were intended and in accordance with Exhibit C.

20. In the event of loss, material damage or destruction of the Goods, the Client shall reimburse MFI for the Goods within 10 days by paying to MFI all rent accrued but unpaid to date of payment plus the Optional Purchase Price appearing on Exhibit H as applicable to

the rent payment date next following date of payment. The Goods shall be guaranteed against loss, material damage or destruction by a contract of Islamic Solidarity (or if that is unavailable, insurance) secured by the Client at the Client's expense naming MFI as beneficiary and in form and substance satisfactory to MFI.

Possession of Goods

21. In the event that Client shall fail to pay when due any amount provided for by this Agreement or breach any other provision of this Agreement, MFI shall be entitled to repossess the Goods and terminate this Agreement and recover from the Client rent accrued but unpaid at the rental payment date next following repossession, plus the excess, if any, of the Optional Purchase Price of the Goods specified in Exhibit H on that on that rental payment date over the market value of the Goods.

22. The Client shall return the Goods to MFI at the address given above at the Client's own expense on the Termination of this Agreement.

23. If at any time the Goods shall be in the possession of control of MFI following the breach of this Agreement by the Client, MFI on 10 days' notice to the Client shall be entitled to sell the Goods by public or private sale. The proceeds of sale shall be conclusive evidence of the market value of the Goods.

Access to Information

24. At any time the Client shall supply to MFI any information, material or documents relating to the Project or the financial status of the Client reasonably requested by MFI and the Client will grant access to MFI or accountants or agents appointed by MFI to all books and records relating to the Project or relating to the financial status of the Client. The Client shall maintain true and correct books of account relating to the Project and its financial status together with all underlying invoices, records, contracts and all other material documentation at unless MFI shall in writing authorise such to be kept at another address.

Disputes*

25. In the event of any dispute between the parties regarding this Agreement or the execution of this Agreement that is not amicably resolved, then the dispute shall be submitted to Arbitration in accordance with the rules of the   . Each party shall name on arbitrator and the two so named can nominate a third. If they fail to so nominate a third, such third shall be nominated by the Religious Supervisory Board of Dar Al-Maal Al-Islami, the direct or indirect parent of MFI. Any issue not settled by the text of this Agreement or any ambiguity in the text of this Agreement shall be determined or construed in accordance with Islamic law as set forth in the Glorious Shari'a.

26. Set Off

MFI may set-off the balances of any account maintained by the Client at MFI or any other obligation of MFI to the Client against any obligation of the Client to MFI hereunder.

Formalities

27. Any notice shall be deemed to have been given to any party five days after posting in domestic mail addressed to the address given above or one day after actual delivery at such address.

28. No failure to act by either party hereunder shall be deemed to be a waiver of any right hereunder.

29. This Agreement may be amended or any term or condition waived only in writing executed by persons duly authorised.

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* In any country with an Islamic Arbitration Counsel.

30. This Agreement has been executed in two original counterparts and each page of each Exhibit has been initialed for identification.

MFI:	The Client:
MASSRAF FAYSAL AL-ISLAMI OF X COUNTRY	
By :____________________	By :____________________
By :____________________	By :____________________
Duly authorised	Duly authorised
____________________	____________________
____________________	____________________
Printed Names of Signatories	Printed name(s) of signatory(ies

DATED

MURABAHA/DMI/BF/850/EB

B.5 Lease-Purchase Contract

IN THE NAME OF ALLAH, THE MERCIFUL AND THE COMPASSIONATE

Massraf Faysal Al Islami of X Country
Address

Re : Lease Purchase Financing (Ijara Wa Iktina)

Gentlemen :

May the peace, blessing and mercy of Allah be upon you.

I/we/(the "Client") understand that you wish to employ your assets for profitable investment in strict accordance with Islamic law. The Client wishes to obtain such financing from you for purposes consistent with Islamic law.

The Client acknowledges that the Client has received and read your Information Booklet entitled "Islamic Financing with Basic Forms". In this connection, the Client applies to you to procure from third parties certain goods (the "Goods") to be leased to the Client by you until purchase of the Goods by the Client (Ijara Wa Iktina).The Client proposes to use the Goods for certain commercial purposes (the "Project"). The Client estimates the cost of the Goods at approximately ____________________. The term of the lease would be _________.

The Client acknowledges that the Client has carefully examined the chapter of such Information Booklet entitled "Lease Purchase Financing (Ijara Wa Iktina)" and the Basic Forms appearing in that Chapter and accepts such forms in principle subject to minor amendments to be negotiated between the parties.

For your information and to induce you to participate in the financing of the Project the Client encloses with this letter copies of the following which have been prepared in accordance with the instructions contained in the Information Booklet and which the Client represents to be true and correct:

1. A description of the Goods.

2. A completed Client Information Form.

3. A completed Project Information Form.

4. Balance Sheets and Statements of Profit and Loss of the Client for the last three fiscal years.

5. A Cash Flow Projection for the Project.

Items 1-5 above have been prepared by the Client on the basis of forms supplied by you in accordance with the instructions given in the Informational Booklet. The Client encloses with this letter the Client's cheque to your order in the amount of __________ in conformity with your standard fee schedule for your services and expenses in reviewing this application. The Client understands that this fee will be refunded in the event that the Islamic Financing contemplated by this application is effected.

The Client hopes that you will be able to consider this application and the annexes expeditiously and remains at your disposition to supply further information as required. The Client understands that you will use your best efforts to inform the Client of your decision in principle within 30 days of receipt of this letter and in the event that such decision is favourable, the Client will promptly proceed to the execution of the definitive contract in a form substantially conforming to the text contained in the Information Booklet. The Client acknowledges that all your obligations are subject to execution of the definitive contract.

Trusting that Allah will reward our mutual efforts when those are consistent with His Word, we remain,

Very truly yours

FinancngFrm5
DMI/BF/850

February 9, 1982

IN THE NAME OF ALLAH, THE MERCIFUL, THE COMPASSIONATE

FINANCING BY RENTAL OF GOODS
IJARA WA IKTINA

Agreement between Dar Al-Maal Al-Islami of X-Country with its registered office at ("MFI") and (the "Client").

1. Client Information

The Client has furnished to MFI the information concerning the Client disclosed on the Client Information Form annexed as Exhibit A. The Client represents that such information is true and correct and has been prepared in accordance with the Information Booklet "Islamic Financing - Basic Forms" a copy of which has been signed for identification by the Client (the "Information Booklet").

2. Description of Goods

The Client has furnished to MFI the description and specifications concerning the goods which the Client wishes MFI to acquire for lease to the Client (the "Goods") including the names of manufacturers or other suppliers approved by the Client and the location at which the Client will accept delivery of the goods together with date of delivery. The foregoing has led to the preparation of a contract (the "Supply Contract") annexed hereto as Exhibit B between MFI and one of such approved manufacturers or suppliers (the "Supplier") which contract is approved by the Client.

3. Project Information

The Client has furnished to MFI a description of the contemplated commercial utilisation of the Goods (the "Project") in the Project

Information Form annexed as Exhibit C. The Client shall utilise the Goods only in accordance with the information disclosed in the Project Information Form.

4. Client Financial Statements

To demonstrate the Client's prior commercial exnerience and the ability of the Client to fulfill obligations hereunder the Client has delivered to MFI a copy of the audited balance sheet of the Client for the last three fiscal years of the Client and a statement of profit and loss for each of such 12 month periods. The foregoing are attached as Exhibit D. The Client represents to MFI that such balance sheets accurately reflect the financial position of the Client at the years then ended and such statements accurately reflect the results of operations for such 12 month periods. So long as any part of the rental for the Goods shall be unpaid, the Client shall maintain a net worth equal to not less than % of such unpaid part.

5. Project Cash Flow Projection

The Client has prepared the Cash Flow Projection for the Project annexed as Exhibit E in accordance with the instructions of the Information Booklet and represents to MFI that the Cash Flow Projection incorporates or discloses all factors known to the Client or which in the exercise of reasonable prudence and diligence should have been known to the Client and represents to MFI that such Cash Flow Projection is generally prepared with due commercial diligence.

6. Agreement of Rental

The Client promises to accept the Goods and MFI promises to deliver the goods to the Client for rental upon the delivery of the Goods to the point of destination specified in the Supply Contract. Risk of loss with respect to the Goods shall pass to the Client when risk of loss passes from the Supplier pursuant to the terms of the Supply Contract.

7. Rent

The annual rental payable with respect to the Goods shall be as established on the rent list annexed hereto as Exhibit F and the annual rental shall begin to accrue when the Client receives notice of delivery of the goods to the point of destination named in the Supply Contract accompanied by any negotiable or other documents of title specified in the Supply Contract.

8. Term of Agreement

The term of this rental agreement shall be ____________ commencing from the date on which rent shall begin to accrue pursuant to Paragraph 7.

9. Date of Rental Payment

The Client shall pay as advance rent ______ on the date of signature of this agreement and ______ on the day the term of this rental agreement commences. The balance shall be payable as described Exhibit G.

10. Optional Purchase Right

On written notice given by the Client not less than 30 days prior to any date on which rent is payable pursuant to Exhibit G, the Client may elect to purchase the Goods (in entirety) on the rental payment date specified. In the event of such notice, the Client shall pay the

Optional Purchase Price (plus any sales a transfer taxes) to MFI (together with rent due on that date) specified Exhibit A. On such payment, title to the Goods shall vest in the client and this Agreement shall terminate.

11. Mandatory Purchase

The Client shall pay in addition to the rent specified in Paragraph 7 of this Agreement, on the dates specified in Exhibit I hereto the amounts specified in Exhibit I to Islamic Participation Account ______ (the "Account") maintained for the profit and risk of the Client until on any rent payment date specified in Exhibit G the value of the Account equals or exceeds the Optional Purchase Price (plus any sales or transfer taxes) on such date specified in Exhibit H. On such date, title to the Goods shall vest in the client and this Agreement shall terminate. MFI shall debit on that date to such Account the amount of the Optional Purchase Price (plus any sales or transfer taxes). The balance of the Account shall be at the full disposition of the Client. Until such a date, the Account shall be blocked in favour of MFI to secure the Client's obligations hereunder. If the Client shall exercise the Optional Purchase Right described in Paragraph 10 prior to such date, the value of the Account shall be applied to the Optional Purchase Price specified in Paragraph 10.

12. Default by Supplier

Non-performance by the Supplier of any of its obligations under the Supply Contract shall excuse MFI from performance of its obligations hereunder.

13. Waiver of Warranty

As the Client has approved the specifications of the Goods and the identity of the Supplier in the Supply Contract, it is expressly agreed between the Client and MFI that the Goods are rented by MFI WITHOUT WARRANTY of condition or quality of any nature, made by MFI and that the Client in any question relating to the condition or quality of the goods shall look only to the Supplier under the terms of the warranties of the Supply Contract. MFI shall reasonably assist the Client in any claim against the Supplier.

Client's Obligation to Pay

14. The terms of Paragraph 6 hereof notwithstanding, MFI may refuse to deliver the Goods except against immediate payment of all amounts specified in Exhibit G and the amount specified in paragraph 10 as due on that date in the event that MFI has the right to accelerate the due date for rental payments pursuant to Paragraph 15 of this Agreement. If the Client shall fail to pay against delivery, MFI may require the Client to pay damages. Damages shall be the excess, if any, of the sum of such amounts and amount over the market value of the Goods.

15. In the event that the Client shall be in default in any obligation to MFI to pay a sum of money on the date due under this agreement or under any other contract or agreements between the MFI and Client, MFI may by notice to the Client declare all sums due under this contract immediately due and payable.

16. In the event the Client shall fail to pay when due under this Agreement any sum, MFI shall be entitled to actual costs of collection, including attorneys fees borne by MFI.

17. Guaranties

As security for the due and prompt performance of all the obligations of the Client hereunder, the Client shall furnish to MFI the additional guaranties or collateral described in Exhibit J hereto and MFI will not be obligated to furnish the Goods pursuant to this Agreement until executed completed documentation in form and substance satisfactory to MFI has been delivered to effectuate the transactions described on Exhibit J.

18. Absence of Liens; Sign

For so long as any rent obligation with respect to the Goods under this Agreement shall be outstanding, the Client shall not permit any liens or incumbrances to be outstanding on the Goods, the assets of the Client other than those listed on Exhibit J or others, to secure any obligation in favour of MFI or others except as listed on Exhibit K hereto.

The Client shall affix a notice of MFI's interest in the Goods to the Goods as specified in Exhibit L.

Financial Reports

19. Within 30 days of the close of each calendar quarter, the Client shall submit to MFI the following in form and substance satisfactory to MFI:

(a) A Cash Flow statement of the Project prepared in conformity with the principles employed in Exhibit E hereto with a clear explanation of each variation from the Cash Flow Projection included in Exhibit E;

(b) A balance sheet and income statement of the Client, which annual balance sheet and income statement shall be audited by an independant firm of accountants approved by MFI and prepared according to accounting principles consistent with those used in the preparation of Exhibit D.

Maintenance of Goods; Risk of Loss

20. The Client shall maintain the Goods in good working order, reasonable wear and tear excepted. The Client assumes the risk of loss, damage or destruction of the Goods. The Client shall use the Goods only in the manner for which the Goods were intended and in accordance with Exhibit C.

21. In the event of loss, material damage or destruction of the Goods, the Client shall reimburse MFI for the market value of the Goods within 10 days by paying to MFI all rent accrued but unpaid to the date of payment plus the Optional Purchase Price appearing on

Exhibit H as applicable to the rent payment date next following date of payment. On date of payment, the value of the Account will be applied against the Client's payment obligation. The Goods shall be guaranteed against loss, material damage or destruction by a contract of Islamic Solidarity (or if that is unattainable, insurance) secured by the Client at the Client's expense naming MFI as beneficiary and in form and substance satisfactory to MFI.

Possession of Goods

22. In the event that Client shall fail to pay when due any amount provided for by this Agreement or breach any other provision of this Agreement, MFI shall be entitled to repossess the Goods and terminate this Agreement and recover from the Client rent accrued but unpaid at the rental payment date next following repossession, plus the excess, if any, of the Optional Purchase Price of the Goods specified in Exhibit H on that rental payment date over the market value of the Goods. The Value of the Account shall be applied against any recovery and any excess paid to the Client.

23. The Client shall return the Goods to MFI at the address given above at the Client's own expense on the Termination of this Agreement.

24. At any time the Goods (or any part therof) shall be in the possession or control of MFI following the breach of this Agreement by the Client, MFI on 10 days notice to the Client shall be entitled to sell the Goods by public or private sale. The proceeds of sale shall be conclusive evidence of the market value of the Goods.

Access to Information

25. At any time the Client shall supply to MFI any information, material or documents relating to the Project or the financial status of the Client reasonably requested by MFI and the Client will grant access to MFI or accountants or agents appointed by MFI to all books and records relating to the Project or relating to the financial status of

the Client. The Client shall maintain true and correct books of account relating to the Projects and its financial status together with all underlying invoices, records, contracts and all other material documentation at unless MFI shall in writing authorise such to be kept at another address.

Disputes[°]

26. In the event of any dispute between the parties regarding this Agreement or the execution of this Agreement that is not amicably resolved, then the dispute shall be submitted to Arbitration in accordance with the rules of the . Each party shall name one arbitrator and the two so named shall nominate a third. If they fail to so nominate a third, such third shall be nominated by the Religious Supervisory Board of Dar Al-Maal Al-Islami, the direct or indirect parent of MFI. Any issue not settled by the text of this Agreement or any ambiguity in the text of this Agreement shall be determined or construed in accordance with Islamic law as set forth in the Glorious Shari'a.

27. Set Off

MFI may set-off the balances of any account maintained by the Client at MFI or any other obligation of MFI to the Client against any obligation of the Client to MFI hereunder.

Formalities

28. Any notice shall be deemed to have been given to any party five days after posting in domestic mail addressed to the address given above or one day after actual delivery at such address.

29. No failure to act by either party hereunder shall be deemed to be a waiver of any right hereunder.

30. This Agreement may be amended or any term or condition waived only in writing executed by persons duly authorised.

[°] In any country with an Islamic Arbitration Counsel.

31. This Agreement has been executed in two original counterparts and each page of each Exhibit has been initialed for identification.

MFI:

MASSRAF FAYSAL AL-ISLAMI
OF X COUNTRY

By : ____________________

By : ____________________

Duly authorised

____

____

Printed Names of Signatories

The Client:

By : ____________________

By : ____________________

Duly authorised

____

____

Printed name(s) of signatory(ies)

DATED

JARAwaIKTINA/DMI/BF/850/EB

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