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Establishment

The Islamic Research and Training Institute (IRTI) was established by the Board of Executive Directors (BED) of the Islamic Development Bank (IDB) in conformity with paragraph (a) of the Resolution No. BG/14-99 of the Board of Governors adopted at its Third Annual Meeting held on 10th Rabi-ul-Thani, 1399H corresponding to 14th March, 1979. The Institute became operational in 1403H corresponding to 1983. The Statute of the IRTI was modified in accordance with the resolutions of the IDB BED No.247 held on 27/08/1428H.

Purpose

The Institute undertakes research for enabling the economic, financial and banking activities in Muslim countries to conform to Shariah, and to extend training facilities for personnel engaged in development activities in the Bank’s member countries.

Functions

The functions of the institute are to:

A. Develop dynamic and innovative Islamic Financial Services Industry (IFSI).
B. Develop and coordinate basic and applied research for the application of Shariah in economics, banking and finance.
C. Conduct policy dialogue with member countries.
D. Provide advisory services in Islamic economics, banking and finance.
E. Disseminate IFSI related knowledge through conference, seminars, workshops, apprenticeships, and policy & research papers.
F. Provide learning and training opportunities for personnel engaged in socio-economic development activities in member countries.
G. Collect and systematize information and disseminate knowledge.
H. Collaborate to provide policy advice and advisory services on the development and stability of Islamic Finance and on the role of Islamic institutions in economic development to member government, private sector and the NGO sector.
I. Develop partnership with research and academic institutions at OIC and international levels.

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Headquarters

The Institute is located at the headquarters of the Islamic Development Bank in Jeddah, Saudi Arabia.

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Tradable Inventory Certificates
A Proposed New Liquidity Instrument

MONZER KAHF
MAHAH MUJEEB KHAN

Abstract

The paper proposes inventory certificates, a new Islamic financial instrument based on inventory of big corporations to be financed and owned by investors. This instrument uses murābaḥah as the underlying contract and accommodates collateral and guaranteed return. It may be issued for short to medium terms. It has a potential important contribution to solving the problems of working capital finance faced by Islamic business institutions in general and liquidity management of Islamic banks in particular. It will also address the dearth of short term investment tools in the Islamic financial markets, providing an instrument which characterized of having stable and low risk returns.

Keywords: Central Banking Product, Short Term Financial Product.
JEL Classification: G120, G310.
KAUJIE Classification: K1, K13.

1. Introduction

One of the basic principles of Islamic financial system is the entitlement to profit which comes with acquiring ownership of an asset. Based on this principle, a few financial products have been designed which are now commonly issued and traded in Islamic financial markets such as a variety of sukūk based on ījārah, muḍārabah,
etc. The most significant factor distinguishing these securities from non-Sharīʿah-compliant securities, such as bonds, is the nature of asset which is represented by these securities. Sharīʿah-compliant securities represent ownership in real utility-generating assets, goods or usufructs not merely debts.

After the global financial crisis of 2008, liquidity management has become the single most important area for banks (Ernst & Young 2010 (in Ali)) as well as for regulators; Basel Committee on Banking Supervision has extensively addressed the issue in the Third Basel Accord (Basel III). Islamic banks are also in pressing need of efficient and Sharīʿah-compliant liquidity management tools as their profiles have moved towards fewer liquid assets and greater maturity gaps. Unlike conventional banks, interbank market for Islamic banks is not well developed, so this avenue is rarely used for obtaining liquidity by Islamic banks. Commodity murābaḥah or tawwaruq has emerged as the most commonly used tool for liquidity management in Islamic banks. However, the OIC Fiqh Academy, in its 2009 resolution, ruled tawwaruq to be non-Sharīʿah-compliant. This ruling presents a challenge for creating Sharīʿah-compliant tools that can fulfill financing needs of individuals and liquidity management needs of business corporations and financial institutions in general, and Islamic banks in particular. The Islamic capital market is still eager to see more securities with variant risk profiles in order to respond to the tremendous needs of Islamic banks for more genuine tools to replace the artificiality of tawarruq. These liquidity tools would not only help Islamic banks but also business corporations to fulfill short term financing needs.

The present paper also uses the principle of ownership in assets, along with a combination of Sharīʿah-permissible contracts to propose a structure for tradable inventory certificates. This paper discusses the definition of these certificates and their ability to generate stable returns, followed by some key features a company issuing these certificates should possess. Then the operational mechanism of the certificates is explained with examples using a hypothetical model for profit calculation and distribution followed by a discussion regarding the Sharīʿah-permissibility and tradability of these certificates. Finally a brief discussion regarding risks associated with these certificates and recommendations for expanding the use of these certificates conclude the paper.
2. Tradable Inventory Certificates

2.1. Definition

The proposed certificates may be defined as “certificates of equal value representing ownership of equal shares or percentages of a list of inventory items stored in a warehouse with commitment by the company to gradually buy them, as needed, on murābaḥah basis and with wakālah-based arrangement to replenish at cost and to distribute profit periodically” (Kahf 456).

The basic mechanism of these certificates is derived from this definition. They represent ownership of the underlying assets, i.e., as these certificates represent inventory, the holder will be owner of the inventory items. Each of these standardized certificates will represent equal share of the underlying inventory. The holders of the certificates will authorize, by way of a wakālah agreement, the company (whose inventory is financed by the certificates) to sell the inventory to itself on murābaḥah basis and to replenish the inventory as well by purchasing new items from suppliers until the end of the term of the certificates.

2.2. Advantages

The certificates not only provide an alternative financial approach that uses short term financing to purchase inventory but also provide an attractive investment for investors looking for low risk securities with stable returns. This stability is due to transfer of ownership of inventory from the certificate holders to the company by way of murābaḥah sale. Murābaḥah sale is a sale at a specified profit margin above the declared cost. However, it is used in contemporary Islamic finance jargon for a sale in which goods desired, selected and ordered for purchase by the buyer are bought by an intermediary financial institution from the seller and sold at a pre-agreed markup on a deferred payment basis. The deferred payment may be made in installments or as a lump sum amount. (Iqbal, Mirakhor 17).

Being based on murābaḥah, the certificates have several advantages. First, unlike partnership contracts such as mushārakah or muḍārabah, the underlying contract is sale-based and therefore it offers the certificate holders a guaranteed and pre-known return. Second, in addition to a fixed rate of return, the certificates have the ability to provide variable-at-interval fixed return. Sharīʿah requires the mark-up of a murābaḥah contract to be fixed at the time of sale so in cases which involve a single sale transaction, the return or mark-up cannot be changed. Since the operational mechanism of the certificates involves a series of sales over an extended period of
time, the return can be changed at the beginning of each new time-interval to offer a fixed return for all new Murābaḥah sales concluded during that interval. At the beginning of each new interval a new mark-up rate is set based on a pre-agreed formula. This can then make the return on investment consistent with current market return and reflective of current market conditions. The intervals can be fixed as quarters, months or weeks depending on the certificate’s terms as set in the prospectus.

Murābaḥah contract exposes both the buyer and seller to benchmark rate risk, i.e., while the mark-up rate is fixed at the beginning of sale contract, market rates may change exposing either party to opportunity risk. The ability to vary returns at short intervals, gives corporations the flexibility to issue financing instruments which match their financing strategies.

Similarly, the proposed certificates offer investors return features matching the market return while their preferences for secured principal and a minimum guaranteed return can be satisfied because the certificates represent insurable assets committed to be sold at a minimum guaranteed mark up through murābaḥah contracts which, by definition accommodate adequate securities, guarantees and collaterals. Furthermore, a clause is inserted in the prospectus requiring the sale of a minimum number of inventory items to the dealership at specified intervals, irrespective of the sales to customers by the dealership, will ensure a minimum stable return and pay off to the certificates holders.

These proposed certificates are not exclusively a banking product and the issuing mechanism is such that they can be issued without any involvement by an Islamic bank. However, they can play an instrumental role in solving several of the contemporary problems faced by Islamic banks. They can help in solving Islamic banks’ liquidity management problems which arise due to a dearth of Islamic money market instruments. The negotiability feature particularly provides Islamic banks additional flexibility in liquidity management. These certificates can also be used as short term investment tools. Very few central banks provide Sharīʿah-compliant overnight financing facilities. This puts Islamic banks at a disadvantage relative to conventional banks. The certificates can be designed on short intervals to reflect changes in market rate of return and used for providing a short-term liquid and secured facility to Islamic banks.
2.3. Prerequisites for Efficient Functioning

For these tradable certificates to work efficiently, for both the investor and the company that needs financing, the company’s business cycle and its inventory must possess some key features. First, the company’s business should involve tangible assets since each certificate represents ownership of a percentage of actual physical assets whose physical existence should be traceable. Second, the company should have a good inventory management system with history demonstrating that inventory does not pile up. Third, the business should have a stable and predictable cash conversion cycle so that it has a business cash flow that warrants scheduled payments to certificates’ holders. Fourth, the amount of financing required should be large enough to warrant issuance, i.e., the costs and efforts associated with issuing the certificates should be outweighed by the benefits of such financing to the company. This method of finance from the public may be used by both private sector and public sector corporations for financing their inventories.

3. Proposed Model

To delineate the proposed model, we will express it as a mechanism for using these tradable certificates by a hypothetical car dealership. The dealership sells imported cars and their parts, therefore these certificates can be used to finance the imported inventory. In this case, an Islamic Bank acting as underwriter, issues certificates and collects funds from investors. A trustee for the certificate holders will act as an intermediary between the bank and the certificate holders and will represent them for matters related to defending their interests.

3.1. Mechanism

The basic mechanism of these certificates can be divided into five steps:

i. Flow of proceeds to finance the import of inventory.
ii. Withdrawal of inventory by the dealer on murābaḥah basis from warehouse
iii. Replenishment of inventory.
iv. Distribution of profit to the certificate holders.
v. Amortization of certificates or capital return to holders.
3.1.1. Step 1: Flow of proceeds to finance the import of inventory

Since the purpose of the certificates is to finance the purchase of inventory for the car dealership, the Islamic Bank acting as an underwriter will issue certificates on behalf of the dealership which will represent equal ownership shares in the cars and parts to be purchased and held in the warehouse of the dealership.

The prospectus shall contain all the conditions and rights and obligations for the different parties involved. It will lay down the details of rate of return; what the rate will be and whether it will be fixed or variable at intervals. The mechanism involves repetitive sale contracts of quantities from the inventory executed by the car dealership to itself on behalf of the investors, being appointed as their wakīl for selling to itself and also for replenishing from suppliers. The prospectus must clearly state the terms and conditions of such a wakālah contract so that the rights of investors are protected. If the investors are not protected from the conflict of interest which may arise in such an arrangement, it may lead to Sharīʿah issues. Since the investors own the inventory, the contractual relationship with the car dealership should be clear and specific about inventory takāful insurance, all conditions of the sale contracts as well as the repurchase from suppliers for inventory replenishment. The authority of the wakīl must be made sufficiently clear to ensure avoidance of any conflict of interests and to protect the investors in case of abuse, loss or damage to inventory or infringement on investors’ rights. The prospectus will also contain commitment by the dealership to purchase the inventory at the specified markup as well as other conditions which guarantee the sale price that includes principal and return as practiced in regular murābahah to the purchase orderer.

Whether the murābahah rate of profit will be fixed or floating will also be specified within the prospectus. In case the rate is to be variable at specified intervals, the basis of its determination will be contractually set within the prospectus. For example, if the rate is to be fixed at LIBOR+2% at the beginning of each month or quarter, then these details will be specified within the agreement.

As usual, the trustee will collect funds from the certificate holders and will, in turn, deliver the certificates issued by the Islamic Bank on behalf of the car dealership to the investors making them the certificate holders. Using these proceeds to pay for the desired inventory, the supplier will deliver the required inventory, according to the dealership’s specifications and determination of items and quantities. The inventory will then be deposited in the obligor’s (dealer’s) warehouse as a trusted agent (wakīl). At the end of this step, the certificate holders will be owners of the purchased inventory which is held in the obligor’s warehouse.
The process of issuance is summarized in the following figure:

3.1.2. Step 2: Withdrawal of inventory by the dealership on murābahah basis from warehouse

The second step will be accomplished by way of a wakālah agreement between the certificate holders and the dealership. This wakālah will be granted to the dealership by the certificate holders and will be included in the prospectus. Consequently, certificate holders will allow their agent, the dealership, on their behalf to sell to itself and withdraw a part of the inventory from the warehouse. The agent sells a portion of the inventory to itself on murābahah basis. This will result in the dealership owning the withdrawn part of inventory and being indebted to the certificate holders for the agreed amount (cost plus already declared and agreed profit). Since the dealership now owns the purchased part of the inventory, it can be sold to final customers according to market. Practically, the prospectus either defines a markup or gives a definite way of determining it such as LIBOR+2, for all items/quantities sold to the obligor. The rate of markup to be used can vary depend on the country or region in which the certificates will be issued. An Islamic index, if available and widely accepted, can also be used. The use of LIBOR in the proposed model is based on the rationale that it is already widely used in Islamic financial contracts, is an internationally recognized benchmark and no other comparable benchmark alternative is currently available.

Furthermore, as the certificates are designed to provide periodical profit distribution with or without capital amortization, the maturities of all these
murābaḥah purchases are unified and fixed as the end of the intervals of profit distribution. For instance if the profit is distributed on quarterly or monthly basis, all prices of murābaḥah purchases from the inventory shall be due for payment at the end of current quarter or current month and the mark up or profit of each such purchase is then calculated for the number of days from the day of payment of the item’s cost when bought from the supplier until the last day of current month or quarter.

3.1.3. Step 3: Replenishment of inventory

According to the terms of prospectus, which in reality is the agreement between the issuer/obligor and certificate holders as established in standard No. 17 of the AAOIFI. The holders will also authorize the dealership to purchase inventory items on their behalf to replenish the stock in the warehouse. The amount of replenishment will be based on the dealership’s sales forecast and determined according to the amortization terms of the certificates as stated in the contract (prospectus). The inventory may be replenished by the dealership by virtue of the wakālah agreement. In this case, the capital or a part of it may be retained by the dealer to purchase new inventory and only the profit is distributed to the certificate holders through their trustee. The ownership of the newly purchased inventory will remain with the certificate holders until it is sold to the dealership on murābaḥah basis. The policy for replenishing the inventory should be determined in the prospectus and may be made subject to minor adjustments to take into consideration any changes in sales forecasts and market conditions.

These steps ii and iii are summarized as follows:

![Diagram showing the transfer of sale and replenishment of inventory and flow of cash and murābaḥah sale price from the dealer to the certificate holders](image-url)
As shown in the figure above, by virtue of the *wakālah* agreement, the dealer will sell to itself inventory items stored in the warehouse through a series of *murābaḥah* contracts. These sales will be made according to a pre-agreed schedule of quantities and dates based on the dealership business plan regarding as and when inventory is required. The schedule of these *murābaḥah* sales may alternatively determine a range of quantities for each period. For instance it may set a minimum and maximum quantity to be purchased by the obligor for each week in order to give flexibility which allows accommodating market variations.

The mark up rate is already determined on the basis of, say, LIBOR plus 2% so that it can vary daily from one *murābaḥah* sale to another or it can be made fixed for a short period of time such as a week or month as may be determined in the agreement/prospectus. This is made possible because the *murābaḥah* sales are independent one from the other.

The *wakālah* agreement allowing issuer to sell the inventory as an agent of the investor to itself may raise some issues regarding conflict of interest since the obligor is both the buyer and the seller’s agent. However, if the terms of such an arrangement are clearly spelled out in the prospectus these issues can be completely mitigated.

3.1.4. Step 4: Distribution of profit to the certificate holders

The fourth step is the distribution of profit which may be done periodically on a monthly, quarterly or yearly basis, as agreed in the prospectus. As the markup is fixed for the maturity duration of each *murābaḥah* sale while it varies from one sale to another the repetition of sales during a profit period will smooth out differences in the profit and bring profit distribution closer to the current market rate. Alternatively, the markup itself may be “fixed” for a single profit distribution period. For example, if profit to certificate holders is to be paid quarterly, then the markup for this quarter may be fixed at LIBOR+2%. At the beginning of each quarter, previous day’s LIBOR+2% will be the new “fixed” markup for the quarter. So the variation in the markup appears from quarter to quarter, however, for a single payment term, the markup remains fixed. On the other hand, the markup may also be fixed for the entire duration of the certificates i.e. each sale between the dealer and the certificate holders (on *wakālah* basis) will have the same markup. In this case the only factor which will cause the profit payable to the certificate holders to vary is the number of units of inventories sold during the payment term. Quantities to be sold to the dealership are set in the prospectus but may not be equal for all intervals.
3.1.5. Step 5: Amortization of certificates or capital return to holders

Certificates may be issued with capital refund at the end of the term as a lump sum amount or amortized at periodical intervals. They may be issued for a short term of 3-9 months or for medium terms of one to five years. The details about the adopted method will be given in the prospectus. The prospectus should determine whether the certificate holders’ capital will remain invested in the inventory until the end of its term or will be returned or amortized, periodically, along with profit payments. If the capital is to be returned at maturity of certificates, the principal amount will remain with the issuer/obligor until maturity and the periodical amounts paid to holders will constitute only the mark up from murābahah sales. The principal will remain with the issuer/obligor and will be used for replenishment of inventory as per agreed terms. This will allow the obligor to have an unvarying fund to finance inventory. This is particularly useful for businesses which have steady sales throughout the year as their cash would not be tied up in purchasing inventory. It can also be used by businesses which are looking to build their own capital for inventory. In case the certificates are amortized over a period of time, the periodic return to holders will comprise of mark up on murābahah sale and a part of capital. The final payment at maturity will contain murābahah markup and any unpaid capital remainder. The issuer/obligor can enter into this type of arrangement when the financing of inventory is on a non-continuous basis. Depending on the terms of the agreement, the payment made to the certificate holders may include a portion of the capital along with the markup or only the markup may be paid while the capital remains invested in the inventory until certificates’ maturity. When the user/obligor agrees to return the capital periodically along with profit payment, any remaining unpaid capital will be returned to the certificate holders at the end of the certificates’ term.

3.2. Calculating Payable Profit

The profit payable, in all cases, will vary depending on the number of units sold since the amount will become payable only when murābahah sale contracts between the certificate holders and dealership have been concluded.

However, depending on the nature of inventory and the financed business the prospectus may include a commitment by the obligor to purchase either a definite amount or a minimum amount of inventory each period. This would essentially guarantee to the investors a definite or minimum return. Any additional units sold above the minimum amount will provide the investors additional return. This lends the certificates the feature of guaranteeing a minimum return along with variability
of return above that minimum amount. In case, the issuer’s sale forecast for a period changes post-issuance, the issuer will still be obliged to buy the specified number of units thereby providing the certificate holders a stable or pre-determined cash inflow and a guaranteed minimum return.

The amount payable to the certificate holders will have two components; the cost of items and the markup. The “cost” will be calculated by multiplying the number of units of an item sold by the purchase price of that item and summing up the costs for all the items to get the “Total Capital Recovered”

\[
\text{Total Capital Recovered} = \sum_{x=1}^{n} (\text{Purchase price of item } x_{n} \times \text{Number of units of item } x_{n} \text{ sold}) \ldots \quad (i)
\]

The total markup payable will be calculated by using “Financing Days” and “Cost” figures which are calculated as follows:

The financing days for return of capital at all quarters begin at the beginning of the year when the certificates are issued, funds collected and inventory purchased. In case of no replenishment, murābaḥah-purchased items during the first quarter are financed for 90 days (until day of payment), items purchased in the second quarter are financed for 181 days, items purchased in the third quarters are financed for 273 days and items purchased in the fourth quarters are financed for 365 days. Of course this is based on the assumption that all murābaḥah sales have same maturity which is the same as periodical payment of amortized capital plus profit, i.e., the end of each quarter in this example in order to coincide with payment and periodical redemption of capital plus profit. This inventory murābaḥah sale is unlike normal murābaḥah sale to the purchase orderer which is intended for negotiated maturity between the two parties. The reason for the difference is apparent because we already set pre-agreed dates for amortization of capital and payment of profit. Accordingly the total markup for the first quarter will be calculated as follows:

\[
\text{Total Markup}_{Q1} = \text{Total Capital Recovered} \times \text{contractual rate of Profit} \times 90/365 \quad (ii)
\]

However, if the prospectus includes variable markup, equations (i) and (ii) should be segregated such that Total Capital Recovered for all Murābaḥah sales concluded under same markup will be summed together and multiplied by the relevant rate of profit.

In case an inventory item falls below the lower limit as determined in an annex to the prospectus, the capital required to replenish these items will be taken from the
Total Capital Recovered and kept aside for payment of replenishment and the remaining amount will be the “Total Capital Payable”

\[ Total \ Capital \ Payable = Total \ Capital \ Recovered - \sum_{x=0}^{m} (Price \ item \ x_m \times No. \ of \ units \ replenished) \] \hspace{1cm} (iii)

Replenishment is like re-investment of dividends in the stock market, you start with them a new cycle of investment. This means that the calculation of profit in equation (ii) is not affected by the amount of funds used for replenishment. Accordingly, in case of replenishment, items sold out of replenished items at any quarter are financed from day of replenishment until end of the quarter when capital is paid back to investors:

Thus, the amount of quarterly payment out of replenishment consists of replenishment capital recovered plus its markup. Replenishment capital payable is equal to the cost of replenished items which are sold to the obligor on Murābahah as follows:

\[ Replenishment \ Capital \ payable = \sum_{x=1}^{n} (Number \ of \ sold \ units \ of \ item \ x_n \ replenished \times Cost \ price \ of \ x_n) \] \hspace{1cm} (iv)

The replenishment items markup payable for all items sold to the obligor out of replenishment will be determined by multiplying the “Financing Days” for each replenished item by their respective “Cost”. The financing days for each replenished item are the number of days between replenishment and the end of the quarter. Then the sum of the products for all the items will be multiplied by the daily equivalent profit rate which is determined according to the rules adopted in the prospectus.

\[ Replenishment \ Markup \ Payable = \left( \sum_{x=1}^{n} (Financing \ Days \times Cost \ of \ item \ x_n) \right) \times Daily \ Rate \] \hspace{1cm} (v)

Of course the total capital distributed to certificate holders for the quarter is the sum of equations (iii) and (vi) while the total profit paid is the sum of equations (ii) and (v). Also:

Total Amount Payable = Total Capital of sold inventory – total capital used for inventory replenishment + Total Markup Payable on all sold inventory items, i.e.(ii)+(v) \hspace{1cm} (vi)

And:
Total Amount Payable = \textit{murābāḥah} Sale Price – cost of net re-investment \ (vii)

Where:
Net re-investment = cost of replenishment – cost of sold replenished items \ldots \ (viii)

To ensure that the certificate holders receive a minimum return irrespective of the business of the issuer/obligor, the issuer will undertake to purchase either a definite amount of inventory or a set minimum every quarter, as stated earlier.

3.3. Illustration of the Model

To illustrate the profit calculation mechanism we present in this section an assumptive model depicting the basic features of these certificates. This model is based on the following assumptions: we assume the issuer and beneficiary of the finance who is also the obligor to be a car dealership in Qatar which issues these certificates to finance its inventory. The total amount invested/raised by issuing the certificates is 1,046,000. Payments are made on a quarterly basis. Furthermore:

i. Certificates expire at the end of one year.
ii. Markup for \textit{murābāḥah} sale is fixed at the beginning of each quarter at LIBOR+5%.
iii. Capital is repaid along with markup on quarterly basis.
iv. “Cost” is the product of number of inventory items sold on \textit{murābāḥah} basis to the dealer and the purchase price of each item. “Total Capital Recovered” is the sum of “Cost” for all the sold items.
v. The “Total Markup Payable” is the markup due to the certificate holders as a result of the \textit{murābāḥah} sales. This is calculated using equation (ii).
vi. Inventory is replenished at the end of each quarter.
vii. Inventory is replenished to equal opening amount when it falls below 25\% of original opening inventory (in the first quarter). This replenishment is carried out by retaining part of capital recovered and using it to purchase new inventory. For example, in the second quarter inventory item 9 falls below the 25\% mark. Replenishment of this item to the initial amount of 80 requires a capital of $46,900. This amount is retained from the “Total Capital Recovered” of $281,680 and the remaining amount of $234,780 is returned to investors as payment of capital.
viii. Prices of inventory items remain the same for original purchase as well as for replenishment purchases.

ix. If total capital recovered until the end of the year and actually paid does not equal the amount of capital contributed by the certificate holders, the dealership will make up for the difference in these amounts by buying all the remaining inventory items at the agreed-upon sale price. For example, in the model the total capital repaid until the end of the four quarters is $938,000. So the difference of $118,000 will be paid by the dealership by purchasing the remaining inventory at the end of certificates’ term on murābaḥah basis at the already agreed-on rate of profit of LIBOR + 5% on the last day, which is the day of final amortization of the certificates (the prospectus may, alternatively, the prospectus may state that settlement shall be at known LIBOR of the first day of certificates, i.e., the beginning of the year). The Obligor potential indebtedness to certificates’ holders requires, undoubtedly, a guarantee to support the obligor’s ability to pay.

x. The final murābaḥah sale price of the remaining items of inventory shall be $122,530 based on the assumption that settlement of any balance shall be made at the profit rate of the fourth quarter of the certificates, i.e., LIBOR of Oct. 1st plus 5%.

xi. Financing days for each inventory item depends on when the item is bought and then its murābaḥah-sale price is paid by the car dealership, i.e., the murābaḥah maturity date which is the end of each quarter. For instance an item bought at the beginning of the first quarter and sold in the third quarter will have 273 days as financing days. For replenished items the financing days begin on the day of withholding the amount from Total Recovered Capital and paying it to the supplier. For example, 67 units of item 9 are replenished at the beginning of the 3rd quarter, when these replenished items are sold in the 4th quarter, financing days should be 184.

The calculations based on the above model and assumptions are shown in the following charts on a quarter by quarter basis plus the final settlement Murābaḥah sale:
Monzer Kahf & Mahah Mujeeb Khan: Tradable Inventory Certificates

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<th>Closing inventory after replenishment</th>
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Capital used for replenishment: 0
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Total Capital Payable: 315000
Total Markup Payable: 4182.0188
Total Amount Payable: 319182

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Capital used for replenishment: 4690 |
Total Capital Recovered: 281680 |
Total Capital Payable: 234780 |
Total Markup Payable: 7487.7203 |
Total Amount Payable: 242268 |

Quarter 1 (Jun-Mar)

LIBOR (3 month): 0.311%
LIBOR + 5.311%
Daily Rate: 0.015%
Annual Rate: 5.311%
Total Capital Required: 1,046,000$
Face Value of each certificate: $1,000
Total certificates issued: 1046
Payment: Quarterly
Lower Limit of inventory (as a percentage of opening): 25%
End date: 3/31/2013

Quarter 2 (Apr-Jun)

LIBOR (3 month): 0.287%
LIBOR + 5.287%
Daily Rate: 0.0147%
Annual Rate: 5.29%
End date: 6/30/2013
Quarter 3 (Jul-Sep)

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Capital used for replenishment 86400
Total Capital Recovered 173400
Total Capital Payable 87000
Total Markup Payable 6138.3542
Total Amount Payable 93138

Quarter 4 (Oct-Dec)

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Capital used for replenishment 0
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Total Capital Payable 290100
Total Markup Payable 13341.7298
Total Amount Payable 303442
The above five charts are summarized in the following table which shows the quarterly cash flow of the inventory certificates, keeping in mind that final settlement is also assumed to be at the same time as the fourth quarter payment. This table indicates that the average annualized rate of return on the certificates was 5.293% per annum.

**Quarterly Cash Flow at Periodically Variable Profit Rate**

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<th>Item details</th>
<th>Price (QAR)</th>
<th>Opening inventory</th>
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<th>Financing Days</th>
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| Capital used for replenishment | 0 |
| Total Capital Recovered | 118000 |
| Total Capital Payable | 118000 |
| Total Markup Payable | 4530.1242 |
| Total Amount Payable | 122530 |

| Investment: face value of certificates | 1,046,000 |
| Payment: 1st quarter | 319,182 | 315,000 | 4,182 | 5.311 |
| Payment: 2nd quarter | 242,268 | 234,780 | 7,488 | 5.287 |
| Payment: 3rd quarter | 93,138 | 87,000 | 6,138 | 5.275 |
| Payment: 4th quarter | 304,562 | 291,220 | 13,342 | 5.260 |
| Settlement payment | 122,530 | 118,000 | 4,530 | 5.260 |
| Total | 1,081,680 | 1,046,000 | 35,680 | 3.41 |
| Annualized profit rate | 5.289 |
For investors there may be a variation in amount of quarterly payment resulting from the agreed upon schedule of *murābaha* sales to the obligor which is in turn based on variation in the business of the company including its production line, there is also variation between quarters resulting from change of profit rate. This variation may be reduced by requiring the company to purchase a minimum amount every quarter. For company, cost price for items taken varies according to the duration inventory remains in warehouse, since higher markup has to be paid for inventory kept for longer periods. This variation and the cost can be reduced by improving the professional inventory management. Alternatively, the prospectus may require equal periodical purchases so that the total capital recovered will be equal for all quarters and if you eliminate the replenishment element fixed capital recovery flow will be secured for all quarters. In such a case the only source of variation in the cash flow will be the variation of the rate of markup.

A Fixed Return and Cash Flow Scenario

A condition may be added whereby the obligor pledges to buy fixed and equal quantities of the inventory every period on weekly, monthly or quarterly basis. In this scenario the amount of cash inflow for the investor will be predictable and predetermined either for all payments during the whole period of investment if a fixed rate of profit is adopted or for the cost part of the payments if the rate of profit varies from one period to another.

We present in the following a second scenario of the same hypothetical example based on quarterly fixed rate of profit.

The following schedule gives the periodical payment and profit distributed as a result of *murābaha* sales effected during each quarter.

### Quarterly Cash Flow at Periodically Variable Profit Rate

<table>
<thead>
<tr>
<th></th>
<th>Cash flow</th>
<th>capital recovered</th>
<th>profit</th>
<th>profit rate %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment: face value of certificates</td>
<td>1,046,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment: 1st quarter</td>
<td>264,972</td>
<td>261,500</td>
<td>3,472</td>
<td>5.311</td>
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<tr>
<td>Payment: 2nd quarter</td>
<td>268,451</td>
<td>261,500</td>
<td>6,951</td>
<td>5.287</td>
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<tr>
<td>Payment: 3rd quarter</td>
<td>271,961</td>
<td>261,500</td>
<td>10,461</td>
<td>5.275</td>
</tr>
<tr>
<td>Payment: 4th quarter</td>
<td>275,068</td>
<td>261,500</td>
<td>13,568</td>
<td>5.26</td>
</tr>
<tr>
<td>Total</td>
<td>1,080,452</td>
<td>1,046,000</td>
<td>34,452</td>
<td>3.24</td>
</tr>
<tr>
<td>Annualized profit rate</td>
<td></td>
<td></td>
<td></td>
<td>5.283</td>
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CALCULATION OF PROFIT DUE TO CERTIFICATE HOLDERS WITH VARIABLE MARKUP WHICH IS FIXED FOR THE PAYMENT TERM

<table>
<thead>
<tr>
<th>Quarter 1 (Jan-Mar)</th>
</tr>
</thead>
<tbody>
<tr>
<td>LIBOR (3 month)</td>
</tr>
<tr>
<td>LIBOR +</td>
</tr>
<tr>
<td>Daily Rate</td>
</tr>
<tr>
<td>Annual Rate</td>
</tr>
<tr>
<td>Total Capital</td>
</tr>
<tr>
<td>Required</td>
</tr>
<tr>
<td>Face Value of each</td>
</tr>
<tr>
<td>certificate</td>
</tr>
<tr>
<td>Total certificates</td>
</tr>
<tr>
<td>issued</td>
</tr>
<tr>
<td>Payment</td>
</tr>
<tr>
<td>Quarterly</td>
</tr>
<tr>
<td>purchase, No</td>
</tr>
<tr>
<td>replenishment</td>
</tr>
<tr>
<td>End date</td>
</tr>
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<table>
<thead>
<tr>
<th>Item details</th>
<th>Price (QAR)</th>
<th>Opening inventory</th>
<th>Inventory sold</th>
<th>Financing Days</th>
<th>Cost</th>
<th>Closing inventory</th>
<th>Cost*Financing Days</th>
<th>Closing inventory After replenishment</th>
<th>Capital used for replenishment</th>
<th>Markup</th>
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<td>75</td>
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Capital used for replenishment: 0

Total Capital Recovered: 261500
Total Capital Payable: 261500
Total Markup Payable: 3471.7394
Total Amount Payable: 264972
### Quarter 2 (Apr-Jun)

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<th>Price (QAR)</th>
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<th>Cost</th>
<th>Closing inventory</th>
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<th>Closing inventory after replenishment</th>
<th>Capital used for replenishment</th>
<th>Markup</th>
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### Capital used for replenishment
- 0

**Total Capital Recovered:** 261500

**Total Capital Payable:** 261500

**Total Markup Payable:** 6951.2882

**Total Amount Payable:** 268451

### Quarter 3 (Jul-Sep)

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### Capital used for replenishment
- 0

**Total Capital Recovered:** 261500

**Total Capital Payable:** 261500

**Total Markup Payable:** 10461.0406

**Total Amount Payable:** 271961
In fact, it is possible to use this inventory certificate as a very impressive Sharīʿah-compliant liquidity tool. Consider a weekly payment along with fixed profit rate for the period of the certificate until maturity and you will get a very short term instrument with known cash flow which is similar to a corporate bond but it is at the same Sharīʿah compliant and tradable at the same time. Alternatively it can also be used for short term placement if the rate of murābaḥah sale markup is made variable on weekly or even daily basis.

4. Sharīʿah Considerations

Since the mechanism of these certificates involves different contracts at different stages of execution, it is important, first, to consider these contracts individually to
determine their compliance with Sharīʿah and then to analyze the conformity of the collective effect of these contracts with Sharīʿah.

The first issue arises regarding the representation of an undivided ownership share in the underlying assets by the certificates. This issue has been settled by the OIC Fiqh Academy as well as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) since both have allowed certificates such as shares and ṣukūk to represent ownership in a basket of underlying assets. According to AAOIFI, “A share represents an undivided share in the capital of a corporation, just as it represents an undivided share in its assets and the rights associated with it upon conversion of the capital into tangible things, benefits, debts and so on” (2008). Similarly for ṣukūk which are defined by AAOIFI as “certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity” (2008) From these definitions it is clear that there is no Sharīʿah objection regarding certificates representing an undivided share in ownership of a collection of items of inventory.

The second issue arises from the arrangement of the wakālah given to the dealer to sell the inventory, on behalf of the certificate holders, to itself and to replenish the stock on behalf of the holders too while maintaining the ownership of the certificate holders. Wakālah is a well-established Sharīʿah permissible contract and is extensively used in Islamic finance. However, whether a wakīl may sell to itself is controversial. Those who prevent it use the idea of conflict of interests. Of course when a wakīl sells to itself there is a conflict of interest because he would give himself best deal at the expenses of the interest of the principal who would like highest price and soonest date of payment. On the other hand those who allow it argue that the specific authorization of the principal for the wakīl to sell to himself covers this matter as the principal is of course aware of the conflict of interests and he overlooks it. But the wakālah to sell to himself and to replenish decrease in inventory in the certificate is permissible even according to the most strict view because all the conditions of these sales and purchases are already specified and agreed upon in a transparent way in the prospectus which represent the agreement between investors and user of funds. The way of calculating sale price, the amount of profit, the terms of payment, the quantities and items sold or bought, etc. all are determined in the prospectus. Accordingly this wakālah is in the final analysis only procedural to implement the already agreed upon conditions. The wakālah contract also specifically includes an authorization to the wakīl (obligor/issuer) to hold and safely keep the assets in its warehouse and to take delivery on any and all purchased items on behalf of the certificate holders. Accordingly, this wakālah arrangement
contains not a minute trace of conflict of interests and it is therefore Sharīʿah-permissible.

The third issue is the sale of inventory from the certificate holders to dealer on *murābaḥah* basis. In this case, *murābaḥah* is also a well recognized contract in Islamic finance and there is no dispute regarding its permissibility nowadays at least. Regarding the promise of purchase goods from the owner, the OIC *Fiqh* Academy in its fifth meeting concluded that, “A promise made unilaterally by the purchase orderer or the seller, is morally binding on the promisor, unless there is a valid excuse. It is however legally binding if made conditional for the fulfillment of an undertaken obligation, and the promisee has already incurred expenses on the basis of such a promise. The binding nature of the promise means that it should be either fulfilled or a compensation be paid for damages caused due to the unjustifiable non-fulfilling of the promise.” (OIC *Fiqh* Academy 86). Therefore a unilateral promise is legally binding on purchaser/obligor; the side that makes the promise.

A fourth issue may arise concerning the combination of two contracts (*murābaḥah* and *wakālah*) in one contract. However, as the terms and details of the contract are spelled out clearly in the master agreement, there will be no conflict of interest. Furthermore such a combination of contract is already being approvedly used in other Islamic financial instruments such as *murābaḥah* line of credit and *mushārakah* line of credit.

A combination of these contracts results in a group of people (certificate holders) jointly owning the inventory. The tradability of the certificates is unquestionable because they represent real physical assets in the possession of the *wakīl* of their owners. At issuance, these certificates represent ownership in assets but the following *murābaḥah* sales result in the certificates representing goods and debt (the amount due from the dealer). The OIC *Fiqh* Academy and AAOIFI are unanimous on the non-tradability of debts. However, regarding the tradability of debts resulting from another transaction such as, in this case, the sale of inventory, the OIC *Fiqh* Academy, in its 21st meeting, has ruled that “if a debt results from the transaction itself, it is considered an addendum to the underlying assets and does not negatively affect the tradability of the certificate” (OIC *Fiqh* Academy 2013) Therefore it is safe to conclude that nothing in the structure or form of these certificates is in conflict with Sharīʿah or may limit their listing and negotiability at a market price in a formal exchange market.

Once the terms and conditions of the certificates’ mechanism have been laid out in consultation with the relevant Sharīʿah Board, Sharīʿah supervision will be limited
to approving the Shari’ah compliance of the inventory items. Constant supervision will not be required as the terms of the contract will be sufficient to ensure Shari’ah compliance.

5. Risks Involved

The major type of risk faced by the holders of these inventory certificates is the credit risk of default i.e. the obligor/dealer may fail to repay the capital and markup. Another consideration is the moral hazard that may result from the authority given to the dealership by virtue of wakālah agreement and the fact that inventory is handled by the dealer alone. This moral hazard can be mitigated by introducing an appropriate accounting and auditing system which will help in overseeing that the subsequent murābaḥah sale contracts of inventory from the certificates holders to the dealers are undertaken in conformity with the master agreement as set in the prospectus. Moral hazard can also be reduced by incorporating appropriate conditions in the contract which limit the authority of the dealer such as a clause specifying minimum units to be purchased in any period. In addition, the investors have the property risk to which the inventory is exposed. It is the risk to which every owner is exposed which is mentioned in the Ḥadīth “الخراج بالضمان.”

Risk of default depends on the credibility and rating of the obligor/dealer and can be mitigated by using appropriate guarantees and collaterals. The risk of ownership can be mitigated by using appropriate Islamic insurance. The insurance may be included as a part of the agreement or the inventory and warehouse can be insured externally while the cost of insurance can be added to the markup. These three kinds of risks are normal in most securities especially the Islamic ṣukūk which have always obligors who have certain financial obligations to fulfill (credit risk), properties of ṣukūk holders in the hand of other than the owner (moral hazard risk) and ownership of properties other than debts (ownership/property risk). In other words, the certificates of inventory are not different in any substantial way from all other Shari’ah compliant securities. However, because it all is based on murābaḥah, it can accommodate taking guarantees, securities, and liens of any kind for the whole transaction from beginning to end. Therefore, takāful insurance of the inventory items along with any other appropriate guarantees, mitigate any risk of loss to the inventory.

1 The Ḥadīth is reported by al Timithi from ‘A’ishah, No. 1286, al Timithi said it is good/correct. It is also reported by Ib Habban in his correct collection, No. 4929.
From the point of view of the obligor, the fixed or minimum purchase clause exposes the dealer to risk in the event that its sales for a period go down while it is still obligated to purchase the fixed or minimum inventory from the investors. Another risk faced by the obligor is the markup rate risk which is a part and parcel of any murābāḥah contract, i.e., once the rate has been fixed and a sale concluded, it cannot be readjusted for that period irrespective of the rates prevailing in the market. However, this risk can also be minimized by readjusting the rate after every specified period, which can be small intervals, as per the conditions of the prospectus. In fact, since we are dealing with a series of murābāḥah contracts there is no Sharī‘ah restriction on adopting a different rate of mark up for every new murābāḥah purchase. In other words, as in murābāḥah the price, and consequently the mark up, is fixed at the time of the contract and cannot be changed until maturity, any new murābāḥah contract can be set at a different mark up. This flexibility allows us to set a rule of variable weekly or daily rates. For instance the rule of mark-up may be as follows: “profit is equal to yesterday’s LIBOR plus 5% multiplied by the number of days from the date of cost payment until the end of current period.”

Accordingly, the rate of certificate’s earning at the end of each accounting period, e.g., quarter, month or year, will always average out around the market rate assuming that LIBOR is the latter’s representative. Of course variation of the certificate’s periodical earning is affected by the intensity of purchases at certain days of the quarter. But this variation will always be limited and does not make the certificates’ rate of return to go outside the range between lowest and highest market rate of return in the same quarter or period which is set for periodical profit distribution and amortization payment whether it is a quarter, a month or even a week.

6. Other Uses

The use of these certificates is not only limited to individual investors; they can also be used extensively by Islamic banks. Currently, Islamic banks cannot earn return on funds kept as reserve requirement because it would amount to interest. The idle reserve requirement fund for Islamic banks is an important issue which can be addressed by these certificates. The Islamic banks can finance government inventories and hold sovereign short term certificates as reserves while at the same time they earn a return on them.

Additionally, depending on the rating of the obligor, inventory certificates may be used for short term liquidity management and as a cushion for earning return on short term available liquidity.
7. Comparison with Ṣukūk and Other Securities

7.1. Inventory certificates versus Ijārah Ṣukūk

One of the most common types of ṣukūk found in Islamic financial markets is based on ijārah contract. Although several different types of structures of ijārah ṣukūk exist in the market, a generic structure is explained here and used for comparison.

The following three parties are involved in ijārah ṣukūk:

i. The originator (beneficiary). The originator later assumes the role of lessee/obligor,

ii. The Special Purpose Vehicle (SPV) is the issuer of the ṣukūk. The SPV has a separate legal identity and is a bankruptcy remote entity,

iii. The investors.

Structuring the ṣukūk involves the following steps:

i. The originator sets up an SPV and sells the ijārah assets to the SPV. These assets are leased back by the originator from the SPV,

ii. The SPV then securitizes these assets and issues them as ṣukūk to the investors. The proceeds from the investors are paid to the originator as price of the asset,

iii. The originator who becomes now the obligor then makes rental payments to the SPV according to the terms of the ijārah contract which are passed on to the investors,

iv. At the termination of lease period or periodically on installments, the originator/obligor repurchases the assets at the face value of the ṣukūk.

2 Of course Islamic and conventional banks may be involved as underwriters.

3 We mention this structure because it is the most common structure of ijārah ṣukūk in the market although it raises an apparent ḍīnah controversy. We are not discussing the ḍīnah issue in the present paper. However, the structure can be changed if the obligor sells the assets on behalf of a supplier to the ṣukūk holders. Then the obligor becomes only a lessee and purchaser from ṣukūk holders and the ḍīnah does not exist.
This repurchase of the *ijārah* assets at face value has raised Sharī‘ah concerns. According to AAOIFI such a repurchase at face value is not permissible.

Standard No. 17 paragraph 5/2/2 “In the case of negotiable *ṣukūk*, it is permissible for the issuer to undertake, through the prospectus of issue, to purchase at market value, after the completion of the process of issue, any certificate that may be offered to him, however, it is not permissible for the issuer to undertake to purchase the *ṣukūk* at their nominal value.”

A comparison of the inventory certificates with *ijārah ṣukūk*, shows that:

i. Both types of securities are negotiable.

ii. Return is guaranteed: In *ijārah ṣukūk*, since the return is the rent payment by the originator, it is specified in the contract and is therefore guaranteed. In inventory certificates, the markup for *murābaḥah* sale is also guaranteed and secured in the prospectus.

iii. The pricing mechanisms of both kinds of securities are similar to some extent. In *ijārah ṣukūk*, the *ṣukūk* price is determined on the basis of its relation to the current market rate of return. The price has generally an inverse relation with market return. Of course, this is in addition to the risk element, market liquidity and other variables that affect bonds and *ṣukūk* prices.

In regard to pricing the inventory certificates when the *murābaḥah* purchase component is structured to follow the market rate of return, the certificate price would be more stable than that of *ṣukūk* because its return is tied to the current market rate. In other words, inventory certificates’ market prices may be more sticky to their nominal value than the *ṣukūk* prices, a matter which makes price variations narrow and therefore these certificates are less volatile. This gives them an edge over *ijārah ṣukūk* and makes them a better instrument of liquidity management use than *ijārah ṣukūk*; an attractive point for Islamic banks.

iv. Fixation of return: In *ijārah ṣukūk* the rent can be fixed for the period of the contract. However to avail of the variation privilege we have to take the approach of rent for shorter periods with a renewal clause and a change of the rent only at the contract renewal

The variation in the certificates takes a different dimension. As we work with consecutive *murābaḥah* purchase contracts each contract can take a new rate of profit. This allows the inventory certificates to follow market rate of return at closer steps much more than *ijārah ṣukūk* can.
v. *Ijārah ṣukūk* are more long term financial securities as they are used to finance long term assets. Alternatively, inventory certificates are more suitable for relatively shorter terms.

vi. Unlike *ijārah ṣukūk*, inventory certificates do not face Sharīʿah issues of *ʿīnah* regarding sale and buy-back because of the normal practices of inventory. Companies and institutions usually obtain them from their suppliers; third parties.

vii. *Ijārah ṣukūk* are more suitable for fixed assets which are leasable while inventory certificates are appropriate for high turnover materials.

7.2 Inventory certificates versus *muḍārabah ṣukūk*

The following three parties are present in a *muḍārabah ṣukūk* structure:

i. The originator who acts as the *muḍārib*,

ii. Special Purpose Vehicle (SPV) acts as a trustee for the investors,

iii. The investors who subscribe to the ṣukūk as *rabb al māl* and their funds are passed on to the originator.

The structure involves the following steps:

i. The SPV issues the ṣukūk to which the investors subscribe. The funds from the subscription are in trust to the SPV,

ii. The SPV enters into a *muḍārabah* contract with the originator. The SPV acts as a representative of *rabb al māl* and the originator as *muḍārib*,

iii. The funds from investors are passed on to the *muḍārib*,

iv. Profits are distributed between the *rabb al māl* and *muḍārib* according to a predetermined profit sharing ratio as agreed upon in the contract. These profits pass through the SPV as a trustee,

v. The profits from the *muḍārabah* are paid to the investors for each payment period,

vi. At termination, the originator buys the *muḍārabah* interests at market value and the *muḍārabah* entity is dissolved. This payment by the originator is used to return any outstanding amounts to the investors,

vii. *Muḍārabah ṣukūk* are usually loaded by a handful of conditions about expected profit rate, burden of providing evidence, *muḍārib* incentives, etc. which turn the profit/loss unpredictability characteristic of *muḍārabah*
dysfunctional for the objective of assuring investors of an almost guaranteed return and protected capital.

A comparison of muḍārabah ṣukūk with inventory certificates shows that:

i. In muḍārabah ṣukūk, the return is not guaranteed. In case the muḍārabah venture generates a loss, the investors will bear the loss. Although the profit sharing ratio between the muḍārib and rabb al māl is agreed upon at the initiation of the contract however, the return cannot be fixed for any party. In contrast, the return in inventory certificates is determined as per the terms of the prospectus and definitely positive although it is variable as we discussed earlier.

ii. In practice, several muḍārabah ṣukūk are structured in such a manner that aims essentially at guaranteeing a fixed return. This type of structure has serious Sharīʿah concerns. Inventory certificates have no such concerns regarding fixing the return since the underlying contract is murābaḥah.

7.3 Inventory certificates with corporate promissory notes and commercial papers

A corporation may issue promissory notes as a mode of financing its inventories after it has exhausted other modes of financing such as direct borrowing from banks and bonds issuance. Promissory notes are usually of short and medium terms and have a higher risk attached to them. They are normally offered to investors who can bear such high risks. In comparison with inventory certificates which can also be issued by corporations for short terms, the latter are of low risk since they represent ownership of the physical inventory stored in warehouses in addition to being secured like promissory notes by additional guarantees and securities.

Commercial papers are short term debt certificates which are not secured by any collateral therefore any corporation seeking to issue commercial papers relies on its own credit rating. Alternatively, inventory certificates are secured by owning the underlying inventory and therefore can be issued by any corporation wanting to finance its inventory without heavily relying merely on its credit rating. Both, promissory notes and commercial papers are interest based debt instruments and are therefore non-Sharīʿah-compliant.

8. Conclusion

In conclusion, the inventory certificates have the potential to address several problems prevailing in the Islamic financial markets without raising Sharīʿah
concerns which are observed in other instruments present in the market. Liquidity management of Islamic banks is one the pressing concerns of the Islamic financial industry which can be addressed by issuing these short term inventory certificates. Corporations can use this instrument for managing their financing needs for high turnover inventory items. From the investors’ perspectives, these certificates provide an avenue for investment which is of short term, guarantees a minimum return and is low risk.

The structure of the certificate is flexible so as to meet a variety of needs of the parties. The return may be fixed for the entire term of the certificates or it may vary at each payment period as per the prospectus terms. Rights of the investors can be protected by including additional terms in the prospectus such as the minimum inventory clause. Risk of ownership to the investors can be mitigated by using Islamic insurance and adding its contribution to the markup to avoid reducing the net return to investors. The negotiability feature of the certificates makes these certificates more attractive for investors.

Compared with *ijārah* and *muḍārabah ṣukūk*, the certificates’ features address some of the issues that raised concerns in the two instruments. The Shari‘ah concern in *ijārah* for sale and buy back of the leased asset is bypassed in the certificates. Furthermore, *ijārah ṣukūk* are long terms instruments whereas the certificates provide short term financing and investing opportunities. *Muḍārabah ṣukūk* cannot have a guaranteed fixed return, and any attempts to structure *muḍārabah ṣukūk* which guarantees a return raises Shari‘ah issues. The certificates do not invoke such objections regarding fixing or guaranteeing the return, rather they have an additional feature that the return can be fixed every payment period to avoid the benchmark rate risk.

Lastly, these certificates can provide stable returns to individual and institutional investors and allow businesses to finance their inventory without having to tie up their own cash in the process and at the same time can be used to address some major issues faced by Islamic banks.

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Product Development and *Maqāṣid* in Islamic Finance: Towards a Balanced Methodology

Muhammad Al-Bashir Al-Amine

Abstract

Islamic finance and its adherence to the core objectives of Sharī’ah (maqāṣid) has been a controversial issue for some time. However, this debate has intensified in the last few years. Two particular issues have been widely argued. These are the overuse of debt-based instruments by Islamic financial institutions and the strict compliance of large number of ṣukūk structures with Sharī’ah principles. The current reliance of the industry on debt-based instruments is considered to be a failure and not in line with maqāṣid al Sharī’ah. This paper argues against this conclusion, as it is unwarranted and based on shaky grounds. In correspondence to this issue is the ṣukūk market and, despite its resounding success, suffers from some structural shortcomings. These defects are illustrated in this paper by the absence of ‘true sale’ in most ṣukūk issues in the market. This flaw casts real doubts regarding the transfer of the ṣukūk’ assets from the balance sheet of the originator to that of the issuer, and as a result becomes the source of misgivings regarding the Sharī’ah compliance of some ṣukūk structures and their conformity with maqāṣid al Sharī’ah. The paper argues that if these shortcomings are not addressed then it can be argued that these structures are not in full conformity with maqāṣid al Sharī’ah. Some suggestions and recommendations are proposed to address these critical issues.

Keywords: Islamic finance, Ṣukūk.
JEL Classification: G00, Z120.

The debate about Islamic finance and its adherence to the core objectives of *maqāṣid al* Sharī’ah is not new. However, this debate has intensified in the last few
years with regards to two particular issues: the overuse of debt-based instruments by Islamic financial institutions, and the strict compliance to Sharī`ah principles of a large number of ṣukūk structures. Specific issues within this debate are generally being highlighted by the critics. These include concerns, among other the apprehension that the reliance of the industry on debt-based instruments was at the expense of profit-loss sharing products, and the marginal role of Islamic financial institutions in fulfilling their social responsibilities, specifically poverty reduction. These concerns are the outcome of the legalistic methodology promoted by Sharī`ah scholars in approving or disapproving some industry products. The debate is sometimes explained as differences between Sharī`ah scholar influences: i.e. by the juristic and legalistic approach or the economists’ approach, that focuses on the social needs of the society or, in other words, the macro-maqāṣid and micro-maqāṣid. It is also sometimes described as a conflict between idealism and pragmatism or as a clash between Islamic finance and Islamic economics. Others portray it as a conflict between the individualistic maṣlaḥah methodology and the maqāṣid way, or a debate between analogical reasoning and empiricism. Based on this debate a new classification of products is advanced by some researchers such as Sharī`ah based products, Sharī`ah compliant products, and pseudo Islamic products or Sharī`ah compliant products in form and others in substance.

The paper argues that there is a need to be clear whether the maqāṣid of Sharī`ah as a general concept differs from the maqāṣid of Islamic economics on one hand, and the primary purposes and objectives of Islamic finance on the other. An accurate conceptualisation of maqāṣid with regard to these three spheres of Islamic law will shed light on the current debate and its ramifications. The need for a demarcation is prompted by the fact that if the objectives of Sharī`ah or maqāṣid in these three areas are not the same, then, demanding Islamic finance to fulfil some of the maqāṣid of Islamic economics or those of Islam as a whole is unwarranted. Moreover, putting such demarcations in place will allow valuable efforts to be preserved and not wasted in a vain debate due to confusion and misunderstanding. The paper further argues that the bases of the above classifications with regards to Sharī`ah compliance are debatable and need to be assessed from a Sharī`ah perspective given the fact that these classifications are not concerned with the permissible and non-permissible.

Some critics maintain that equity or profit sharing financing products are superior to debt-like financial instruments. They consider them the ideal instruments for Islamic finance while debt-based instruments should be the exception. It is also asserted that equity based financial products are in line with the spirit of the Sharī`ah and its objectives while other instruments are not. Some have gone to the extent of describing the debt-based instruments as kind of “stratagem” or “interest in disguise”
and therefore, the solution, for some, will be through the removal of debt-based instruments from the list of permissible instruments.

Yet, the present paper argues that the Sharī‘ah foundations for the above contentions are shaky. Therefore, it is imperative to be clear, from the outset, whether Islamic finance is a Sharī‘ah compliant financial system where debt-based products and profit and loss sharing instruments cohabit harmoniously or a profit-loss sharing industry where debt-based instruments are used as necessity? There is no evidence to support the claim that Islamic financial institutions have to limit themselves primarily to profit and loss sharing instruments such as muḍārabah and mushārakah. Looking at the primary and secondary sources of Islamic law, the message is clear that the industry is free to use any Sharī‘ah complaint instrument including debt-based instruments such as murābaḥah, istiṣnā, salam, ijārah, tawarruq or any other developed products or to be developed as long as it does not contradict any explicit text or principle.

It is worth noting that the case against conventional interest based debt instruments is well argued by Muslim economists based on the fact that it is against Sharī‘ah principles and its contractual arrangements. At the same time, the conventional financial system is rejected as it leads among others to instability, creates room for gambling, speculation, and increases disparities in the distribution of income and wealth. However, the question is whether the use of Sharī‘ah debt-based instruments have negative results similar to those observed in the conventional financial system or whether any comparison between the two debt-based instruments is unwarranted? We argue that the concept of debt and its use in the two systems are diametrically different and therefore, judging one based on the negative effects of the other is unjustifiable.

On the other hand, the paper examines if a financial system based mainly on profit loss sharing is sustainable in the current environment. Can the risks involved in over reliance on profit loss sharing be easily mitigated given the characteristics of profit loss sharing products on the one hand, and the absence of regulatory regimes that promote the use of such products on the other such as the unfair taxation treatment or lack of regulations?

Moreover, the paper argues that the debate in favour or against debt-based instruments would not be clarified unless we refer to the fact that Sharī‘ah considers the existence of debt-based instruments as part of its objectives and maqāṣid and a number of evidence from the primary sources support this.
Thus, the paper argues that it is unfair to consider the Islamic finance industry as a “failure” due to the marginal use of profit loss sharing instruments. Instead, it is argued that it will be useful if all efforts are directed towards innovation of new products that will increase the share of exiting profit loss sharing products such as private equity and venture capital and the design of institutional settings where other non-monetary financial intermediaries would be best placed to use profit loss sharing modes of finance. In short, presenting practical alternatives to the use of debt-based instruments would be the best way forward rather than the call for the rejection of debt-based instruments.

It has also been contended by the critics that the primary goal of Islamic financial institutions is not profit-making, but the endorsement of social goals such as socio-economic development and the alleviation of poverty. Therefore, Islamic financial transactions should not be solely profit-oriented, but aimed at serving the overall needs of society. Mere maximisation of profits cannot be a sufficient goal and therefore, according to the critics the current Islamic finance industry is not particularly interested in economic development and social welfare but driven by profit maximisation.

The present paper argues that it is critical to be clear whether Islamic financial institutions are profit driven institutions or charitable organizations. Thus, we submit that wisdom requires proving first to the world, beyond reasonable doubt that, a Shari'ah compliant financial system can be just as profitable as the conventional and capable of freeing humanity from the injustice of ribā. It is based on this legitimate aim that it is upheld that Islamic financial institutions are under obligation to compete with conventional institutions using all permissible means in order to prove the viability of the system without neglecting the use of profit loss sharing instruments while laying down the foundations of a more equitable financial system. Moreover, the paper argues that, is it possible to eradicate poverty just because a profit-loss sharing system is implemented or such a goal is not reachable unless the entire Islamic economic system is implemented or more realistically when there is a complete Islamic system in place? Therefore, is it fair to consider Islamic finance as a failure as it has not been able to eradicate poverty in four decades of its existence?

One of the practical approaches in highlighting the role of Islamic financial institutions in corporate social responsibility should be by allowing Islamic financial institutions to take the lead towards directly distributing their zakāh. Zakāh is the third pillar of Islam and one of the foundations of an Islamic economic system. Unfortunately, it is thus far poorly implemented across the Muslim world. Even within the Islamic finance industry zakāh is generally left to discretionary power of
individual shareholders and not distributed by the institutions. In order to avoid some of the existing shortcomings in zakāh distribution and to stress the social responsibility of Islamic financial institutions, zakāh distribution should be directly effectuated through Islamic financial institutions and not left to the discretionary powers of individual shareholders.

On the other hand, if the concept of maqāṣid al-Sharī‘ah is used by some to justify their criticisms against debt-based instruments, the same concept is used by some practitioners to overlook certain obvious Sharī‘ah shortcomings in certain Islamic financial products particularly the so called “asset based ṣukūk”. These infringements are generally justified on the ground of gradual implementation of Sharī‘ah principles or the aim of preserving the hard gained achievements of the Islamic finance industry and its noble’s objectives. However, the paper argues that overlooking these non-Sharī‘ah structural issues in ṣukūk contravene one of the important features of Islamic law that “contracts are judged by their essence and meaning, not by their form and structure”. Such an approach will not help in providing a financial service that adds value to the real economy or strengthen the linkage between Islamic finance and productive economic activities. Overlooking these shortcomings will not fit with the necessity for appropriate due diligence on the viability of business proposals and the requirement for transparency and disclosure considered all to be genuine maqāṣid of Islamic finance. Moreover, these shortcomings in ṣukūk structuring are against the juristic approach promoted by practitioners given the fact that some basic conditions of a valid contract are being compromised. In short, overlooking these shortcomings will be against maqāṣid al-Sharī‘ah.

To illustrate the weakness in ṣukūk structures and the criticisms against it on the basis of maqāṣid, the present paper discuss the issue of ‘true sale’ and the transfer of the ṣukūk assets from the balance sheet of the originator to that of the ṣukūk issuer. This fundamental Sharī‘ah contractual requirement is not observed in a very large number of ṣukūk issues. Despite various criticisms against these practices and their obvious detrimental effects to the industry in the end and more importantly their disregard to maqāṣid al-Sharī‘ah, the practice continues.

Thus, the overuse of debt-based instruments and the structural defects in ṣukūk and the relation of both issues with maqāṣid al-Sharī‘ah form the focus of this paper. The paper calls for a balanced methodology and concludes that to consider the use of debt-based instruments as against maqāṣid al-Sharī‘ah is unfair and counterproductive. On the other hand, to continue structuring ṣukūk despite their obvious infringements of some contractual requirements is against maqāṣid al-
Sharī‘ah. The present paper is an attempt to critically analyse the marred and misunderstood relationship between Islamic finance and *maqāṣid al-Sharī‘ah* with particular reference to the above issues and how this debate is guided to benefit the industry and not to ruin its hard gained achievements. The first part of the paper will discuss the issue of *ṣukūk* and *maqāṣid al-Sharī‘ah* while the second part will focus on the issue of debt-based instruments and *maqāṣid al-Sharī‘ah*.

*Ṣukūk* and *Maqāṣid al-Sharī‘ah*

As mentioned above, some practitioners disregarded some of the fundamental jurisprudential and contractual principles in *ṣukūk* structuring. This group argues that in order to preserve the existing *ṣukūk* market and sustain its growth, the prevailing structuring mechanism should continue. Growth and development should take precedence over compliance with specific contractual requirements. Thus, despite an obvious recognition of these shortcomings the trend is continuing. According to the proponents of this opinion, insisting on some of the details might lead to the disappearance of the system as a whole. Therefore, preserving the system is much more important than fixing the details and this is in line with *maqāṣid al-Sharī‘ah*. Despite obvious and unequivocal resolutions from different institutions such as AAOIFI and the Islamic Fiqh Academy on the necessity to abide by the contractual requirements in *ṣukūk* structuring, unfortunately a large number of *ṣukūk* in the market are structured without due consideration to these principles.

The present paper limits itself in highlighting the above concern by discussing one of the core issues that could have a negative impact on the *ṣukūk* industry as a whole. This is the issue of ownership of the *ṣukūk* assets and whether there is a ‘true sale’ in a particular *ṣukūk* structure and the implications of such an arrangement in case of default in protecting the right of the *ṣukūk* holders. There is a need to establish whether the concept of beneficial ownership as widely used in *ṣukūk* structuring complies with the basic conditions of a valid sale contract in Islamic law. Whether the condition of preventing the purchaser from selling the purchased assets or to dispose of it contradicts any Sharī‘ah principle of a valid sale contract or not? Whether the lack of due diligence or even inquiry regarding the purchased assets will be considered a case of *jahālah* and *gharar* and by consequence renders the contract null and void or not?
‘True Sale’ and Asset Backed Šukūk¹

The global šukūk market continued its steady growth momentum in 2014 with expectations that the primary šukūk market will once again register a new record as the industry continues to attract new jurisdictions and players into the fastest growing segment of the Islamic finance industry. However, if šukūk market growth is recording new heights, changes in terms of structures seem to be slower than expected particularly with regard to the adoption of asset backed šukūk based on ‘true sale’.

Despite the fact that the debate over “asset backed” and “assed based” šukūk started several years ago, it is still relevant nowadays not only because it represents one of the most contentious issues in terms of šukūk structuring and restructuring, but also because it constitutes a defining criteria that determines the unique nature of šukūk as an alternative to conventional bonds. It also embodies the clearest substantiation and tests whether Islamic finance in general, and šukūk in particular, is not another variation of a conventional debt financing mechanism but a genuine alternative that is linking finance to the real economy and a suitable mechanism for raising capital to finance critically needed funds for infrastructure projects. At the same time, the issue of ‘true sale’ in šukūk structuring is still passionately debated given the fact that no substantial change has occurred since the deliberation started.

Based on the definition² of šukūk, it is clear that šukūk does not create indebtedness and the certificate is not a proof of investor’s loan to the šukūk holders as is the case in conventional bonds. On the contrary, the certificates are evidence of ownership of an underlying asset, usufruct, or services of the šukūk. Therefore, šukūk is an investment facility and not a loan arrangement.³ Šukūk must be certificates that represent co-ownership of an asset or business venture⁴ and should grant particular investors a share of an asset or business venture along with the cash flows and risk commensurate with such ownership.

Thus, the theoretical bases for an asset backed šukūk structure are obvious from the Sharī’ah standards and resolutions on šukūk while its benefits are acknowledged

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¹ For further details please see, Muhammad al-Bashir Muhammad al-Amine Al-Amine, ‘Global Sukuk and Islamic Securitization Market: Financial Engineering and Product Innovation’ (Brill’s Arab and Islamic Law Series) Leiden; Boston: Brill, 2012.
² See AAOIFI Standard on Sukuk
by all players including by Sharī‘ah scholars, economists, and regulators. Thus, a leading regulator stressed that:

“Asset-backed ṣukūk, has profit and loss sharing elements that thus offers investment sustainability. The possibility of a default is minimized, as investors of asset-backed ṣukūk are not guaranteed to receive income or capital gains, and profits are paid by the issuers only when the underlying assets earn profits”5.

Thus, the problems with asset-backed ṣukūk are not related to its theoretical bases or beneficial advantages but with the practical implementation and the absence of a favourable legal environment. The non-existence of modern Sharī‘ah compliant securitisation law, trust law, favourable tax legislations, or secured transactions legislations in many Muslim countries is obvious indication of this legal vacuum. However, the pillar and defining characteristic towards an asset-backed ṣukūk structure resides on the necessity of structuring ṣukūk on the basis of ‘true sale’ and the legal transfer of the underlying assets of the ṣukūk from the originator to the issuer. Such a transfer needs to be grounded on a genuine and thorough due diligence about the assets underlying the ṣukūk and practically substantiated and verified by the transfer of the sold assets from the balance sheet of the seller to that of the purchaser.

Ṣukūk Structuring and ‘True Sale’

By “true sale” we mean a sale that complies with Sharī‘ah principles and observes AAOIFI standards and resolutions on ṣukūk. The main requirements for such a sale are: (a) a genuine due diligence according to custom and modern practices about the underlying assets to avoid any possibility of jahālah and gharar; (b) a legal transfer of ownership of the assets sold from the buyer to the purchaser; (c) the assets sold are transferred from the balance sheet of the seller to that of the purchaser; (d) non-existence of any condition or clause that prevents the purchaser from exercising his rights to sell the asset or dispose of it; (e) return of the ṣukūk are based on the actual performance of the asset underlying the ṣukūk; and (f) the purchaser has direct recourse to the asset in case of default.

In a “true sale”, the underlying asset has been validly transferred to the SPV and that this transfer cannot be re-characterised as a secured loan or otherwise avoided.

upon an insolvency of the originator. The concept simply addresses whether the SPV has ownership of the asset. The essential test of true sale is whether the assets will be available to the originator’s creditors on its insolvency. A primary objective in most securitisation transactions is to separate the underlying asset from the credit risk of the originator and invest it in the SPV.\(^6\)

The issue of ‘true sale’ is one of the first steps in structuring a \(\text{sukūk}\) transaction. It is not limited to specific types of \(\text{sukūk}\) such as \(\text{ijārah}\) or \(\text{wakala}\) \(\text{sukūk}\) but is present in almost all \(\text{sukūk}\) structures. Its importance is born out of the fact that if the first step is wrong, then the following steps will definitely be erroneous. If the sale and purchase of the asset underlying the \(\text{sukūk}\) structure do not reflect a Shari‘ah compliant ‘true sale’, then, the presence of assets in the whole structure will not reflect the real status of an authentic \(\text{sukūk}\) structure. At the same time, the profit or return of the \(\text{sukūk}\) will not be based on the actual performance of the asset but that of the credit worthiness of the originator. Moreover, if the presence of the asset in the \(\text{sukūk}\) structure is not based on a ‘true sale’ it will be difficult to rebut the claim that the transaction is akin to a conventional credit based operation. In addition, such a structure could not be marketed unless supported by the widely criticised “purchase undertaking” to guarantee the repayment of the capital at maturity. Finally, if the legal transfer and enforcement of the underlying assets of the \(\text{sukūk}\) is not ascertained, it could be the source of dispute in case of default. Thus, the issue of ‘true sale’ is central to all other Shari‘ah issues in \(\text{sukūk}\) structuring.

In addressing the issue of ‘true sale’ and the controversy surrounding the issue of asset-backed and asset-based \(\text{sukūk}\) the AAOIFI 2008 resolution is very clear. The resolution states:

\(\text{Sukūk}\), to be tradable, must be owned by \(\text{Sukūk}\) holders, with all rights and obligations of ownership, in real assets, whether tangible, usufructs or services, capable of being owned and sold legally as well as in accordance with the rules of Shari‘ah, in accordance with Articles (2)1 and (5/1/2)2 of the AAOIFI Shari‘ah Standard (17) on Investment \(\text{Sukūk}\). The Manager issuing \(\text{Sukūk}\) must certify the transfer of ownership of such assets in its (\(\text{Sukūk}\)) books, and must not keep them as his own assets.\(^7\)

One of the important classifications of \(\text{sukūk}\) that has dominated discussions in recent years is the division into asset-backed and asset-based \(\text{sukūk}\). This division

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\(^7\) AAOIFI 2008 Resolution on \(\text{sukūk}\), \texttt{www.aaoifi.com}
seeks to replicate the conventional classification into asset-backed securities and debt-based bonds or simply secured and unsecured securities. Once again, the main feature distinguishing the two concepts is the fundamental concept of ‘true sale’. The ṣūkūk structure is asset-backed if there is a ‘true sale’ as defined above, while it is asset-based when there is no legal transfer of the asset even if the ṣūkūk holders have a beneficial ownership. It is extremely important to differentiate between the two distinct concepts of “legal transfer” and “legal registration” that are sometimes confused. Legal transfer of rights is a fundamental requirement in any Shari‘ah compliant sale while the simple official legal registration is not and can be compromised for reasons of high tax cost or practical delay as long as it is possible to craft a way out without contravening the legal regime in place.

A random survey and review of the Offering Circular of a number of ṣūkūk structures issued between 2008 and 2013, the period that followed the AAOIFI resolution and guidance on ṣūkūk, shows that despite the presence of an asset in the sale and purchase agreement in these ṣūkūk structures, the transfer of ownership in such sale/purchase agreements are based on beneficial ownership that does not include the full transfer of the legal title. AAOIFI’s 2008 resolution on ṣūkūk as quoted above clearly rejects this practice which is acceptable under English law. Accordingly, if the transfer of ownership is not legally achieved, it would not be based on ‘true sale’ and as a result all other observations mentioned above such as the originators keeping the asset on their balance sheet rather than transferring it to that of the issuer, the lack of genuine due diligence regarding the asset from the issuer when purchasing it or the provision that the ṣūkūk holders have no rights of disposal over the assets or right of direct recourse to the assets in case of default or insolvency will be present.⁸

It has also been observed that if ṣūkūk investors have no recourse to the assets, the transaction does not focus on the underlying asset but rather on the credit worthiness of the sponsors or originators of the ṣūkūk. These types of ṣūkūk do not grant the certificate holders the right to cause the sale or other disposal of any of the trust assets upon default of the issuer. Ṣukūk holders can only cause the trustee to call a meeting of the certificate holders and exercise their rights under the transaction documents including issuing a notice to the originator pursuant to its undertaking to repurchase the assets on maturity or default of the ṣūkūk. Such is an asset-based ṣūkūk structure.⁹

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⁸ Sukuk “Back on Tract” Kuwait Finance House, July 20, 2010,
Under an “asset-backed” sukūk, legal title to the underlying assets will typically pass by way of a ‘true sale’ from the originator to the issuer SPV and therefore, in case of default by the issuer, sukūk holders would be able to exercise full ownership rights and control over such assets. In such a structure, if the underlying assets are performing well while the originator is facing bankruptcy, the sukūk holders’ payment will not be interrupted. However, if the underlying assets are incurring losses, the sukūk holders must bear the risk of the non-performance of the assets as the real owners of the asset. It would be clear provisions in the sukūk documents that sukūk holders will be exposed to market and credit risk of the assets and not that of the originator.\(^1\)

It is clear from the above that asset-backed sukūk are arguably closer to an equity position or asset securitisation mechanism whereby sukūk holders own the underlying assets and are exposed to the risk and performance of the sukūk assets and have no recourse to the originator in the event of a payment shortfall. Asset-based sukūk on the other hand, are closer to debt-based transactions and have some features of conventional bond because the sukūk holders have direct recourse to the originator if there is a shortfall in payments.\(^1\) To reiterate, in asset-backed sukūk, there is a ‘true sale’ between the originator and the special purpose vehicle (SPV) that issues the sukūk. Assets are owned by the SPV, returns are derived from assets, and asset prices may vary over time.\(^1\) On the other hand, the asset-based structure normally results in debt creation. The debt that is created represents the receivables which will be distributed to the entitled parties. Thus, in asset-based sukūk structures, the debt represents the coupon plus principle investment via a right in the obligor’s cash flow.\(^1\) In asset-backed sukūk (ABS) on the other hand, the sukūk holders are actually buying undivided shares of the underlying asset which will be represented by way of transfer of legal title. They have the full ownership rights over the asset and are thus entitled to revenues generated from it. At the same time, they will also share the risks that come with ownership such as loss or damage to the underlying asset.\(^1\)

Thus, it is widely observed that in most sukūk issuers are trying to avoid a common law ‘true sale’ and instead entering into what appeared to be a sale, but was not a perfect sale from a Sharī‘ah perspective. The issuer was able to transfer only

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\(^1\) Usman Hayat “Islamic Finance’s sukūk explained”, Financial Times, April 11 2010.

\(^1\) Ibid.


\(^1\) Ibid
the ‘beneficial ownership’ of the asset or business venture to a common law trust-SPV.\(^{15}\)

Thus, the main issues surrounding \(\textit{ṣukūk}\) structures which require further scrutiny so that \(\textit{ṣukūk}\) structure are in full conformity with AAOIFI requirements revolve around the absence of criteria enumerated in the definition of ‘true sale’ are: (a) a genuine due diligence according to custom and modern practices about the underlying assets to avoid any possibility of \(\textit{jahālah}\) and \(\textit{gharar}\); (b) a legal transfer of ownership of the assets sold from the buyer to the purchaser; (c) the assets sold are transferred from the balance sheet of the seller to that of the purchaser; (d) non-existence of any condition or clause that prevents the purchaser from exercising his rights to sell the asset or dispose of it; (e) return to the \(\textit{ṣukūk}\) are based on the actual performance of the asset underlying the \(\textit{ṣukūk}\); and (f) the purchaser has direct recourse to the asset in case of default.

All these requirements seem to be lacking in a large number of \(\textit{ṣukūk}\) structures and therefore, such structures are not strictly complying with the requirement of ‘true sale’ and asset-backed \(\textit{ṣukūk}\). The following are some direct quotations from the offering circulars issued between 2009 and 2013. Given that such statements are common in these \(\textit{ṣukūk}\) structures, we preferred not to give any specific reference to a particular \(\textit{ṣukūk}\) issue but to establish the case and look for future actions on how to improve. At the same time, these Offering Circulars can be easily accessed at www.zawya.com.

Sometimes the certificate holders purchasing the \(\textit{ṣukūk}\) assets will not perform any due diligence or enquire regarding the asset. Sometimes they have no right to do so:

No investigation or enquiry will be made and no due diligence will be conducted in respect of any of the constituent assets comprised in the Portfolio … the Certificate holders shall have no ability to influence this selection. Only limited representations will be obtained … in respect of the Portfolio of any Series of Trust Certificates. In particular, the precise terms of any of the constituent assets comprised in the Portfolio will not be known (including whether there are any restrictions on transfer or any further obligations required to be performed …to give effect to the transfer of any of the relevant constituent assets comprised in the Portfolio). No steps will be taken to perfect any transfer of any of the relevant

constituent assets comprised in the Portfolio or otherwise give notice of the transfer to any lessee or obligor in respect thereof.

In another offering circular the following was stated:

No investigation will be made to determine if the Purchase Agreement will have the effect of transferring any beneficial interest and rights in and to the assets described therein. No investigation has been or will be made as to whether any interest and rights in and to any of the Portfolio Assets may be transferred as a matter of the law governing the contracts, the law of the jurisdiction where such assets are located

Another offering circular states the following:

No investigation has been or will be made as to whether any Relevant Lease Asset may be transferred as a matter of the law of the jurisdiction where such assets are located or any other relevant law. No investigation will be made to determine if the relevant Purchase Agreement will have the effect of transferring the Relevant Lease Assets of the relevant Series.

The question that arises is that why investors do not ask for a genuine due diligence about the assets and why such a right is denied although they are investing hundreds of millions of dollars. Why are they not allowed to investigate whether the ownership of the asset they are purchasing is legally transferable or is valued at the cost price? More importantly, why are investors not asking if the asset would continue having a value in case of default in order to protect their rights? Answers to these questions seem clear. Investors in such structures are relying on the credit position of the originator and are depending on the purchase undertaking for the return on their capital. They have no right to dispose of the asset and therefore, there is no need for legal or financial due diligence over the asset.

A Shari‘ah question that will arise based on the above is that considering the absence of a due diligence and inquiry about the asset purchased, does this constitute a kind of jahālah and gharar that will affect the Shari‘ah compliance of the sale? Based on Shari‘ah principles, the sukūk holders should be able to deal freely with the asset they purchased and the seller should not have any claim over the asset after its sale. This means the sukūk holders should have priority claim over the asset if there is default and the right to sell it or place it as a security. They are the real owners of the asset and should thus have full control over it. However, the reality is that the sukūk holders cannot dispose of the asset and can only enforce the purchase
undertaking. They have to rank pari passu with other unsecured creditors of the obligor in case of default. Moreover, the transfer of ownership would not be perfected and the underlying assets of the ṣukūk will remain on the balance sheet of the obligor.

Thus, it is clearly stated in some of these offering circulars that:

“Taking enforcement action in the name of the Trustee against the Obligor for all amounts due to be paid or shares to be delivered under the Purchase Undertaking provided always that, for the avoidance of doubt, such enforcement action shall not include the right to sell Muḍārabah Assets”.

In another offering circular the following was stated:

“Under no circumstances shall any Certificate holder, the Trustee or the Delegate have any right to cause the sale or other disposition of any of the Trust Assets except pursuant to the Transaction Documents and the sole right of the Trustee, the Delegate and the Certificate holders … shall be to enforce the … obligations under the Transaction Documents.

The above seems to be the common position of all ṣukūk structured as asset based ṣukūk whereby ṣukūk holders have no real ownership over the asset and therefore, have no right to sell the asset to a third party or dispose of it or otherwise. It has been rightly asked if such a contract is a genuine sale and purchase from a Sharī‘ah perspective\textsuperscript{16} if the buyer cannot pledge or resell the purchased asset, while the seller maintains control over the assets and has it on its balance sheet.\textsuperscript{17}

It is also upheld by rating agencies that without evidence of a legal ‘true sale’, there is little or no benefit to the assets in an ‘asset-based’ ṣukūk. This is based on the fact that the ‘form’ of the risk and return may appear to be that of assets but the ‘substance’ may be purely that of the corporate or bank originating the ṣukūk and not that of asset risk. More importantly, in most cases, this is exactly what the borrowers


\textsuperscript{17} Ibid
and investors want. Many, with full knowledge and understanding, are content to transact on this basis.\(^\text{18}\)

However, the question from Islamic law will be if the purchaser has no right to dispose or to sell the assets does he have full ownership? If the buyer would not be given full access to the goods purchased without restriction based on the principle of takhliyah and tasarruf, does the contract continue to be valid? What if the buyer does not undertake any effort to see whether the legal title of the purchased goods would be transferred to him? Is the contract really intended to be a sale contract?

The above clauses and provisions are generally discussed by early Muslim scholars under conditions that are incompatible with the objective of the contract (\(al\ shurut allati tunafi muqtada al-'aqd\). The conclusion of the jurists’ discussion regarding the issue is that such conditions would render the contract null and void according to some while a second group maintained that the contract is still valid but the condition is void and therefore should be dropped automatically.\(^\text{19}\) The main argument is that a sale contract by definition entitles the purchaser to have free and full control over the purchased asset; however, such kinds of conditions restrict it and rather go against its spirit (\(Yunafi wa yunaqidu maqsud al-'aqd\)).

It is extremely pertinent to reiterate that moving from legal ownership to beneficial ownership is not simply an issue of registration. Registration of ownership transfer in the Land Register, for instance, is not a pre-condition for the compliance and validity of a sale and purchase contract under Islamic law. A sale and purchase contract is valid through offer and acceptance and there is no Shari‘ah requirement that this must be registered. Registration is a modern legal formality that needs to be observed for reasons of public interest and submission to the legal system in place. Thus, a sale and purchase contract is valid even without registration and the legal ownership is automatically transferred by the sale contract. In addition, under a Shari‘ah compliant sale and purchase contract, the buyer has the right to keep the goods purchased or to resell them to a third party as when he wishes and he has the right to undertake a due diligence over the asset and perform all necessary inquiries about it. Thus, portraying the difference between legal transfer and beneficial

\(^{18}\) Khalid Howladar The future of \(ṣukūk\): substance over form?

transfer of ownership in ṣukūk structure as just an issue of registration is deceptive and misleading.

The crux of the construction was based upon a nuance between the Sharī‘ah and the common law legal systems upon the definition of a ‘sale’ and the acceptance of ‘beneficial ownership’ in the Islamic legal system which was perhaps intended to be a temporary ‘way out’, but unfortunately it seems to becoming a norm.\textsuperscript{20} Some have gone even further highlighting that “the structural ‘substance’ of many existing unsecured ṣukūk to be a deliberate construction whereby many companies do not want to sell their quality assets to investors while many investors do not actually want asset risk, but want the equivalent of conventional bonds.\textsuperscript{21}

Thus, it has been observed that although AAOIFI guidelines are clear, market participants can, and will, make their own decisions in ṣukūk structuring. More importantly, despite the lapse of several years since the controversy over asset-backed and asset-based ṣukūk started and the issuance of AAOIFI’s resolution in 2008 with the aim of clarifying some of the issues, the successful issuance of ṣukūk since then without adoption of these recommendations shows that there is still diversity of opinion and no single agency, institution or individual can really hope to unilaterally resolve the issue. Therefore, there is a need for more coordinated efforts.\textsuperscript{22}

Recommendations on Ṣukūk structures and 
\textit{Maqāṣid al-Sharī‘ah}

The following are some of the issues that need further clarification and a common position from all Islamic finance players including Sharī‘ah scholars, lawyers, accountants, finance specialists, regulators and legislative bodies.

- The pivotal role of the concept of ‘true sale’ in ṣukūk structuring is still a moot point and therefore, it is important to clarify this concept, through collective \textit{ijtihād}, in light of modern securitisation principles and how it is compatible with the Sharī‘ah principles of valid sale contract.

\textsuperscript{22} Ibid.
The concept of “beneficial ownership” is still very much contested particularly among Sharī‘ah scholars and there is a need to resolve the issue with particular reference to ṣukūk and the direct involvement of not only Sharī‘ah scholars but also lawyers and accountants.

The insistence of the originator in some ṣukūk in keeping the underlying asset of the ṣukūk sold in its balance sheet is an issue of genuine concern. Does this reflect in practical reality that these assets were sold or not? Does the mere reference in the ‘notes’ by the auditors that these assets are ‘used’ for ṣukūk issuance is a clear indication that these assets are owned by the ṣukūk holders and they are no longer the property of the originator? Again, the issue is not purely a Sharī‘ah issue but has accounting and legal dimensions and therefore, cooperation among these parties is highly needed in resolving the issue.

Does the reference in ṣukūk structures that the ṣukūk holders “have no right of recourse to the asset in case of default” is in line with Sharī‘ah principles or is it a non Sharī‘ah compliant provision and condition that could render the whole transaction null and void.

Despite the fact that rating agencies have clear distinct methodologies in rating debt-based bonds and asset-backed securities and the concurrence by these agencies that these methodologies are also viable to Islamic structures, the distinction has not found its way with regard to ṣukūk rating whereby the vast majority of ṣukūk in the market are rated based on the credit profile of the originator and not based on the asset underlying the ṣukūk. Therefore, it seems that the issue is not that of rating methodology but unjustified preference of ṣukūk based structures by issuers.

Perhaps one way to address the issue could be a request by the Sharī‘ah Board approving ṣukūk structures to demand a parallel rating of the assets underlying a ṣukūk structure besides that of the originator. This will result in

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a genuine due diligence about the assets and show that they constitute a fundamental part of the structure. Indeed this will be an added cost but justified for compliance purposes.

- The confusion on the above issues and others seems to be based on the lack of some key legislation that could shed light on the above controversial issues, such as the nonexistence of a modern legal framework dealing with issues such securitisation, trust law, secured transactions mechanisms or favourable tax legislations in order to create a level playing field.

- Although the promulgation of the above legislations would be primarily based on government initiatives, it is important to stress that for a genuine asset-backed ṣukūk to a reality, there is a need for some sovereign benchmark asset backed issuances as was the case with the early global ṣukūk that were dominated by sovereign ownership during its early days. Similarly, the Islamic Development Bank (IDB) as a multilateral institution can be a catalyst in driving such initiatives by having its first asset backed ṣukūk.

- Although the presence of such legislations is crucial, what is most important is the market desire to move towards assets backed ṣukūk. For this shift to take place, it is believed that the presently selected legal systems to govern ṣukūk issuance and dispute resolutions such as English or American law must recognise and differentiate between an asset-based ṣukūk and an asset-backed ṣukūk and the example of the Cameron ṣukūk is a testimony to this end. When the transaction defaulted, investors were given the right of direct recourse to the asset by the American court, for the simple reason that the transaction was structured from the beginning as asset-backed and not asset-based transaction. Therefore, it is incumbent upon the industry to make a genuine move towards asset-backed ṣukūk based on ‘true sale’.

- Some might have reservations over the transfer of the asset to a Special Purpose Vehicle given the fact it is a shell company, however, to mitigate such a risk it is important the SPV is audited or explore the possibility of having banks play the role of trustee rather than SPV.

- Securitisation and asset-backed ṣukūk opportunities abound in countries with Sharī‘ah legal and financial systems. Such a move will allow smaller companies and sovereigns with no investment grade the highest rating if they have strong good assets. This rating can be even higher than the issuer or government. For instance, a company or a sovereign with an overall “B” rating with “AA”-rated assets on its books might be able to raise funds at an “AA” rather than “B” rating by securitising those assets.
A sudden shift towards asset-backed šukūk is not feasible and not advisable. However, in order to be much closer to the principles of Sharī‘ah and maintaining the main characteristics that distinguish Islamic finance, a systematic move towards asset-backed and securitisation based šukūk is a must.

If the first part of this paper focused on one of the deficiencies in šukūk structuring and its relation with maqāṣid al-Sharī‘ah, the second part will shed light on the continued debate of labelling the Islamic finance industry as a “failure” in line with maqāṣid al-Sharī‘ah based on the assumption that the current Islamic financial system is emphasising the legalistic or contractual approach that ignores the masalih-mafāṣid dimension. It is also grounded on the claim that the ideal way for financing in Sharī‘ah should be financing on the basis of partnership and profit sharing while debt-based Islamic instruments are a kind of stratagem or the contention that debt-based products are meant to be temporary. The critics have also maintained that the current Islamic finance has deviated from the objectives of Islamic economics and social justice.

Maqāṣid al-Sharī‘ah and Debt-based Contracts

As noted above, one of the widely cited features of the relation between Islamic finance and maqāṣid is the so called legalistic or contractual approach. Proponents of this position maintain that the legalistic methodology ignores maqāṣid al-Sharī‘ah. The juristic discussion focused primarily on the contractual aspects with little attention to the masalih-mafāṣid dimension. As an example, critics maintain that even the AAOIFI standards are oblivious to this essential dimension of Islamic law.25 It is also asserted that the legalistic-rational method applied by the Sharī‘ah scholars should be considered as an important part of the social failure of Islamic finance as currently applied ignores the ‘substance’ and prioritize the ‘form.’ Substance according to the critics requires looking at the consequences and outcomes while in the ‘form’ oriented approach, the emphasis is relegated to the process of constructing a product by ignoring the outcomes of the product.26

The level of frustration by some Muslim economists towards the current Islamic finance has reached the level whereby they are considering its inability to access

certain markets as a blessing. It is in this sense that one well respected economist commented on the Indian court’s ruling disallowing Islamic finance saying:

The court ruling may perhaps turn out to be a blessing in disguise for India's 150 million Muslims, a large majority of whom are poor and whose financial needs are certainly not going to be taken care of by the large NBFCs/ banks practicing the "spurious" variety of Islamic banking and investments. The so-called mainstream Islamic banking and finance is a sham, targeted at high-networth individuals and corporates, against true Islamic ideals and spirits, a poor attempt to disguise conventional products in Islamic garb and no wonder, is getting popular in UK, USA, Germany, France and elsewhere in the developed world. What Indian Muslims need is provision of finance and other inputs for micro-enterprise and livelihood development.27

It is argued that the overall goal of this system is to realise the objectives of Islamic law which should manifest in the economy as enabling growth, justice, and equity. This implies that other than fulfilling the legal requirements, an Islamic financial system should also cater to the social needs of the society. In doing so, the legalistic forms of contracts are fulfilled but the substance and spirit are not.28

1. Islamic Finance Should be Profit Loss Sharing

A number of economists backed by some Sharī‘ah scholars hold the opinion that Islamic finance should be based on profit loss sharing and avoid possible debt-based instruments. It has been argued that if Islamic finance transactions are based on debt-based products, then they are not different from products offered by conventional banks. It is also upheld that the use of debt-based instruments created a suspicion amongst unconvinced Muslims as they did not see any difference between Islamic and conventional finance since the net result of both systems are almost the same.29 Critics also emphasised that the distinguishing features of Islamic finance from its conventional counterpart are entrenched in its vision to move away from debt-based financial intermediary to an equity based and risk-sharing arrangement. In other words, an ideal Islamic financial system is reflected through its balance sheet

28 Ibid
structure that is dominated by profit-loss-sharing on both assets and liabilities.\textsuperscript{30} Thus, the bulk of financing by Islamic banks has to be equity oriented.\textsuperscript{31} Islamic finance in its purest form should be based on mushārakah and muḍārabah. An Islamic bank is conceived as a financial intermediary mobilising savings from the public on a muḍārabah basis and advancing capital on a partnership basis.\textsuperscript{32} Unfortunately, according to the proponents, Islamic financial institutions deviated in practice from the two-tiered profit and loss sharing system. Most funds on the deposit side are raised on the basis of a muḍārabah contract or deposits made on a loan basis and guaranteed by the Islamic banks. On the asset side, however, profit and loss sharing instruments are rarely employed. Instead, a variety of debt or quasi-debt financing modes are used.\textsuperscript{33} It is also upheld that Islamic financing should be on the basis of partnership as it is the best method that incorporates fair distribution of wealth among the people and guides the excess of money from the rich to the general public while the expansion in the use of debt-based instruments will narrow the scope of partnership operations and encourages the usurious mentality, which aims at profit seeking without bearing any risk and this will not bring about any genuine change in the current prevalent capitalistic system.”\textsuperscript{34} Some have gone even further and considered Islamic products such as murābahah, deferred payment sale, bay’ al salam, bay’ al- istisnā’, ijārah and other debt-based instruments as an exception and maintained that these modes of financing cannot be expected either to remove the injustices of the interest-based system or to contribute to the achievement of socio-economic objectives which Islam seeks to achieve.”\textsuperscript{35} Moreover, these modes of financing are regarded immoral since they operate in a similar fashion as the conventional products.\textsuperscript{36} Some have gone to the extreme by suggesting that “Bai’ mu’ajjal is removed from the list of permissible methods altogether” because even if we accept its permissibility from a legal perspective, we have the overriding legal maxim that anything leading to something prohibited stands prohibited and

\textsuperscript{30} Ibid
\textsuperscript{32} M Kabir Hassan and Mervyn K. Lewis, “End and Means in Islamic Finance” Review of Islamic Economics, Vol.11, Special Issue, 2007
\textsuperscript{33} Ibid.
\textsuperscript{34} Taqi Usmani “Ahkam Al Tawarruq wa Tatbiqatuhu al-Masrafiya” paper submitted to the nineteen session of the Islamic Fiqh Academy, United Arab Emirates.
therefore, it will be advisable to apply this maxim to *al bay' al mu'ajjal* in order to save interest-free banking from being sabotaged from within.\textsuperscript{37}

### 2. Debt-Based Products are Temporary

To justify the continued existence of debt-based instruments in the Islamic finance industry and their approval by Sharī’ah scholars, the critics contend these contracts have been currently approved by scholars on temporary basis. It has been argued that Fiqh academies and Sharī’ah boards of Islamic financial institutions approved the permissibility of these products in consideration of the conditions that faced Islamic financial institutions at their inception and the dominance of interest based transactions and the difficulty of conducting financing activities purely on the basis of *mushārakah* and *muḍārabah* debt-based instruments are allowed to avoid clear and explicit *ribā*.\textsuperscript{38} Thus, it has been pointed out that:

“Undoubtedly, Sharī’ah supervisory boards, academic councils, and legal seminars have given permission to Islamic banks to carry out certain operations that more closely resemble stratagems than actual transactions. Such permission, however, was granted in order to facilitate, under difficult circumstances, the figurative turning of the wheels for those institutions when they were few in number”. Once the normal question will be how to approve a number *Ṣukūk* structures based on the assumption that they could be made more Sharī’ah compliant once the market had grown\textsuperscript{39}. 

### 3. Islamic Finance *Maqāsid* and Social Responsibility

Another criticism to the current practice of Islamic finance is labelled as a tension between Islamic finance and Islamic economics. Islamic debt financing does not support, nor is it supported by the normative assumptions of Islamic economics. The current pragmatic approach according to the critics has opted for a more profitable Islamic financing such as *murābaḥah* at the expense of *mushārakah* and as a result the Islamic finance industry has deviated from the aspirational stand of Islamic economics. Thus, according to the proponents of this view, Islamic finance should relate to the social and economic ends of financial transactions, rather than just focusing on the mechanics of the contract. Therefore, correcting the failure of


\textsuperscript{38} Taqi Usmani “Ahkām Al Tawarruq wa Tatbiqatuhu al-Masrafiya” paper submitted to the nineteen session of the Islamic Fiqh Academy, United Arab Emirates.

Islamic finance, which has deviated from the aims of Islamic economics, would be through the introduction of robust social justice oriented principles into Islamic finance, and by restructuring and redirecting its operational strategies towards that of social banks.\textsuperscript{40} Thus, despite the successful financial performance of the industry so far, this accomplishment has been at the expense of the ‘social and economic’ aspirations of Islamic moral economy.

The debate in recent years around the issue of social responsibility has been framed around phrases such as ‘form vs substance’ or ‘Shari’ah compliant finance vs the Islamic based finance’. Some contend that the legitimacy of the current practices in the Islamic finance industry has been brought into question. Failure of the Islamic finance industry in the social dimension resulted in a convergence between the Islamic and conventional systems. Thus, it has been concluded that considering the fact that some products in the conventional system are responsible for its failure, the fear of their impact on the Islamic finance industry is important to consider.

Critics also stressed that an Islamic economic system is equity or profit-and-loss sharing financing based and superior to debt-like financial instruments. Therefore, having Islamic financial institutions involved in more debt-like financing is an indication that Islamic financial institutions have deviated from their aspirational origins. Islamic financial institutions have opted for profitability and efficiency over equity and value propositions of the Islamic Moral Economy and this is evidenced by the lack of Corporate Social Responsibility initiatives in the Islamic financial system.\textsuperscript{41} These critics stressed that the contribution of Islamic financial institutions to economic development is elusive, as these institutions preferred to opt for short-term financing which brings a much higher return.\textsuperscript{42}

Critics maintain that “the legalistic-rational method applied by the Shari’ah scholars should be considered as an important part of this observed social failure, which by definition ignores the ‘substance’ by prioritizing the ‘form’” and can lead to unethical practice as it ignores the broader issues related to moral teachings of


\textsuperscript{42} Ibid
Islam. More drastically, some have gone to the extent of considering the failure in human development in countries where Islamic finance is practiced to be a testimony of the failure of Islamic finance. Thus, it have been upheld that when examining the Human Development Index as well as other social indices, it is clear that the ranking of these countries is very low.

4. Need for a New Classification of Sharī‘ah Compliance

Another issue highlighted by the critics of Islamic finance and the claim that it is not fulfilling maqāṣid Sharī‘ah is the proposition to differentiate between “Sharī‘ah-compliant” and “Sharī‘ah-based Islamic products”. Although there is an acknowledgement from the advocates of this classification that there are no clear definitions as to what these terms entail or the fact that some scholars did not see difference among these terms. However, proponents maintain that there is still a need to distinguish between different nuances of Islamic finance in terms of legal and social Sharī‘ah requirements. Elaborating on this classification, three type of products have been identified: “pseudo-Islamic product”, “Sharī‘ah-compliant Products” and “Sharī‘ah-based Products”.

1. A pseudo-Islamic product conforms to the legal form only but does not fulfil the substance of the Sharī‘ah or serve the social needs. It is the outcome of using stratagems to develop products that fulfil the legal form of the contracts, but in substance represent an illegal transaction. It is worth noting that according to the proponents of this classification in certain cases when no Sharī‘ah-compliant alternatives are available to serve a pressing need; the maxim of necessity can be invoked. Under such situations, the prohibitions can be relaxed to satisfy the dire need. However, once the need ceases to exist or alternatives are available, the lawful ruling due to necessity becomes void. Thus, it has been stressed that using a tawarruq when other Sharī‘ah-compliant alternatives are not available may be legitimate. However, using tawwaruq when Sharī‘ah-compliant alternatives are available would make it a pseudo-Islamic product.

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43 Habib Ahmed, “Defining Ethics in Islamic Finance: Looking Beyond Legality” Paper presented at 8th International Conference on Islamic Economics and Finance, Center for Islamic Economics and Finance, Qatar Faculty of Islamic Studies, Qatar Foundation


2. Sharī‘ah-compliant Products: Sharī‘ah-compliant products would satisfy the form and substance of Islamic law, but did not pay attention to the social goals. Specifically, a Sharī‘ah-compliant product will not meet the survival and security financial needs of the poor and that of small enterprises adequately. An example mooted by the critics is that of a mutual fund that sets very high minimum investment requirements targeting only the affluent segment of the society. Such a fund would be Sharī‘ah-compliant but does not meet its social goals as it does not serve the middle class and poorer sections of the population.

3. Sharī‘ah-based Products: A Sharī‘ah-based product is a Sharī‘ah-compliant product that fulfils the legitimate needs of all market segments. Such a product will not only satisfy the form and substance of Islamic law, it will also satisfy the survival and security needs of all sections of the population including the poor and small entrepreneurs. Thus, a Sharī‘ah-based product is a Sharī‘ah-compliant product that fulfils the social goals. For instance, a home financing product that targets all segments of the population, including the poor, would be Sharī‘ah-based.\[^{46}\]

It is maintained that fulfilling the social goals of Sharī‘ah would firstly entail serving the financial needs of all market segments in general and the poor in particular. These social responsibilities can be ascertained by examining the extent to which the various financial needs of different groups in a society are satisfied. New terminologies such as survival, security, and growth have been invoked in replacement of widely used terminologies in classical Islamic jurisprudence such as necessities (\(\text{daruriyyat}\)), complementary (\(\text{hajiyyat}\)), and luxury (\(\text{tahsiniyyat}\)). Thus, survival needs would rank higher than serving the security needs which in turn will rank higher than the growth needs.\[^{47}\]

Comments and Recommendations

Based on the discussion and issues raised above, it might be observed that the debate over \(\text{maqāsid al}\) Sharī‘ah and Islamic finance needs to take into consideration the following:

1. The concept and principles of \(\text{maqāsid al}\)-Sharī‘ah have a different scope and understanding when discussed in relation to the implementation of the


\[^{47}\] Ibid, pp.163-164.
entire principles of Sharī’ah or just with regards to the application of Islamic economic principles. This scope of differences would be much wider if it is extended to the implementation of Islamic finance. Any confusion in this area could create greater misunderstanding rather than resolving unsettled issues. The widely held definition of Maqāsid al-Sharī’ah is that it aims in safeguarding faith (dīn), self (nafs), intellect (’aql), posterity (nasl), and wealth (māl). However, it is also recognised that while these five may be considered as the primary objectives of Sharī’ah, other equally important purposes can serve as pre-conditions and upshot of the major or primary objectives. These auxiliary objectives could include among others principles such as justice and equal treatment, security of life, individual freedom, education, minimisation of crime and others. If these are the objectives of the Sharī’ah as a complete system of life, Islamic economics has its objectives which are much narrower than the above. Although there is no single understanding of the objectives of Islamic economic concepts such as falāḥ has been selected as the fundamental objective of an Islamic economics. Chapra as one of the leading Muslim economists highlighted four Sharī’ah frameworks as Maqāsid or goals of Islamic economics. The four are to achieve the economic well-being within the framework of the moral norms of Islam, to uphold universal brotherhood and justice, to attain equitable distribution of income and to accomplish freedom of the individual within the context of economics emerged since the prophetic period from the social welfare. The main objective of Islamic economics are to establish social justice, elimination of poverty, tangible reduction in economic disparities, free of corrupt society, institutionalisation of zakāh, interest free system, and moral and ethical instruments of Islamic teachings. The primary objective of Islamic finance is to free Muslims and non-Muslims alike from non-permissible financial arrangements and their associated negative consequences. These non-permissible elements could include among others explicit, ribā, gharar, gambling, dealing in non-permissible goods and services as well as other non-permissible activities in whatever forms and structure they are presented. These are some of the major principles that Islamic finance stands for.

48 Chapra, The Future of Economics: An Islamic Perspectives, (Leicester: The Islamic Foundation), 2000
49 Chapra, Objectives of The Islamic Economic Order. The Islamic Foundation, Leicester, 1979.
2. Islamic finance is a Sharī'ah compliant or based system and not just a profit loss sharing industry. Therefore, there is no limitation to innovation and creativity as long as there are no clear infringements of Islamic principles. Thus, using muḍārabah, mushārakah and wakālah instead of sale and ijārah in a specific transaction has the same preference as maqāṣid al Sharī'ah and the industry has to choose what best fulfils its objectives. It is based on such an understanding that some of the scholars who are calling for greater use of profit loss sharing instruments acknowledge that:

Greater reliance on equity does not necessarily mean that debt financing is ruled out. This is because all financial needs of individuals, firms, or governments cannot be made amenable to equity and PLS. Debt is, therefore, indispensable. Debt does not, however, get created in a truly Islamic financial system through direct lending and borrowing but rather through the sale or lease of real assets via the sales- and lease-based modes of financing (murābaḥah, ijārah, salam, istiṣnāʿ and šukūk). The purpose is to enable an individual or firm to buy now the urgently needed real goods and services in conformity with his ability to make the payment later. The conditions, however, are that the asset which is being sold or leased must be real and not imaginary and that the transaction must be a genuine trade transaction with the full intention of giving and taking delivery. In the case of such sales or leases, the rate of return gets stipulated in advance and becomes a part of the deferred payment price. Since the debt is associated with real goods or services and the rate of return is fixed in advance, it will be less risky and, therefore, more attractive for banks, as compared with equity and PLS financing.51

1. There is no explicit text from the Qur’ān or the Sunnah that prioritise profit sharing products over debt-based instruments. The position of some early scholars in the early days of the emergence of the idea of modern Islamic economics or Islamic finance that give preference to profit loss sharing products is just an ijtihād and has nothing to do with maqāṣid al-Sharī'ah and therefore, these early opinions have no binding effects. On the contrary, these positions need to be revised and adjusted.

2. Indebtedness is by itself a valid Sharī'ah objective in financial transactions. It is so, as Ibn Ashur explained that the prohibition of ribā should not be considered to cover and reject all legitimate indebtedness. It is one of the great means of business expansion as a good entrepreneur may not have the capital he needs and therefore, he has to resort to indebtedness to develop

his skills in business, industrial activities, and agriculture.\textsuperscript{52} It is also worth
noting that the indebtedness we are referring to here does not include
indebtedness that is triggered by a drive towards over spending on luxury and
extravagance which is definitely discouraged by the Sharī‘ah.

3. If Islamic debt-based instruments are permissible, then this permissibility
should not be limited to a certain time and conditions and if the opposite is
ture, then, it should be rejected from day one.

4. Eradicating poverty and other social responsibilities are the objectives of an
Islamic economy and not the primary aim of an Islamic financial system.
Yet, Islamic finance can contribute towards that objective but its role will be
secondary. More importantly, poverty will not be eradicated and social
justice will not prevail unless Islamic economic principles are fully
implemented and the principles and values of Islam are realised. Expecting
Islamic finance to eradicate poverty under the current conditions is unfair
and might be based on a misunderstanding of *maqāṣid* al-Sharī‘ah.

3. Any attempt to create two different methodologies with regards to Sharī‘ah
compliance one for Sharī‘ah scholars and another one for economists will
not help in moving forward but could be the source of futile and unnecessary
debate and discussion that would only create confusion among ordinary
persons.

4. The notion of *maqāṣid* al-Sharī‘ah is primary a juristic concept and
therefore, is better understood by Shariah scholars. However, this does not
deny the fact that it has its economic dimensions and therefore, a close
cooperation between Shariah scholars, economist and financiers is a must
and any attempt to discuss the issue of *maqāṣid* al-Sharī‘ah by one group in
isolation of the others will be counterproductive.

5. Despite the criticism of the methodology of Islamising and adopting some
existing conventional products, it is by no means a sign of weakness in
Islamic law and finance but a testimony of its strength, flexibility, and
adaptability. It is a methodology that existed since the early days of Islamic
law and will continue. Even if contracts such as *muḍārabah* and *mushārakah*
are considered to be the preferred products of Islamic finance these are not
products of Islamic jurisprudence but adopted from early practices from the
pre-Islamic era after being refined and scrutinised. This was the
methodology adopted by the Prophet (PBUH) in approving the *salam*
contract. The same needs to be followed.

\textsuperscript{52} See Mohammad Al Habib Bin Khojah, *Bayna Ilamy Usul Al Fiqh Wa al Maqasid*, Ministry of Awqaf
6. Although it is acknowledged by the critics that some scholars did not see any difference between Sharī‘ah-compliant and Sharī‘ah-based products, it should emphasised that if products are classified based on Sharī‘ah rulings of permissible and non-permissible, it is believed that a consensus could be easily obtained among Sharī‘ah scholars that a product that is permissible and Sharī‘ah-compliant should also be Sharī‘ah-based. Sharī‘ah principles will not declare a product or a contract to be permissible if it is against its objectives and maqāṣid. If a product is in substance illegal, how can it be accepted in cases of dire need? Perhaps what is intended by the critics is dire necessity. However, if it is true that what is meant here is dire necessity, then, necessity will be a ground for easiness not only with regards to these types of contracts but even the explicitly prohibited contracts.

7. Although new classifications of Sharī‘ah compliance such as Sharī‘ah-based products, Sharī‘ah-compliant products and pseudo Islamic products or the classification of Sharī‘ah compliant-products by form and others by substance are advocated by some, a clear scrutiny of Islamic jurisprudence would not accommodate such classifications. A product is either Sharī‘ah-compliant or not and there is no possibility of having a product which is half Sharī‘ah-compliant. Preference of one product over the other due to specific circumstances has never been an issue of permissibility. As such, some of these classifications are creating confusions rather than solving outstanding issues.

8. Claiming that financial products that set very high minimum investment requirements as non- Sharī‘ah-compliant because it is targeting the affluent segment of the society only and not serving the middle class and poorer segments may not be easily accepted by any Sharī‘ah scholar. It is possible to say that it is not the ideal structure for an Islamic fund but declaring it not Sharī‘ah-based is unwarranted.

9. Criticisms against specific products should not be generalised as non-compliance or failure of the entire Islamic finance industry. Unfortunately, some of the critics’ conclusions have been drawn based on the rejection of certain products by some Sharī‘ah scholars or intuitions and concluded that Islamic finance has failed to abide by Sharī‘ah principles. Thus, it is upheld that the rejection of some products such as “total return swap”, “bay‘al-‘īnah” or even “tawwaruq” will not condone the unwarranted conclusion that contemporary Islamic finance does not fulfil maqāṣid al-Sharī‘ah. Moreover, the rejection of these contracts by scholars is based on the contractual jurisprudential methodology criticised by those who consider it one of the reasons for the deviation of current Islamic finance.
10. The claim that by using debt-based instruments Islamic finance is just another version of the interest based financial system is lacking the minimum evidence to support it given the fact that the difference between the current Islamic financial system and the conventional are obvious and cannot be denied. Islamic finance is not about trading debt at discount or through Credit Default Swap (CDS), nor is it about gambling and speculation through derivatives or short selling and other type of products not permissible in Islamic finance and considered to be the main reasons behind the recent and financial and economic crisis. It is because of these differences that the Islamic finance industry has been less affected by the crisis compared to its conventional counterpart. It is also because of these differences that the two systems are regulated differently, preferred by growing customers and forcing conventional financial institutions to convert into Islamic or at least have Islamic windows. In short, Islamic finance is about prohibiting and avoiding ribā, gharar, and maysir which are the pillars of the conventional financial system.

11. The differences between products such as murābahah, ijārah, and tawarruq on one side and a loan with interest on the other from a Sharī‘ah perspective are obvious and explained in details by Sharī‘ah scholars. It is beyond the scope of this paper to repeat what is widely considered to be common knowledge. Even from an economic perspective as Chapra explained, the predetermined rate of return on sales and lease-based modes of financing may make it appear like interest-based instruments. It is, however, not so because of significant differences between the two for a number of reasons. First, the sales and lease-based modes do not involve direct lending and borrowing. They are rather purchase and sale or lease transactions involving real assets. Secondly, the Sharī‘ah has imposed a number of conditions for the validity of these transactions such as the condition that the seller (or lessor) must also share a part of the risk to be able to get a share in the return. Thus, the seller or lessor is required to own and possess the goods being sold or leased. When the seller (financier) acquires ownership and possession of the goods for sale or lease, he/she bears the risk. All speculative short sales, therefore, are ruled out automatically. Financing extended through Islamic modes can thus expand only in step with the rise of the real economy and thereby help curb excessive credit expansion, which is one of the major causes of instability in the international financial markets. Thirdly, the price of the good or service sold, and not the rate of interest that is stipulated in the case of sales or lease-based modes of finance. Once the price has been
set, it cannot be altered, even if there is a delay in payment due to unforeseen circumstances.\textsuperscript{53}

12. One of the distinctive feature of Islamic finance is that it is an entrenched system into the real domain of the economy. Actual involvement and transfers of the real good in the relevant transactions is strongly required as an essential condition. Thus, \textit{murābaḥah} for instance, is legitimised because it is neither monetary, nor nominal transaction, but is a transaction based on the actual buying and selling of goods. The source of legitimacy of profit in \textit{murābaḥah} is considered to be an opportunity cost of the real goods in the relevant market. In contrast, the source of prohibition of interest in conventional interest-based loans is regarded as an opportunity cost of the monetary good. Thus, any profits in debt-based instruments are legitimised because all the relevant parties appropriately bear the market risk of the relevant real good.

13. Although some advocate the adoption of community banking, microfinance, socially responsible investment, and similar financial arrangements to replace the existing model of Islamic banking, the fact is that such ideas are always welcome and strongly recommended if the objective is to enhance and complement the existing model. However, no one could claim that the existing model is against \textit{maqāṣid} al-Sharī‘ah and therefore we need to adopt a new one close to it.

14. Although some criticise Islamic finance and its social role in relation to \textit{maqāṣid} al-Sharī‘ah, it is worth noting that it is also acknowledged even by the proponents of this opinion that:

\begin{quote}
“While Islamic economists and scholars assert the inclusion of \textit{maqāṣid} and social goals in the operation of Islamic financial institutions, there are no specific discussions on how this can be done at the operational level\textsuperscript{54}"
\end{quote}

15. The practical way towards the expansion of the use of profit loss sharing instruments will be by shifting the focus towards minimising and mitigating the risks involved in these products rather than calling for the Islamic finance industry to be based on these products. This is based on the fact that the limited use of profit and loss sharing products can be explained through different reasons and grounds such as their inherent vulnerability to agency

\textsuperscript{53} Chapra, M. Umer, “Innovation and Authenticity in Islamic Finance”, a keynote Forum lecture delivered at the inaugural session of the Eighth Harvard University Forum on Islamic Finance held on 19-20 April 2008 in the Harvard Law School

problems, the requirement of well-defined property rights for an efficient functioning of such products which is unfortunately not available in most Muslim countries where property rights are not properly defined or protected or the fact that Islamic banks and investment companies are forced to offer less risky modes of financing particularly debt-based financing products in order to remain competitive compared to their conventional counterpart. Moreover, profit sharing products are less attractive as to the restrictive role of investors in management makes them non-participatory in nature and allows a sleeping partnership or the fact that equity financing may not be suitable for funding short-term projects due to the high degree of risk which forces Islamic financial institutions to rely on debt-based products to ensure a certain degree of liquidity. Furthermore, Islamic financial institutions lack the necessary liquidity management tools available to conventional institutions including the facility of lender of last resort due to their avoidance of ribā. Finally, the unfair treatment in taxation is also considered a major obstacle in the use of profit sharing products and makes them less reliable as a tool for reward sharing.  

16. Given the above impediments in the implementation of profit sharing products, it is clear that the avoidance of equity financing in contemporary Islamic finance is not an indication that Islamic financial institutions are not interested in economic development and social welfare as claimed, but due to genuine hurdles that require Islamic economists to double their efforts to find solutions to such obstacles. Mitigating the risks of profit sharing products is needed if we take into consideration that even equity financing products such as muḍārabah and mushārakah as they have been heavily criticised by some Muslim economists on the grounds that they have failed in internalising socio-economic justice and the value of work or the claim that sharing profits through them has been non-participatory.  

17. We need to adjust to reality and think about an Islamic economic system not only based on profit loss sharing instruments but also to genuinely consider debt-based instruments as fundamental components of the system. These instruments are part of the Islamic financial system from day one and they are here to stay.  

18. Criticising both attempts of describing Islamic finance as a profit loss sharing industry or the focus only on Ṣahrī’ah compliant debt-based mechanism some scholars stressed that both approaches are suffering from some shortcomings. The comprehensive feature of Islamic finance is the harmony and cohesion between partnership-based and debt-based instruments. Implications from the above analyses show that financial instruments in Islamic finance support the fact that all the relevant parties appropriately bear the market risk of the relevant real good or business. This is the source of legitimacy for each instrument. Considering this insight from the perspective of the economic system as a whole, it can be said that the financial system highly depends on the real domain in the Islamic economic system. It is based on such findings that it has been concluded that:

The emergence of Islamic finance opens a new page in the history of both Islam and finance. ..., the comprehensive financial systems did not exist in the pre-modern Islamic world. Therefore, the current practice of Islamic finance is an unprecedented experiment in the history of Islam. On the other hand, structured banking without interest has never existed in the history of finance, too. Therefore, although Islamic finance stays on the genealogy of the —embedded‖ universal financial system, the modern novelties of Islamic finance can be observed.

19. One can also question, how to build an Islamic economy system when corruption is rampant in Muslim countries not only at the governmental level but when it has become part of the culture of individuals. Similarly, we must ask how to build an Islamic economic system when concepts such as zakāh are equated with charity and when important economic notions of an Islamic economy such as bait al mal becomes just ideological concepts without any practical value.

20. Creating an Islamic financial system that balances between equity or profit loss sharing instruments and debt-based products would not be through the rejection of debt-based instruments but through the development of equity based investment alternatives such as venture capital, private equity, asset management and deep stock markets which all are still underdeveloped. As it is rightly articulated by the governor of the central bank of Malaysia, the concept of risk-sharing in finance is not new or peculiar to Islamic finance. Even in the conventional system and despite the fact that currently risk-transfer activities dominate the system, risk-sharing in the form of equity has

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long been a cornerstone of capital markets with vibrant stock exchanges. Techniques used by venture capital financiers share similarities with risk-sharing contracts in Islamic finance. The development of a more equity-based financial system where risk-sharing takes place reduces over-reliance on debt funding, thus avoiding excessive debt and speculation and thus financial system fragility. In Islamic finance, this is further reinforced by Shari’ah principles that strongly discourage excessive debt given its detrimental effects on society. The use of risk-sharing transactions and undertakings under participatory finance models in Islamic finance thus offers the potential to reinforce the links between finance and the real economy. The contractual arrangements between the financier and the entrepreneur place strong emphasis on the value creation and economic viability of the enterprise. This results in a close link between the growth of the financial sector and real sector activities in which the expansion or contraction of credit is dependent on developments in the real sector. This would provide a restraint on financial engineering and innovation, as financial transactions need to be supported by real assets, thus aligning innovation to productive economic activities. As a result, the dangers of unbridled innovation are also substantially reduced. The move to embrace the risk-sharing dimension of Islamic finance also presents new opportunities for financial management. The profit sharing and risk-sharing characteristics of Islamic financial transactions strengthen the incentives for Islamic financial institutions to undertake the appropriate due diligence on the transactions to ensure that the profits are commensurate with the risks assumed. The explicit risk-sharing element between the financier and customer instils greater discipline and responsibility, given the obligation and economic incentives created for participants to the contract to evaluate the risk profile of the product or investment proposition, the underlying trends in earnings and cash flows, and its income-producing potential. Such a process strengthens safeguards against the widespread mispricing of risks. The strong incentives for financial institutions to understand the nature and level of risk and leverage embedded in the Islamic financial instruments would in turn lead to more responsible innovation.58

Conclusion

The paper argued that the claim that the overuse of debt-based instruments by Islamic financial institutions is not in line with maqāṣid al-Sharī’ah is unjustified and needs to be revised. The paper stressed that Indebtedness is by itself a valid Sharī’ah objective if it is practiced within Sharī’ah parameters and therefore, criticisms should be directed against its forms involving explicit non-Sharī’ah compliant elements and not against the concept itself. On the other hand, eradicating poverty and other social responsibilities are the objectives of the entire Islamic economic system and not the primary aim of an Islamic financial system. Moreover, Islamising and adopting some existing conventional products, is by no means a sign of weakness or mimicking but was and will continue to be part of the Islamic law methodology of product development and the evidence from the early days of Islam are overwhelming. Furthermore, it has been stressed that deficiencies in the mechanisms of implementing specific product should not be construed as deficiencies in the product itself or the industry as whole as it is claimed by some regarding tawarruq, murābaḥah and other debt based products. Therefore, it is submitted that the best way to strengthen the use of profit and loss sharing products is to innovate the best equity based investment alternatives which are still below their potential such as venture capital, private equity, asset management and to work towards deepening the stock markets which all are still underdeveloped.

At the same time, it is maintained that the continued used of some šukūk structures despite their shortcomings is contravening some important Sharī’ah contractual requirements and therefore are not in full harmony with maqāṣid al-Sharī’ah. To address the issue the pivotal role of the concept of “true sale”, “beneficial ownership” in šukūk structuring need urgent clarification and resolution through collective ijtihād. Similarly, the rights of šukūk holders at times of default and insolvency require further elucidation and clarification so that they are in line with the principles of justice and fairness in Islamic of law and its objectives.

It seems that the debate on the issue of maqāṣid is not a mere methodological discourse. It is the logical outcome of a lack of cooperation between Sharī’ah scholars and Muslim economists. It is a problem due to absence of a favourable political and regulatory environment. The lack of a systematic and institutionalised approach to product development is another shortcoming. This is sometimes manifested through contradicting opinions by the existing Fiqh Academies and institutions as is the case with tawarruq which is acceptable under AAOIFI standards while the Islamic Fiqh Academy declared it non-permissible as currently practiced by Islamic financial institutions. Perhaps the language gap is also a cause. Sharī’ah
opinions are generally expressed in Arabic while economics research is generally presented in English. The limited efforts that are currently afforded to make good translation available are not sufficient. Thus, it is strongly: opined that for a viable discussion on maqāṣid al-Shari‘ah a direct interaction and discussion between the different stakeholders is necessary.

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Assessing Socio-Economic Development based on *Maqāṣid* al-Sharī‘ah Principles: Normative Frameworks, Methods and Implementation in Indonesia

**Rahmatina Kasri**  
**Habib Ahmed**

**Abstract**

Despite calls to expand and implement the concept of *Maqāṣid* al-Sharī‘ah, it has been rarely utilized in economics and development studies. This paper fills this gap and proposes a framework to assess socio-economic development of Muslim societies based on the maqāṣid principles. It is argued that human wellbeing/poverty is a central theme in the historical deliberations of maqāṣid and should be the same when using it to frame policies to resolve development challenges in current Muslim world. Drawing insights from the discourses on happiness, quality of life and multidimensional poverty based on the capability approach pioneered by Amartya Sen, the paper reviews a number of operational indicators and multidimensional poverty indices. It then proposes a simple, linear and decomposable multidimensional *Maqāṣid* al-Sharī‘ah based poverty index encompassing five dimensions of wellbeing/poverty consistent with the maqāṣid perspective. The index is subsequently applied to evaluate the welfare changes amongst the recipients of zakāh in Indonesia by using data collected through a survey conducted covering 685 households living in Jakarta, Indonesia. While the study found that zakāh institutions have the expected positive contribution in reducing poverty amongst the poor, it also provides a workable example of how *Maqāṣid* al-Sharī‘ah principles can be implemented in assessing impacts of socio-economic policies in Muslim societies.

Keywords: *Maqāṣid* al-Sharī‘ah, multidimensional poverty, human development, zakāh institution, impacts of zakāh in Indonesia.

JEL Classification: D6, I3, O12

KAUJIE Classification: B5, H47, N5
1. Introduction

Maqāṣid is presumably one of today’s most important intellectual means and methodologies for Islamic studies, particularly in Islamic jurisprudence (Auda, 2008). Outside this area, however, it is rarely discussed in contemporary Islamic scholarships. This is presumably related to the difficulties in translating the concept into workable developmental models and policies (Kasri, 2012). As such, even though there have been persistent calls to expand and implement the concepts of Maqāṣid al-Sharī‘ah to economic and development studies particularly considering underdevelopment and poverty persistently exist in most of contemporary Muslim countries (Al-Sufi, 2013; M. U. Chapra, 2008; Mirakhor & Askari, 2010), the concept is rarely applied in such studies.

With this perspective, the paper discusses the basic concepts of Maqāṣid al-Sharī‘ah as the foundation to translate them into appropriate development models and policies. Based on the similarity and significance of works in developing the maqāṣid principles, it is argued that human wellbeing/poverty is one of the central themes in the historical deliberations and should be the same when using it to frame policies to resolve development challenges in current Muslim world. Considering that increasing wellbeing and reducing poverty are also the main development objectives, it subsequently develops a general framework to assess socio-economic development status of Muslim countries in the light of maqāṣid. It also provides a workable example to show how this framework can be implemented in evaluating the wellbeing changes of Muslims in Indonesia.

Following this introduction, the paper is structured as follow. Section two discusses the basic concepts related to Maqāṣid al-Sharī‘ah while section three reviews the concepts of poverty/wellbeing. Based on the literature review, a general framework for assessing socio-economic development of Muslim societies is developed in section four. A simple, linear and decomposable multidimensional Maqāṣid al-Sharī‘ah based poverty index is also briefly discussed. In section five, the index is subsequently applied to a case study which evaluates the welfare changes amongst the recipients of zakāh in Indonesia. Primary data collected through a survey conducted in 2011 covering 685 households living in nine cities of Greater Jakarta Metropolitan area in Indonesia is used to carry out this exercise. The final section concludes the study and notes some remarks for future research.

2. Maqāṣid al-Sharī‘ah and Human Wellbeing/Poverty

2.1. Basic Concepts and Classifications of Maqāṣid al-Sharī‘ah

The term ‘Maqṣid’ (plural: Maqāṣid) literally means a purpose, intent, objective, principle, goal or end. Maqāṣid al-Sharī‘ah could therefore be literally defined as the
objectives, purposes, intents, ends or principles behind the Islamic law or Islamic rulings (Ashur, 2006) or the higher objectives of the law giver (Al-Raysuni, 2005). Some scholars also refer *Maqāṣid* al-Sharī‘ah as ‘people’s interests’ (*masalih*; singular *maṣlahah*).¹ These interpretations are slightly wider than the literal meaning and reflect the ‘interest for humanity’ in the meaning of *Maqāṣid* al-Sharī‘ah (Auda, 2008).

*Maqāṣid* al-Sharī‘ah is normally classified according to levels of *maṣlahah*, beginning with the essentials (*daruriyyah*), the needs (*hajiyyah*) and the luxuries (*tahsiniyyah*). The essentials or primary interest can be defined as things which are vital to human survival and wellbeing, such that their ‘destruction’ will jeopardize a normal order of life in society.² The needs or complementary interest (*hajiyyah*) can be seen as benefits which seek to remove severity and hardship that do not pose serious threats for the survival of normal life.³ Meanwhile, the luxuries or embellishment (*tahsiniyyah*) can be regarded as things that seek to attain refinement and perfection in the conduct of people at all level of achievement (Kamali, 2008).⁴

Recently, following some critics regarding the ‘inability’ of the *maqāṣid* approach to cope with complexities of time and solve current problems of the *ummah*, dimensions of the ‘classical’ *maqāṣid* have been extended into various

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¹ For example, Imam al-Juwayni uses the term al-*maqasid* and public interest (al-*masalih al-ammah*) interchangeably (Auda, 2008). Imam al-Ghazali places *maqasid* under what he called as ‘unrestricted interests (al-*masalih al-mursalah*), which is agreed by his followers al-Razi and al-Amidi (al-Raysuni, 2005; Abu Sway, 1996). Meanwhile, al-Qarafi links *maṣlahah* and *maqasid* through a fundamental principle in which “a purpose (*maqsid*) is not valid unless it leads to the fulfilment of some good (*maslahah*) or the avoidance of some mischief (*mafsadah*)” (Auda, 2008:20).

² It is often classified into what preserves one’s faith, soul, wealth, mind and offspring. In relation to this, adultery, alcohol or wine-drinking and intoxicants are banned in Islam as they pose threats to the protection and wellbeing of family (offspring) and the integrity of human intellect (soul and mind) respectively. Islam also bans thefts, monopoly, hoarding of wealth (*rikaz*), *riba* and *ghurar* transactions to protect the human wealth. The preservation of faith is also a necessity for human life, albeit probably more in the afterlife sense because Islam perceives life as a ‘comprehensive’ journey in the world and the hereafter (Kamali, 2008).

³ With respect to ritual worship (*ibadah*), for example, Sharī‘ah has granted many concessions (*rukhas*) such as shortening of prayers and opening of fast for the sick and traveller in order to make things easier for Muslims. In daily ‘worldly’ life (*muamalah*), examples of this need are marriage, trade and means of transportation. Although Islam encourages and regulates these activities, the lack of any of these needs is not a matter of life and death especially on an individual basis. However, if the shortage becomes widespread and jeopardizes people’s life, they could be considered as necessities and thus move from the level of complementary interests to the level of necessities.

⁴ This is reflected in the use of, among others, perfume, jewellery, stylish clothing, beautiful homes and sporty cars. These things are important and perfecting human life, although in a lower priorities than the essentials and the needs. They also serve as further signs and proofs for God’s endless mercy and generosity towards human life.
aspects (freedom, human rights, etc.) and particular scopes (based on rulings, scope of people, etc.) (Auda, 2008). The ‘new’ maqāṣid, however, have some similarities and differences with the classical perspective particularly in relation to human wellbeing/poverty as will be discussed in the next section.

2.2. Maqāṣid Principles and Human Wellbeing/Poverty

The historical development of maqāṣid principles can be generally classified into three milestones (Kasri, 2012), as illustrated in Figure 1. First, the early maqāṣid period developed by jurists during the first four Islamic centuries (1-4 AH). In this period, works on maqāṣid was dominated by attempts to survey and find ‘wisdoms behind rulings’ from the scripture and not directly to the wellbeing objectives. Despite that, most of the wisdom discussed was closely related to important aspect of human wellbeing. Second, the major maqāṣid period lasted from the fifth to the eight of Islamic century (5-8 AH). This is the ‘golden’ period where Islamic scholars really devoted their time and attention to develop appropriate juristic methods and subsequently construct fundamentals of the maqāṣid principles in which human wellbeing/poverty became the focus. Finally, the contemporary period (from 9AH-now, but especially from 13th Islamic century onwards) which is marked by extensions of the ‘classical’ principles of maqāṣid based on the complexities of time and the need to reform the current Islamic world including in economic and development dimensions.

5For example, al-Tarmidzi al-Hakim wrote Kitab al-Salah wa Maqasiduna (the Book of Prayers and Their Purposes) in which the wisdoms and spiritual ‘secrets’ behind each of the prayers rituals (such as ‘confirming humbleness’ as the maqsid or purpose behind glorifying God’s with every move during prayers (takbeer) or ‘focusing on one’s prayers’ as the maqsid behind facing the direction of the Ka’bah) are discussed. Abu Zayd al-Balkhi wrote a book dedicated to maslahah called Masalih al-Abdan wa al-Anfus (Benefits for Bodies and Souls). This book explains how Islamic practices and rulings contribute to human’s health, physically and mentally, which are important aspects of human wellbeing. Other example is a more comprehensive volume of 335 chapters written by al-Qummi, which ‘rationalize’ believing in God, Prophets, heavens as well as the wisdoms behind prayers, fasting, pilgrimage, charity, and other moral obligations (al-Raysuni, 2005; Auda, 2008).

6Imam al-Juwayni was probably the first scholar that introduces a theory of ‘levels of necessity’ which later inspired his followers to develop the maqasid principles (Auda, 2008). However, the most influential works on maqasid during this period are probably the works developed by al-Ghazali with his ‘order of necessities’, al-Shatibi and his postulate ‘Maqasid as fundamentals’ and Ibn Taimiyyah and Ibn-Qayyim who calls for what Shar‘ah is all about” (Al-Raysuni, 2005). Some of the relevant works/citations will be mentioned later in this section.

7Ibn Ashur, for instance, emphasized purposes dealing with the ‘nation’ (ummah) instead of those dealing with individuals. Rashid Rida included ‘reform’ and ‘women’s rights’ in his theory of maqasid. Al-Qardhawi embraced the need “to preserve true faith, maintain human dignity/rights and build a more cooperative world” (Auda, 2008). More recently, Chapra emphasized that the ultimate objective of all
Based on the similarity and significance of works in developing the *maqāṣid* principles, it is argued that human wellbeing/poverty is a central theme in the historical deliberations of *maqāṣid*. This is particularly reflected in the writings and conceptualizations of *Maqāṣid* al-Shari‘ah during the classical and contemporary period. Al-Ghazali, for instance, formulated that, “The objective of the Shari‘ah is to promote the wellbeing of all mankind” [emphasize added], which lies in safeguarding their faith (*din*), their human self (*nafs*), their intellect (*aql*), their posterity (*nasl*) and their wealth (*māl*)” (In M. Chapra, 2000:118). Ibn Taymiyyah believed that “Islamic law came to realize and enhance human well-being [emphasize added], and to minimize and neutralize sources of harm and corruption…” (in Al-Raysuni, 2005: 28:34). Ibn Qayyim, the student of Ibn Taymiyyah, added that, “Islamic law is all about wisdom and achieving people’s welfare [emphasize added] in this life and the afterlife. It is all about justice, mercy, wisdom and good.” (in Auda, 2008:20-21). Meanwhile, Al-Shatibi specifically wrote *Kitab al-Maqāṣid* which essentially suggest that the fundamentals of Islamic jurisprudence are definitive in nature and founded on the law’s universals (objectives) included in the essentials (*daruriyyah*), exigencies (*hajjyyah*) and embellishments (*tahsiniyyah*). Furthermore, based on an inductive method rooted in the Qur’an, he contended that the essential objectives can be observed in five Islamic teaching is to be a blessing for mankind, which could only be fulfilled by promoting the real well-being (*falah*) of all people on earth (Chapra, 2008). 

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**Figure-1**

Three Development Milestones of *Maqāṣid* Principles

- **The Early Period (1-4M)**
  - Idea of purposes/causes (*hikam, i'tal, munasabat or ma'ani*) appeared in a number of reasoning methods such as reasoning by analogy (*qiyas*), juridical preference (*istihsan*) and interest (*maslahah*).
  - The ideas were still limited to explain the wisdoms behind Islamic rulings instead of purposes of *Maqāṣid* al-Shari‘ah such as human well-being.

- **The ‘Golden’ Classical Period (5-8M)**
  - Various methods and theories were developed to analyze ‘what was not mentioned in the scripture’ in attempt to cope with the evolving Islamic civilization.
  - Wider and more universal perspectives on *maqāṣid* in relation to human well-being.
  - Prominent scholars: Al-Juwayni, al-Ghazali, al-Salami, al-Qarafi, Ibn Taymiyyah, Ibn Qayyim and al-Shatibi

- **The Contemporary Period (9M-now)**
  - New dimensions of the *Maqāṣid* theory was introduced by reclassifying and extending the classical theories.
  - Emphasis on the level of universality of purposes to meet contemporary challenges.

Source: Kasri (2012)
dimensions namely religion (dīn), human life (nafs), progeny (nasl), material wealth (māl) and human reason (ʿaql) (in Al-Raysuni, 2005:28).

It is also notable that most of the scholars have recommended relatively similar methods to achieve the objectives namely through opening access (promotion) of human wellbeing and protection/prevention of the things that could harm achievement of the objectives. Al-Ghazali suggested that, “Whatever ensures the safeguard of these five [objectives], serves public interest and is desirable” (In M. Chapra, 2000:118). Al-Izz ibn Abd al-Salam argued that Islamic law basically consists of two interests, namely either interests that prevent what would cause harms or achieve what would bring benefits (in Al-Raysuni, 2005:30-32). Similarly, al-Qarafi wrote about ‘opening the means to achieving good ends’ which could be interpreted as opening access to realize human wellbeing (in Auda, 2008:20). Meanwhile, al-Shatibi contended that Islamic law is aimed to preserve the essential interests by preserving their existence and protecting them from annihilation (in Al-Raysuni, 2005:107-109).

While the human wellbeing goal is also acknowledged by contemporary scholars, in the past few decades attention has been given to other purposes such as freedom and justice which is strongly relevant in the context of Islamic revivalism (Auda, 2008). Nevertheless, in today’s context where poverty and underdevelopment are the main development challenges faced by most Muslim nations, promoting the real wellbeing and reducing poverty can be considered as one of the important goals. Indeed, it is mentioned that the ultimate objective of all Islamic teaching is to be a blessing for all mankind, which could only be fulfilled by promoting the real wellbeing (falakah) of all people on earth (M. U. Chapra, 2008:1-3). Thus, increasing human wellbeing or reducing poverty is arguably a central higher purpose of Maqāṣid al-Sharīʿah according to the contemporary scholars.

Somewhat unsurprisingly, the central theme of maqāṣid (i.e. increasing human wellbeing or reducing poverty) has also become the main development objective since the past few decades (Iqbal, 2002; Mirakhor & Askari, 2010; World Bank, 1990). This is presumably due to the fact that developing world, including the Muslim countries, have persistent poverty and even getting poorer overtime (Chen

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8 More than half a billion of the world’s poor is Muslim and live under abject poverty with incomes below US $2 a day (Obaidullah, 2008). Most of them have very limited of access to education and healthcare facilities as well as lived with poor housing and poor sanitation facilities (Ahmed, 2004).

9 In this study, the term increasing wellbeing and reducing poverty are used interchangeably and sometimes simultaneously as they basically have similar essence.
& Ravallion, 2008; Iqbal, 2002; Obaidullah, 2008a) albeit various attempts have been done to alleviate poverty since the 1990s (Booth & Mosley, 2003).

Before proceeding to the next section, it is worth noting that effective poverty alleviation policies may not be feasible without clear concepts of poverty/wellbeing that can be consistently measured (Sirageldin, 2000; World Bank, 2001). Thus, it is important to clearly understand the conceptualizations of poverty/wellbeing prior to developing appropriate framework to measure it based on new perspectives such as the \textit{maqāṣid} principles. These are the main focus of the next sections.

3. Review of Conventional Concepts of Poverty/Wellbeing

In contemporary poverty/wellbeing studies, there are two major approaches to the definitions and measurements of poverty. The first approach is the narrow approach to poverty, which considers poverty simply in material/monetary terms. Under this approach, poverty is typically measured by comparing individuals’ income/consumption with some defined thresholds (poverty line) below which they are considered to be poor. With this approach, aggregate poverty index such as the headcount index and the poverty severity index are widely used to represent the poverty conditions (Ravallion, 1994). The second broader approach goes beyond the traditional monetary measure and includes possession of specific types of consumption goods/services such as shelter, healthcare and education as the basic needs. This approach implies that a household without access to the basic entitlements indeed lives in poverty (Haughton & Khandker, 2009; Townsend, 1985; Yunus, 2007). The Human Development Index (HDI) is often seen as a representative measure of poverty under this approach (Sudhir Anand & Sen, 1997).

More recently, discussion within the second approach has been extended into the capability approach. Pioneered by the works of Nobel Laureate Amartya Sen, it is argued that poverty/wellbeing comes from the capability to function in a society. Specifically, poverty arises when people lack key capabilities which leave them with ‘deficiencies’ and inadequate resources to exist in a society (see, for instance, Sudhir Anand & Sen, 1997; Sen, 1993, 2005). Such deficiencies include, among others, low incomes, low education, poor health, insecurity, low self-confidence, a sense of powerlessness and the absence of rights such as freedom of speech (Robeyns, 2005). Furthermore, poverty is seen as deprivation of capabilities and lack of multiple freedoms that people value or have reasons to value (Alkire, 2007). Viewed in this way, capability poverty is a multidimensional phenomenon that largely depends on people’s norms and values. Under this approach, the Multidimensional Poverty
Index (MPI) launched by the United Nation in 2010 is generally seen as a representative measure of multidimensional poverty (Alkire & Deneulin, 2009).

Following the conceptualizations above, Figure 2 illustrates three main steps typically taken to measure poverty and compares the approaches commonly used in the current conventional poverty studies. Although this framework is generally applied in measuring the monetary poverty (Alkire & Foster, 2007), it is increasingly being utilized to develop the multidimensional poverty measures under the capability approach (Comim & Qizilbash, 2008). However, as multidimensional poverty is a relatively new concept in economic and poverty studies, the framework is not strictly applied in the discipline (Alkire & Foster, 2011; Ravallion, 2011) and a number of other issues need to be considered in assessing poverty across the multiple dimensions.  

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**Figure-2**

Major Steps in Measuring Poverty

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10 According to Alkire (2007), there are a number of important issues require consideration to assess poverty across the multiple dimensions. The issues include, (i) how to choose the domains or dimensions; (ii) how to choose relevant indicators for the domains and related capabilities; (iii) how to model the interaction among indicators and among dimensions; (iv) how to set relative weights for each dimension and indicator; (v) how to aggregate or compare across individuals or groups; (vi) how to aggregate across dimensions or, alternatively, to perform rankings and comparisons; and (vii) how to incorporate freedom and agency into multidimensional capability poverty measures. Discussions on these issues are still on-going until now.
In defining the appropriate indicator of poverty under the first perspective, the choice is normally between income and consumption/expenditure. Each indicator has strengths and weaknesses. Therefore, the choice of an appropriate welfare indicator must eventually be adjusted to the research objectives (Haughton & Khandker, 2009). As for the multidimensional poverty, theoretically there are unlimited options for the poverty/wellbeing dimensions and indicators (Alkire, 2002). As such, the choices of the most appropriate indicators have been a subject of on-going debate amongst the proponents. It is notable, however, that taking account of people’s norms/values is considered as an appropriate method in selecting the dimensions and indicators of poverty/wellbeing (Alkire, 2007).

In policy perspective, an interesting aspect of the aforementioned debate is the ‘limits’ to the number of dimensions and indicators used for constructing the multidimensional poverty index. On one hand, some scholars - including Amartya Sen, the pioneer of the capability approach - believe that there is no ‘fixed list’ of capabilities to go with the general capability approach. This is primarily due to the impossibility of compiling a list that could be used for every purpose and that is unaffected by the importance of different capabilities. As a result, the capabilities should be selected in light of the values of the referent population and the purpose of the study (Sen, 2004). However, other scholars, such as philosopher Martha Nussbaum (2003), argue that such a condition has created problems for policy-makers trying to focus their attention on fighting poverty. She also contended that the specification of one ‘list’ of domains or central capabilities is necessary to ensure that the content of the capability approach carries a critical force and therefore the

11 There are a number of other indicators such as calories consumed per person per day, food consumption as a fraction of total expenditure, nutritional status and observer assessment. However, they are rarely used in calculating (monetary) poverty.
12 Given the limited number of income sources, it is normally easier to measure income than consumption. Nevertheless, it is also likely to be underreported. In contrast, while some expenditure is not incurred regularly, expenditure as a whole is usually easier to recall and less understated than income (Haughton and Khandker, 2009).
13 It is noted by Alkire (2007:7) that in the practical applications of the capability approach and related multidimensional [poverty] approaches, the methods of identifying capabilities or poverty dimensions are surprisingly straightforward. Most researchers draw implicitly on five selection methods, either alone or in combination, based on (i) existing data/convention, (ii) assumption of what people do/should value, (iii) public ‘consensus’, (iv) on-going deliberative participatory processes and (v) empirical evidence from multidisciplinary studies regarding people’s values.
14 Despite that, Sen (2004:80) said that “I have nothing against the listing of capabilities but must stand up against a grand mausoleum to one fixed and final list of capabilities”.
possibility of the ‘wrong’ freedoms being prioritized and expanded could be minimized.¹⁵

Despite the on-going debate, literature generally suggests that there are a number of indicators commonly used in empirical studies related to multidimensional poverty (see Appendix 1). The indicators are drawn not only from poverty/wellbeing studies, but also from sociology, anthropology, psychology/psychometric, philosophy, culture/behaviour as well as quality of life and happiness studies. Some notable dimensions and indicators frequently used in the studies are indicators related to life and/or health (food, nutrition, housing, clothing, access to healthcare services, water, sanitation, etc.), education (literacy, basic education, years of schooling, children enrolled, etc.), economic aspects (work/employment, working conditions, economic security, etc.), religion/spiritual aspects (transcendence-creativity, transcendence peace with God, morality, religious observance, etc.) and other social/family indicators (marriage, children, peace, harmony, participation in/attachment to local community, personal liberty and freedom, etc.).

Furthermore, in establishing a poverty standard, a poverty line is commonly used as a benchmark. In monetary poverty analysis, a poverty line could be technically defined as the level of income/expenditure needed for an individual/household to escape poverty.¹⁶ Thus, it could be considered the minimum income/expenditure required for meeting the basic needs (Ravallion, 1998).¹⁷ With respect to multidimensional poverty analysis, there are two general approaches to determine the poverty threshold. One approach is to use a particular (yet somewhat ad-hoc) poverty cut-off point based on researcher’s judgement, while another approach is to directly ask the poor whether they are deprived in a particular dimension of wellbeing or not.

¹⁵ Nussbaum (2003:33) strongly argued that “capabilities can help us to construct a normative conception of social justice...only if we specify a definite set of capabilities as the most important ones to protect. Sen’s ‘perspective of freedom’ is too vague. Some freedoms limit others; some freedoms are important, some trivial, some good, and some positively bad. Before the approach can offer a valuable normative gender perspective, we must make commitments about the substance”

¹⁶ A poverty line is usually (and officially) defined for an individual. However, since poverty studies are mostly conducted on the household level, the common approach is to construct one per capita line for all individuals and adjust the line with household composition or size. This implies that a household poverty line could be generated by multiplying the per capita line with the household size. For further discussion, see Ravallion (1998).

¹⁷ The current literature also recognizes the so-called ‘subjective’ poverty line constructed by directly asking people about their poverty line. In practice, the self-rated measure is often used as a complement to the more traditional ‘objective’ poverty lines.
Under the multidimensional poverty analysis, the first approach is used by Mack and Lansley (1985) who identified people as poor if they were poor in three or more out of 26 deprivations. It is also utilized in UNICEF’s Child Poverty Report 2003, as mentioned by Gordon et al. (2003), in which a child is called deprived if he/she suffers in two or more dimensions of poverty. Quite recently, a more general (yet somewhat normative) “dual cut-off” method of identification has been introduced and employed in the construction of the UNDP’s Multidimensional Poverty Index (Alkire & Foster, 2011). With this approach, a person is defined as poor if he/she is deprived in two to six out of 10 of the MPI’s indicators (UNDP, 2010). The second approach, which directly asks the poor about their poverty/wellbeing status, is mostly used in psychological/psychometric, happiness and behavioural studies. Examples of such studies are the studies on identification of multidimensional poverty in Germany (Van Praag & Ferrer-i-Carbonell, 2008) and Luxemburg (Fusco & Dickes, 2008).

Once the poverty/welfare measure and the poverty benchmark are determined, aggregate poverty measures can be constructed. Under this approach, the aggregate statistics include poverty index such as Poverty Headcount Index, Poverty Gap index, Poverty Severity Index and Watt Index. As for multidimensional poverty, there have been recent attempts to aggregate various dimensions of poverty into a single composite index called the Multidimensional Poverty Index (MPI). Developed from the ‘counting’ method initially proposed by Atkinson (2003) and Bourguignon and Chakravarty (2003), the MPI is basically the product of the multidimensional poverty headcount (the proportion of people who are multidimensionally poor) and the average number of deprivations each multidimensionally poor household experienced (the intensity of their poverty) in three dimensions and 10 indicators with equal weights.

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18 In a recent publication, Alkire and Foster, who developed the Multidimensional Poverty Index, admit that “The choice of $k$ could therefore be a normative one [emphasis added], with $k$ reflecting the minimum deprivation count required to be considered poor in a specific context under consideration” (Alkire and Foster 2011:483).

19 For more discussion on the index, see Haughton and Khandker (2009).

20 Some studies consider the Human Development Index (HDI) and the Human Poverty Index (HPI) introduced by the United Nations Development Program (UNDP) in 1990 and 1997 respectively as multidimensional poverty indices. However, when the indices were launched, they were never meant to represent the multidimensional poverty concept. Rather, HDI is “a composite index that takes into account three types of deprivations” (UNDP 1990:5), which is closer to the broad approach to poverty. Meanwhile, HPI is a composite index based on several parameters known to influence human capabilities (UNDP 2006). Only recently have the indices been “re-categorized” as multidimensional poverty indices. Despite that, as emphasized in the UNDP’s 2010 Human Development Report, HPI has recently been replaced by the Multidimensional Poverty Index (MPI) (UNDP 2010:95).
More recently, however, it has been pointed out that a single aggregate index is not appropriate and can never be a sufficient statistic of poverty under the multidimensional nature of the approach. Indeed, it is suggested that a credible set of multiple indices such as ‘health poverty’ or ‘education poverty’ be developed rather than a single-composite multidimensional poverty index (Ravallion, 2011). Given the on-going debates, it is anticipated that the method(s) for aggregating the multidimensional poverty measure will continue to be refined in the future (Alkire, et al., 2011).

In addition to the issues above, some other issues might need to be considered prior to assessing multidimensional poverty/wellbeing. An important issue is modelling the interaction between dimensions and indicators of the poverty/wellbeing measure. The choices range from linear relationship to non-linear relationships, and require rigorous examinations prior to model the measure (Alkire, 2007). Other issue is setting the relative weight for each dimension and indicator. While most studies and current indices (such as HDI and MPI) use equal weight for each dimension and indicator (Atkinson, 2003), it is possible to utilize unequal weight provided that appropriate justifications are made. If cross-country comparison becomes one of the measurement objectives, it is necessary to think about the method to aggregate the individuals and subsequently compare or perform the rankings of the index/measures generated (Alkire, 2007). Finally, data availability also needs to be taken into account if global comparison is aimed from the measurement results (Haughton & Khandker, 2009).

4. General Framework for Developing a Maqāṣid al-Sharīʿah Based Multidimensional Poverty Measure

Following discussion in the previous sections, at least three stages are needed to construct a maqāṣid-based multidimensional poverty/wellbeing measure. The stages are (i) defining poverty/wellbeing indicators (i.e. choosing the dimensions and indicators) suitable with the maqāṣid perspective, (ii) defining the relevant poverty/wellbeing threshold, and (iii) constructing an appropriate maqāṣid-based multidimensional poverty/wellbeing measures.

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21 Examples of the non-linear relationships are the equations representing the poverty severity index and the Watts index. For detailed discussion of the index, see Haughton and Khandker (2009).


23 For example, economic dimension of HDI might have a higher weight that education dimension if there are strong reasons (such as gaining more importance worldwide due to economic recovery, etc.) to do so.
In the first stage, it is argued that the *maqāṣid* principles, particularly those advocated by al-Ghazali and al-Shatibi, provide relevant guidance in selecting the appropriate poverty/wellbeing dimensions. To recall, the classical scholars have recommended the safeguarding of five main dimensions of human wellbeing, including faith (*dīn*), human self (*nafs*), intellect (*ʿaql*), posterity (*nasl*) and wealth (*māl*) as the main objective of Sharīʿah. In contemporary time, the dimensions could be interpreted into religious/spiritual, health, education, family/social and economic dimensions.

The Ghazalian/Shatibian maxim is considered as an appropriate framework to examine multidimensional aspects of human wellbeing for at least two main reasons, including (i) its relevance to current situation in the Muslim world where poverty and backwardness persistently exist most notably in the past few centuries, and (ii) its approach which limit the poverty/wellbeing dimensions into five dimensions such that policy makers could focus their attentions and resources to the aspects. Furthermore, from a technical perspective, it is notable that a measurement is easier when it involves relatively limited number of concepts. In this respect, despite its limitations, human wellbeing as measured by the five levels of necessities is relatively easier to measure than those described under an unlimited or open-ended list of human wellbeing indicators as prescribed by other scholars particularly Ibn Taymiyyah and Ibn Qayyim. In a more practical context, it is also more useful to be able to say useful things of what happening and thereby contribute to or at least inspire policy making with the useful empirical findings while keeping ‘alternative’ discourses alive.

It is also contended that the *maqāṣid* principles left the most suitable operational indicators for the Muslim society to determine according to the current conditions and norms/customs (*ʿurf*) of the people. In Islamic studies literature, this ‘method’

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24 This is similar with the perspective of Nussbaum who contended that the specification of one ‘list’ of domains or central capabilities is necessary to ensure that the content of the capability approach carries a critical force and therefore the possibility of the ‘wrong’ freedoms being prioritized and expanded could be minimized.

25 This is similar with the position of Amartya Sen in the debate of operationalizing the capability approach.

26 In relation to this, in an article on the revolutions that occur within economics, a prominent British economics John Hicks acknowledges that economists’ need for a focus. “In order that we should be able to say useful things about what is happening, before it is too late, we must select, even select quite violently. We must concentrate our attention, and hope that we have concentrated it in the right place. We must work, if we are to work effectively, in some sort of blinkers” (1983: 4; quoted from Alkire 2007:115-116).
has been practiced not only by the classical scholars but also by the Prophet (pbuh) and the companions (Mattson, 2003). However, it is notable that the *maqāṣid* principles suggest that human wellbeing could be achieved through opening access (promotion) and protection of the essentials from potential harms such that people have abilities to exist in society and ultimately have a meaningful life and achieve *falāh*. This implies that access and ability should be the focus of the indicators. Based on this consideration, suitable indicators could be selected from a bunch of indicators presented in the earlier table. Examples of such indicators are also presented in Table

In the second stage, an ‘Islamic’ poverty threshold needs to set up to determine a measure that can distinguish the poor from the non-poor. In this respect, as discussed earlier, current literature on multidimensional poverty suggests that the threshold could be either determined based on researcher’s judgment or determined based on people’s perception (i.e. by directly ask the poor whether they are deprived in a particular dimension of wellbeing or not). However, it seems that up to now there is no strong consensus regarding the most suitable multidimensional poverty threshold including the methods to generate it. Indeed, the choice of the threshold is relatively normative and usually determined by the objectives of the study. As such, bearing the purpose of constructing the Islamic poverty measure, a *maqāṣid*-based multidimensional poverty could adopt one of the strategies above in setting a poverty line.27

In the final stage, a *maqāṣid*-based multidimensional poverty measures can be constructed once the dimensions/indicators and poverty/wellbeing threshold are selected. However, as mentioned in the previous section, currently there seems to be no widely acceptable measure of multidimensional poverty/wellbeing. Indeed, debates are still on-going on whether to use a single-composite multidimensional poverty index (such as the MPI) or a multiple composite poverty indices (such as health poverty index or education poverty index). While both methods have their strengths and weaknesses, it appears that the most suitable method for aggregating such measure is determined by the purpose of constructing such index.28

27 It is realized that some Muslim scholars have discussed the minimum living sustenance in the context of eligibility to pay and receive *zakāh*. Specifically, *zakāh* must be paid if the assets reach a certain amount of *zakatable* assets, usually in excess of the basic needs of those subject to paying *zakāh*, known as *niṣāb*. This minimum amount is usually calculated in terms of money. For example, based on the hadith narrated by Abu Mas’ud, al-Thauri suggested that the minimum income required for satisfying the basic necessities of eating and living for a day and a night is around fifty *dirhams* of money (in al-Qardawi, 2000). Therefore, it is more suitable in assessing monetary based measure of poverty instead of the multidimensional measure.

28 On one hand, proponents of MPI argue that a single-composite index is powerful in directing attentions of policy makers regarding poverty conditions of nations (see, for instance, Alkire and Santos
Table 1
Examples of Operational Indicators for a *Maqāṣid*-based Multidimensional Poverty Measure

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Element (Operational Indicator)</th>
</tr>
</thead>
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| Health: Access and ability to meet basic needs and become (physically) healthy | 1. Consumption  
2. Access to healthcare  
3. Awareness of health  
4. Frequency of sickness |
| Education: Ability to access education and be knowledgeable | 5. Access to school  
6. School attendance  
7. Basic knowledge from schooling  
8. Academic/school achievement |
| Economy: Access and ability to earn income and sustain a living | 9. Skill  
10. Employability  
11. Income  
12. Purchasing power  
13. Savings |
| Faith: Access and ability to know and practise one’s religion | 14. Prayers and fasting  
15. Islamic/Qur’anic studies  
16. Charity (*sadaqah*)  
17. *Hajj* (great pilgrimage) |
| Social: Access and ability to manage a family that is Islamic and well-functioning in society | 18. Better future for family  
19. Harmony  
20. Un-Islamic or anti-social activities  
21. Participation in community activities |

Moreover, in relation to the technical model, it is argued that a simple linear model with equal weight amongst the dimensions/indicators is preferable than the others. This is particularly due to its simplicity and easy methods of calculation. This has proven to be the case with the widely used poverty headcount index, poverty gap index and poverty severity index in the literature of monetary poverty.\(^{29}\) As such, an aggregate single-composite linear model of *maqāṣid*-based multidimensional poverty index is proposed. Such a general model could be generally formulated as follow.

\(^{29}\) For more discussion on the index and their advantages, see Haughton and Khandker (2009).
In which MSMPI is *Maqāṣid* al-Sharīʿah Multidimensional Poverty Index; n is the weight for each dimension/indicator, which is assumed to be equal for each dimension and indicator (i.e. n=1/5);\(^{30}\) H, Ed, R, Ec and S are the weighted average value/score of poverty/wellbeing in health, education, religious/spiritual, economic and social dimensions respectively.\(^{31}\) Note that the model could be static (i.e. only measure wellbeing condition in one time period) or dynamic (i.e. measure wellbeing conditions in two period or the changes in the conditions) depending on purposes of study and data availability.

With a similar method, a set of multiple linear indices could be constructed for each of the poverty/wellbeing dimension.

\[
MSMPI = \frac{1}{n} \sum_{i=1}^{n} H + Ed + R + Ec + S
\]

In which MSMPI is *Maqāṣid* al-Sharīʿah Multidimensional Poverty Index; n is the weight for each dimension/indicator, which is assumed to be equal for each dimension and indicator (i.e. n=1/5);\(^{30}\) H, Ed, R, Ec and S are the weighted average value/score of poverty/wellbeing in health, education, religious/spiritual, economic and social dimensions respectively.\(^{31}\) Note that the model could be static (i.e. only measure wellbeing condition in one time period) or dynamic (i.e. measure wellbeing conditions in two period or the changes in the conditions) depending on purposes of study and data availability.

With a similar method, a set of multiple linear indices could be constructed for each of the poverty/wellbeing dimension.

\[
H = \frac{1}{n} \sum_{i=1}^{n} X_i
\]

In which H is *maqāṣid*-based poverty index in health dimension, which is derived from an equally weighted score of the indicators (\(X_i, i = 1…n\)) constructing the index. This general formula could be used to generate a multiple set of poverty/wellbeing index in other dimensions (i.e. Ed, R, Ec and S). As such, the aggregate-composite index (from equation 1) is basically decomposable into five composite indices for each dimension of poverty/wellbeing. Furthermore, it is possible to do other decomposition (by group of people, location, etc.) provided that the subgroups data is available.\(^{32}\)

5. Implementation of MSMPI in Indonesia

5.1. Data and Methods

To provide an illustration for the implementation of the *maqāṣid*-based multidimensional poverty index, this study uses information collected from a survey.

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\(^{30}\) Equal weight was given to each indicator/dimension since there is no strong justification to prioritize one variable above the others. This method has been adopted in many studies, resulting in the Human Development Index and other similar development indices (Sudhir Anand & Sen, 1997; Anto, 2009; Dar & Otiti, 2002).

\(^{31}\) The value/score could be generated either from researcher’s judgment or people’s perceptions discussed earlier.

\(^{32}\) For example, if socio-demographic profiles of respondents (age, gender, education, occupation, income group, etc.) are available, the index could be decomposed according to those characteristics.
of 685 households receiving zakāh assistance in nine cities\(^{33}\) of the Greater Jakarta Metropolitan area of Indonesia in 2011. The group is selected mainly because they are all Muslims households, mostly poor and have received zakāh assistance for around a year such that it is possible to analyze their poverty/wellbeing changes after receiving the assistance by using the maqāṣid framework. Furthermore, the Greater Jakarta area was selected to enable a more focused and rigorous analysis. The primary data was collected in 2011 by utilizing the clustered random sampling method which enabled collection of 685 valid (sampling) responses from 5605 population.\(^{34}\)

A questionnaire based survey (interview-administered questionnaire) sought information on socio-demographic profiles\(^{35}\) and perceptions regarding the changes in the households’ poverty/wellbeing conditions after (with) receiving zakāh assistance.\(^{36}\) Using the framework discussed above, the poverty/wellbeing changes are analysed in five dimensions (i.e. health, education, religion, economic and social) suggested by the Ghazalian/Shatibain maqāṣid principles covering 21 indicators developed from the existing literature (see again Table 2). The indicators used in the economic dimension, for instance, are mostly adopted from Allardt (1993) and Rahman and Ahmad (2010) with the focus to access and ability to earn income and sustain a living for the family. Meanwhile, the social indicators are taken from studies such as those by Ahmed (2002) and Narayan, Chambers et al. (2000).

33 The cities include Jakarta Utara (North Jakarta), Jakarta Timur (East Jakarta) Jakarta Pusat (Central Jakarta), Jakarta Barat (West Jakarta), Jakarta Selatan (South Jakarta), Depok, Tangerang, Bogor and Bekasi.

34 With the clustered random sampling method, the primary data is collected randomly (i.e. based on a table of random sampling) and sequentially according to the households’ city of residence. The list of zakāh recipients was obtained from seven large Indonesian zakāh organizations willing to participate in this study. There were around 5605 households receiving zakāh assistance in Greater Jakarta in 2011. From the list, around 700 of the households are randomly selected by using the sampling method. However, only around 685 of the data (questionnaires) were valid for further analysis. Despite that, analysis with 685 samples should be enough because literature suggests that to achieve 99% confidence level and 5% margin error only around 600 samples are needed (Bartlett, 2001).

35 The main information asked includes socio-demographic profile of head of household (age, gender, marital status, education and occupation) and household size.

36 Ideally, two-round of survey (i.e. before and after) must be conducted to collect the data with an experimental study design. However, due to time and budget constraint, it was decided to conduct one survey asking conditions in two period of time. This method has been implemented by, among others, Jehle (1994) and Beik (2010) to measure the changes of poverty amongst zakāh recipients in Pakistan and Indonesia.
Furthermore, to measure the perception, an itemized rating on the scale of 1-6 was utilized. Score 1-3 reflect negative changes (extremely worse, worse and slightly worse), meanwhile score 4-6 reflect positive changes (slightly better, better and extremely better). As such, any scores above 4 suggest that respondents experience wellbeing improvement or poverty reduction. This implies that the score of 4 is the cut-off point for the multidimensional poverty measure.

Once the data were obtained, this study constructed a single-composite maqāsid-based multidimensional poverty index for each of the poverty dimension (see equation 2). As recommended in literature, the multiple set of index is viewed as the most appropriate representation of the multidimensional nature of poverty (Ravallion, 2011). However, it also calculated an aggregate measure for all wellbeing/poverty dimensions (see equation 1) which is suggested as useful for focusing the attention of policy-makers regarding the importance of the findings (Alkire et al., 2011). The results are presented in the next section.

5.2. Main Findings and Discussions

Generally speaking, descriptive statistics of the respondents reveal that most of the poor households receiving zakāh assistance in Greater Jakarta Indonesia were those led by someone relatively young, female, married, uneducated and mostly not working (see Table 2). Additionally, the household size was relatively large with an average number of 5.1 members. These results are hardly surprising since the profiles are the typical characteristics of poor people in Indonesia (Alisjahbana & Yusuf, 2003).

Further results suggest that most of the households received some sort of education assistance (43.5%) from the zakāh organizations. The assistance is usually provided for the children in the household and given in terms of scholarships (for tuition fee), school supplies and other school related expenditure. Additionally, economic assistance and social assistance were received by around 26.7% and 22.3% of respondents respectively. The economic assistance is given in many forms including working capital (cash and non-cash/in-kind) assistances. Meanwhile, healthcare assistance was received by only around 7.45% of the households.

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37 An itemized rating is a rating of a subject matter (degrees change, etc.) in which numerical scales with various points (usually between 3-10 point scales, as needed) are provided for each item so that the respondents can choose the appropriate number suitable for their conditions.

38 An even-numbered rating (scale of 1-6) is used to avoid neutral and biased answers.
Table-2
Profile of Respondents (Zakāh Recipients)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Frequency</th>
<th>Per cent</th>
<th>Cumulative Per cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15-45</td>
<td>433</td>
<td>63.21</td>
<td>63.21</td>
</tr>
<tr>
<td>46-64</td>
<td>226</td>
<td>32.99</td>
<td>96.2</td>
</tr>
<tr>
<td>&gt;64</td>
<td>26</td>
<td>3.8</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>685</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Gender</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Female</td>
<td>499</td>
<td>72.85</td>
<td>72.85</td>
</tr>
<tr>
<td>Male</td>
<td>186</td>
<td>27.15</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>685</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Marital status</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single parent</td>
<td>257</td>
<td>37.52</td>
<td>37.52</td>
</tr>
<tr>
<td>Married</td>
<td>428</td>
<td>62.48</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>685</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Highest education</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Not going to school</td>
<td>97</td>
<td>14.16</td>
<td>14.16</td>
</tr>
<tr>
<td>Elementary School</td>
<td>199</td>
<td>29.05</td>
<td>43.21</td>
</tr>
<tr>
<td>Junior High School</td>
<td>158</td>
<td>23.07</td>
<td>66.28</td>
</tr>
<tr>
<td>Senior High School</td>
<td>213</td>
<td>31.09</td>
<td>97.37</td>
</tr>
<tr>
<td>College/University</td>
<td>18</td>
<td>2.63</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>685</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Occupation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Not working</td>
<td>328</td>
<td>47.88</td>
<td>47.88</td>
</tr>
<tr>
<td>Informal Sector Labor</td>
<td>91</td>
<td>13.28</td>
<td>61.17</td>
</tr>
<tr>
<td>Trader/Small-Businessman</td>
<td>194</td>
<td>28.32</td>
<td>89.49</td>
</tr>
<tr>
<td>Employee</td>
<td>60</td>
<td>8.76</td>
<td>98.25</td>
</tr>
<tr>
<td>Others</td>
<td>12</td>
<td>1.75</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>685</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Types of Zakāh Assistance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Economic</td>
<td>183</td>
<td>26.72</td>
<td>26.72</td>
</tr>
<tr>
<td>Education</td>
<td>298</td>
<td>43.5</td>
<td>70.22</td>
</tr>
<tr>
<td>Healthcare</td>
<td>51</td>
<td>7.45</td>
<td>77.66</td>
</tr>
<tr>
<td>Social</td>
<td>153</td>
<td>22.34</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>685</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

The estimated *Maqāṣid* al-Sharī’ah Multidimensional Poverty Index (MSMPI) is reported in Table 3. In aggregate level, the estimated index has a score of 4.12. Since the value is higher than four, it can be concluded that the wellbeing of the households have slightly increased after receiving zakāh assistance. In other words, the households’ poverty has decreased due to the contributions of zakāh institution.
However, the aggregate-composite index cannot tell which dimensions actually have the poverty reduction impacts of zakāh. As such, the table also reports the decompositions of the aggregate index.

### Table-3

**Results of the Maqāṣid-based Multidimensional Poverty Index (MSMPI)**

<table>
<thead>
<tr>
<th>Dimension of Poverty/Wellbeing</th>
<th>Obs.</th>
<th>MSMPI</th>
<th>Std. Dev.</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health</td>
<td>677</td>
<td>4.20</td>
<td>0.73</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>Education</td>
<td>581</td>
<td>4.55</td>
<td>0.79</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>Religion</td>
<td>297</td>
<td>4.06</td>
<td>0.74</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>Economic</td>
<td>466</td>
<td>3.65</td>
<td>0.76</td>
<td>1.4</td>
<td>6</td>
</tr>
<tr>
<td>Social</td>
<td>90</td>
<td>4.16</td>
<td>0.67</td>
<td>2.75</td>
<td>6</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td></td>
<td><strong>4.12</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

It is shown that the households have enjoyed slightly higher wellbeing (or slightly lower poverty) in four out of five wellbeing/poverty dimensions as the MSMPI scores are all above the cut-off points of four. The highest welfare enhancement is found with respect to education dimension (score 4.20), followed by health dimension (score 4.20) and social dimension (score 4.16). Meanwhile, the smallest poverty reduction is found in relation to economic dimension (score 3.65).

Further examination for each of the wellbeing dimensions is summarized in Table 4. It is apparent from the table that the highest wellbeing improvement was experienced in the educational dimension. On average, around 87.34% of the respondents mentioned that the household’s wellbeing in terms of children’s school attendance, literacy, school achievement and access to school had increased significantly after the receipt of support from the zakāh institutions. Amongst the indicators, the most positive changes were felt in relation to school attendance and literacy (i.e. ability to read and do mathematical calculations), which seem to be particularly related to the educational assistance provided by the institution.

In contrast, the smallest poverty reduction impact was felt in the economic dimension. Only 53.92%, or slightly more than half, of the households expressed positive changes in wellbeing. Specifically, purchasing power and savings were found to be the measures in which most of the households had reported deterioration in their daily lives, as indicated by the large proportions of negative changes. However, in terms of skills, employability and income, improvements were actually more prevalent. It is therefore suggested that, although the households have
experienced improvement in their economic resources (i.e. the first three indicators), for some reasons the positive changes could not be translated into higher economic outcomes (i.e. purchasing power and savings).

### Table-4
**Specific Changes in Multidimensional Poverty Measure**

<table>
<thead>
<tr>
<th>Poverty Measure/Indicator</th>
<th>N</th>
<th>Negative changes (not-improved/poorer)</th>
<th>Positive changes (improved/less poor)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Frequency</td>
<td>Percentage</td>
</tr>
<tr>
<td>Health Dimension</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food consumption</td>
<td>684</td>
<td>166</td>
<td>24.27</td>
</tr>
<tr>
<td>Access to health service</td>
<td>677</td>
<td>183</td>
<td>27.03</td>
</tr>
<tr>
<td>Health awareness</td>
<td>684</td>
<td>102</td>
<td>14.91</td>
</tr>
<tr>
<td>Quality of health</td>
<td>683</td>
<td>138</td>
<td>20.2</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td></td>
<td>21.60</td>
<td></td>
</tr>
<tr>
<td>Education Dimension</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>School access</td>
<td>599</td>
<td>89</td>
<td>14.86</td>
</tr>
<tr>
<td>School attendance</td>
<td>597</td>
<td>63</td>
<td>10.55</td>
</tr>
<tr>
<td>Literacy</td>
<td>585</td>
<td>70</td>
<td>11.97</td>
</tr>
<tr>
<td>School achievement</td>
<td>595</td>
<td>79</td>
<td>13.28</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td></td>
<td>12.67</td>
<td></td>
</tr>
<tr>
<td>Religious/Spiritual Dimension</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Praying and fasting</td>
<td>682</td>
<td>52</td>
<td>7.62</td>
</tr>
<tr>
<td>Islamic/Qur'anic study</td>
<td>674</td>
<td>127</td>
<td>18.84</td>
</tr>
<tr>
<td>Charity</td>
<td>672</td>
<td>171</td>
<td>25.45</td>
</tr>
<tr>
<td>Hajj</td>
<td>299</td>
<td>208</td>
<td>69.57</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td></td>
<td>30.37</td>
<td></td>
</tr>
<tr>
<td>Economic Dimension</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Skill</td>
<td>663</td>
<td>210</td>
<td>31.67</td>
</tr>
<tr>
<td>Employability</td>
<td>660</td>
<td>263</td>
<td>39.85</td>
</tr>
<tr>
<td>Income</td>
<td>684</td>
<td>253</td>
<td>36.99</td>
</tr>
<tr>
<td>Purchasing power</td>
<td>559</td>
<td>363</td>
<td>64.94</td>
</tr>
<tr>
<td>Savings</td>
<td>562</td>
<td>320</td>
<td>56.94</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td></td>
<td>46.08</td>
<td></td>
</tr>
<tr>
<td>Social Dimension</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Future</td>
<td>663</td>
<td>111</td>
<td>16.74</td>
</tr>
<tr>
<td>Harmony</td>
<td>681</td>
<td>67</td>
<td>9.84</td>
</tr>
<tr>
<td>Anti-social behavior</td>
<td>94</td>
<td>36</td>
<td>38.3</td>
</tr>
<tr>
<td>Community activity</td>
<td>672</td>
<td>127</td>
<td>18.9</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td></td>
<td>20.95</td>
<td></td>
</tr>
</tbody>
</table>

Overall, the findings suggest that *zakāh* institution have successfully reduced the poverty condition of the household receiving *zakāh* assistance in Greater Jakarta
Indonesia from 2010 to 2011. The largest poverty reduction is felt in education dimension, while the smallest reduction is experienced in economic dimensions. This result is an expected result from the institution of zakāh, which add empirical evidence regarding the positive contribution of zakāh institution in reducing poverty in Muslim countries. Additionally, in the context of this study, it provides a workable example on how Maqāṣid al-Sharīʿah principles could be implemented in measuring socio-economic policy results in Muslim societies.

From policy perspective, the findings have at least three implications. Generally speaking, first, negative changes (i.e. higher poverty) in each indicator provide a ‘clue’ for the government and relevant institutions regarding the area that need their supports. Similarly, positive changes indicate that policies in the areas are relatively successful in increasing the recipients’ welfare. Second, zakāh institutions have provided valuable contributions that increased education wellbeing of the recipients. Accordingly, government needs to learn and perhaps collaborate with the Islamic social institution to further improve the model. Third, it is evident that the poor’s economic outcomes (i.e. purchasing power and savings) did not change significantly although their economic resources (skills, employability and income) have increased. This implies that the current economic system might not in favour of the poor. All these implications should be of concern by the government and other relevant institutions.

6. Concluding Remarks

Despite calls to expand and implement the concept of Maqāṣid al-Sharīʿah to frame policies aimed to resolve current development challenges in Muslim world, it has been rarely utilized by Muslim scholars. This paper, therefore, attempts to translate the maqāṣid principles and proposes a general framework to assess socio-economic development of Muslim societies based on the principles. It also provides a workable example on how the Maqāṣid al-Sharīʿah principles could be implemented in assessing socio-economic policy results in Muslim societies.

Despite the attempts, it is realized that the general framework provided could be improved in many ways. The current study focuses on the translation of the maqāṣid principles in choosing dimensions/indicators for constructing a simple linear multidimensional poverty index based on the Islamic perspective. It did not focus, however, on the technicalities to generate alternative forms of models or test the model specifications/properties that could best reflect the multidimensional poverty/wellbeing in Islamic countries. Cross-country comparison is also another issue not addressed in this paper, since it is focused on comparing the
poverty/wellbeing changes in one group of people overtime. These are some of the area of research that could be investigated in further studies to further advance research on contemporary applications of *maqāṣid*. 
Appendix-1
Multidimensional Poverty/Wellbeing Indicators

<table>
<thead>
<tr>
<th>No</th>
<th>Dimensions/Indicators</th>
<th>References</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Nutrition, shelter, health, mortality rate, education, political freedom, economic facilities, social opportunities, transparency guarantees, security</td>
<td>Sen (1993; 1996, 1999)</td>
</tr>
<tr>
<td>2</td>
<td>Life; bodily health; bodily integrity; senses, imagination and thought; emotions; practical reason (education); affiliation; other species; play; control over one’s environment</td>
<td>Nussbaum (2003)</td>
</tr>
<tr>
<td>3</td>
<td>Relatedness, transcendence-creativity, rootedness, sense of identity and individuality, the need for a frame of orientation and devotion</td>
<td>Fromm (1955)</td>
</tr>
<tr>
<td>4</td>
<td>Input-output (nutrition, water, air); climate balance with nature (clothing, shelter); health; community; symbolic interaction and reflection (education)</td>
<td>Galtung (1980)</td>
</tr>
<tr>
<td>5</td>
<td>Life; knowledge (understanding and education); meaningful work and play; friendship and other valued kinds of human relationships; authentic self-direction; transcendence ‘peace with God’ or some non-theistic but more-than-human source of meaning and value</td>
<td>Finnis (1980)</td>
</tr>
<tr>
<td>6</td>
<td>Nutritional food/water, protective housing, work, physical environment, healthcare, security in childhood, significant primary relationships (marriage), physical security, economic security, safe birth control/childbearing, basic education</td>
<td>Doyal and Gough (1991)</td>
</tr>
<tr>
<td>7</td>
<td>Having economic resources, housing, employment, working conditions, health, education; attachments/contacts with local community, family and friends, associations, colleagues, etc.; self-determination, leisure-time (social) activities, meaningful work and opportunities to enjoy nature</td>
<td>Allardt (1993)</td>
</tr>
<tr>
<td>8</td>
<td>Longevity, infant/child mortality, preventable morbidity, literacy, nourishment, personal liberty and freedom</td>
<td>Anand and Sen (1994)</td>
</tr>
<tr>
<td>9</td>
<td>Health/nutrition/sanitation/rest/shelter/security; literacy/basic intellectual and physical capacities; positive freedom or autonomy; negative freedom or liberty; understanding or knowledge; participation in social life</td>
<td>Qizilbash (1996)</td>
</tr>
<tr>
<td>10</td>
<td>Material wellbeing (having enough food, assets and work); bodily wellbeing (being and appearing well, health, physical environment); social wellbeing (being able to care for, bring up, marry and settle children, peace, harmony, good relations in the family/community); security (a physically safe and secure environment, lawfulness and access to justice, confidence in the future); psychological wellbeing (peace of mind, happiness, harmony, spiritual life and religious observance, freedom of choice and action)</td>
<td>Narayan et al (2000)</td>
</tr>
<tr>
<td>11</td>
<td>Morality, food, family, friendship, material resources, intelligence, romantic, relationship, physical appearance, self, income, housing, social life</td>
<td>Biswas-Diener and Diener (2001)</td>
</tr>
<tr>
<td>12</td>
<td>Health (nutrition/food, child mortality); education (years of schooling, children enrolled); Living standard (cooking fuel, toilet, water, electricity, floor and assets).</td>
<td>Alkire and Santos, in UNDP (2010)</td>
</tr>
</tbody>
</table>

Source: Author’s summary from the listed references.
References


Enhancing Intra-Trade in OIC Member Countries Through T-SDRs

Mahmoud Sami Nabi*  
Rami Abdelkafi*  
Imed Drine*  
Sami Al-Suwailem

Abstract

The OIC intra-trade reached 17% in 2012 and the member countries have committed to increase it to 20% by 2015. The 5th OIC Consultative Group Meeting on enhancing OIC intra-trade recommended the establishment of Trade Finance Support Schemes, as one of the driving factors, to accelerate the dynamic of the OIC intra-trade. Meanwhile, the United Nations World Economic and Social Survey (2012) considered that issuing new SDRs constitutes one of the solutions for the international community to mobilize additional resources for Development Finance. In this paper, we suggest the creation of Trade-based Special Drawing Rights (T-SDRs) among the OIC member countries to be issued by a dedicated regional financial institution on a regular frequency and according to a special mechanism. We discuss the allocation mechanism and its practical implementation among which the option to assign the role of issuance and clearing house to the Islamic Development Bank.

Keywords: OIC, intra-trade, Special Drawing Rights.

JEL Classification: F130, F330.

KAUJIE Classification: K1, H34.

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I. Introduction

Promoting intra-trade at the OIC regional level needs innovating payments arrangements which support cross-borders investment, facilitate trade, and allow better allocation of resources across the region. Lee (2011) shows that the response of the OIC economies to structural shocks are largely asymmetric except for some sub-groups, suggesting that creating a common currency is still an unfeasible target and the author recommends the creation of small currency areas in a first stage. To overcome this shortcoming, the OIC countries need a payment system which inspires confidence and boosts their intra-trade. Indeed, progressively enhancing trade integration is the pre-requisite of any tentative of creating common currency (Frankel and Rose, 1998).

The idea of creating a regional payment system for the OIC countries has been launched by Tun Dr. Mahathir Mohamad in November 2000 during the OIC Summit held in Doha, who called on the Islamic world to embrace the use of the Gold Dinar for the settlement of their international trade. In this paper we propose instead the creation of a payment system based on the issuance of OIC Special Drawing Rights (SDRs) that we call Trade based SDRs or T-SDRs.

The needs for additional financial resources for development has renewed the interest in the role of the IMF Special Drawing Rights (SDRs). For example, Joseph Stiltigtz suggested that the role of SDRs should be expanded through new issuances and by increasing their use in IMF lending. In this case, IMF member countries would convert their reserves in hard currency into SDRs. This mechanism would give to the IMF the possibility to create more official liquidity to finance its member countries, especially in time of crisis. At the same time, the US dollar would continue to play its role as the main currency for private transactions. The proposal of Stiglitz has been endorsed by other prominent economists and policy makers who also recommended transforming the SDRs into an international currency and to increase their issuance with relatively small scale to avoid inflationary pressure. More recently, the United Nations World Economic and Social Survey (2012) considered that the SDRs issuance could be considered as one of the practical solutions for the international community to mobilize resources for Development

1 In 2002, Tan Sri Nor Mohamed Yakcop recalled the proposal of using a gold dinar to settle net trade balances among the OIC countries. This was at the occasion of the international conference “Stable and Just Global Monetary Systems” held in Kuala Lumpur, in August, 2002 (Tan Sri Nor Mohamed Yakcop occupied the position of economic adviser to Tun Dr. Mahathir Mohamad at that time)
2 "The best alternative to a new global currency", ft.com, March 31st.
Finance. According to this report, the major part of the proposed annual allocations of SDRs 150 billion – 250 billion should go to developing countries. However, the UN report emphasized that a regular issuance would not have a direct link to development finance. It would rather reduce the need for developing countries to have international reserves protecting them from external shocks.

The idea of creating financial assets denominated in the IMF – SDRs was defended by the Governor of the China’s Central Bank in Zhou (2009) when he noted that “the centralized management of its member countries’ reserves by the Fund will be an effective measure to promote a greater role of the SDR as a reserve currency. To achieve this, the IMF can set up an open-ended SDR-denominated fund based on the market practice, allowing subscription and redemption in the existing reserve currencies by various investors as desired. This arrangement will not only promote the development of SDR-denominated assets, but will also partially allow management of the liquidity in the form of the existing reserve currencies. It can even lay a foundation for increasing SDR allocation to gradually replace existing reserve currencies with the SDR.”

Another related experience is the 'Asian Bond Fund - ABF' launched in 2003 by the Executives' Meeting of East Asia and Pacific Central Banks (EMEAP) in order to allow its members to invest in bonds issued by Asian sovereign issuers in EMEAP economies.3 The IMF report (2010) emphasizes the importance of using SDRs denominated instruments in trade transactions noting that “promoting invoicing of international trade and finance in SDRs could further enhance its role as a reserve asset. Invoicing commodities, such as oil, could be a useful and visible starting point. Since prices in SDRs are more stable than in the constituent currencies and commodities are used as hedges against dollar depreciation, invoicing in such markets may take root sooner than in other markets.”

In this paper we propose the creation of a payment system based on the issuance of Trade-Special Drawing Rights (T-SDRs). The T-SDRs would be issued at the OIC regional level by a regional financial institution which could be newly created by the Central Banks of the OIC member countries or by an existing institution like the Islamic Development Bank and the International Islamic Financial Market. It is proposed that the issuance of T-SDRs general allocations takes place each three years and be linked to the evolution of the OIC intra-trade volume. These regional

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3 The inaugural Asian bond fund was a US$1 billion issue that was launched in June 2003 and managed by the Bank for International Settlements. The second ABF issue was issued in December 2004 and denominated in member currency funds. For further details see http://www.emeap.org/aboutemeap.asp
purchase power facility has to be allocated among the OIC countries according to fair and transparent criteria. In this paper we suggest detailed criteria intending to incentivize the contribution of member countries to the enhancement of OIC intra-trade. We also suggest coupling this payment system with the issuance of T-SDRs sovereign ṣukūk in order to provide investment opportunities to the countries having T-SDRs surpluses.

This proposed system can be implemented first for a small group of countries before its gradual generalization at the OIC level. The T-SDRs payment system will enhance OIC intra-trade by reducing the problems related to the instability and uncertainty of the bilateral exchange rates⁴. In addition, central banks in OIC member countries could hold at least a portion of their foreign exchange reserves in T-SDRs if they are offered sufficiently attractive return. The rest of the paper is organized as follows. Section II discusses the role of trade in the golden age of Muslim world and its resurgence. Section III presents the origin and current situation of the SDRs issued by the IMF. The suggested Trade based Special Drawing Rights (T-SDRs) is presented in section IV. Finally, section V concludes.

2. Role of Trade in the Golden Age of Muslim World and its Resurgence

While OIC countries differ in terms of resources endowments and economic evolution, they share common history and cultural heritage. To better understand the present and to build the future we need to learn from history (Deepak Nayyar, 2009). It is clear that the economic performance of the Muslim World during the golden age (8th -13th century) was not simply a coincidence but the result of good management of existing capacities combined with the willingness to seize opportunities offered by the favorable global environment. Trade within the Islamic World played a key role in its development and technological progress as pointed out by Findlay and O’Rourke (2007). The Muslim World has managed to maintain a unique geopolitical significance throughout its history. Stretching across two continents, the Islamic World was a thriving centre of trade. Control over main commercial networks helped to establish Muslim World as the world’s leading economic power from the 7th to the 13th centuries. Muslim explorers and traders created a prosperous global economy through a commercial network that stretched from the Atlantic Ocean and the Mediterranean to the Indian Ocean and China Sea. Its cities were integrated with

⁴Indeed, many regional trade integration experiences show that the reduction of transaction and information costs, resulting from currency changes, facilitates the comparison of prices within participating countries and favor their intra-trade. Currently, the majority of the OIC member countries use international currencies (US$, EURO, etc) in their intra-trade transactions and have to secure the related foreign exchange risk. This represents a serious constraint for the development of intra-regional trade.
no restrictions on the free flow of people, ideas, techniques, goods, and capital (Findlay and O’Rourke, 2007). As Lombard (1975) notes, the region at that time could be perceived of as a series of urban islands, linked by trade routes with the supply of precious metals lubricating the movement of goods and factors of production along these circuits.

**Figure-1**

An early form of market economy flourished between the 8th and 12th century, due mainly to the development of trade. A monetary system based on a strong, stable and high valued currency (the dinar) was created in the 7th century to facilitate the exchange of goods and production factors (Findlay and O’Rourke, 2007). Innovative new business techniques and forms of business management adapted from different civilizations were promoted during this period by economists, merchants and traders. Scientific advances in many fields such as hygiene, sanitation and medicine resulted in a significant increase in urbanization. According to Lombard (1975: 118) “This prodigious urban expansion was characterized at first by the creation of towns, some of which rapidly became the largest in the world”. A modern system of irrigation, based on the knowledge of complex hydraulic and hydrostatic principles, was introduced early in the 9th century, providing the foundation for the region’s agricultural revolution (Watson, 1983). The agricultural revolution was based on four key principles: the development of a sophisticated irrigation system, adoption of a scientific approach to improve agricultural techniques, incentives based on a new approach to land ownership that recognized the private property and the introduction of new crops that transformed private farms into enterprises supporting the export industry. Findlay and O’Rourke (2007) argue that industry and mining were also highly developed. In the Nile valley, for example, flax was the cornerstone of the flourishing linen industry. Major capital-intensive industries, using very
advanced technology such as in sugar refining and papermaking, were developed in cities like Andalusia (Ashtor, 1992). The fusion of a variety of cultures and knowledge from many civilizations and the integration of diverse economies during the region’s ‘golden age’ gave birth to the earliest forms of capitalism that were adopted and further advanced in medieval Europe from the 13th century onwards (Labib, 1969; Banaji, 2007).

**Figure-2**

Evolution of Intra-Trade in IDB Member Countries

![Intra-Trade in IDB Member Countries](image)

Source: Data from IDB-56 Trade Profile – ERPD – Chief Economist Complex - IDB

Currently, OIC intraregional trade represents around 17% of total trade. This modest share of intraregional trade is mainly explained by the multiple restrictions on the movement of goods and the lack of dynamic mechanism of cooperation, and this despite the increasing number of trade opportunities. Nevertheless, during the recent two decades, intra-regional trade recorded important and continuous increase. Intra-regional trade in 2011 amounted to US$ 676.2 billion, compared to less than US$ 100 Billion in 1995. This promising increase in intra-regional trade is a unique opportunity to boost regional integration and economic development.

*Could “propinquity” be a driving force to trade integration among Muslim economies?*

For the recent years, we notice a proliferation of regional integration agreements as alternative means to integrate international markets. The current process of globalization tends to strengthen the role of the geographical proximity and the
emergence of regional poles with the marginalization of peripheral zones. The failure of North-South integration projects to achieve industrialization and development has revived debate on the South-South integration as an alternative strategy for developing countries to reach higher level of development. In fact, South-South regional agreements in Asia and Latin America have led to considerable growth of intra-regional trade. The OIC member countries lag behind other regions in terms of regional integration. Indeed, despite many favorable conditions and the advantage of geographic and cultural proximity, that give them a comparative advantage in the international markets; the share of OIC intra-regional trade is still low. In addition, many analysts confirm that Muslim world loses in terms of GDP growth is in part due to slow progress in economic integration process and lack of effective mechanisms of cooperation and coordination. Some analysts confirm that the lack of satisfactory results is due to the fact that current integration projects in the region are driven by political considerations and not by natural process of integration. The natural integration processes is defined as a process fostered by market and for which geographic proximity is considered as an essential factor. However, geographic proximity per se will not have an effect on trade among partners if neighboring countries lack complementarities. Geographic proximity can give additional stimulus to trade between the concerned countries only if the preconditions for dynamic growth exist. In other words, preconditions are needed for a natural process of integration to reinforce growth. It is clear that in order for the OIC member countries to improve their intra-regional trade, a favorable ecosystem should be established. An important characteristic of regionalism, such as in Europe, is that trade dynamics are led by the stability in the value of money. We argue that the emergence of a virtuous circle of trade among OIC countries requires the establishment of an innovative payments arrangements which support cross-borders investment, facilitate trade, and allow better allocation of resources across member countries

3. The Current Market of SDRs

3.1. Origin and Present of the SDRs

Created by the IMF in 1969, the SDRs served to support the Bretton Woods (1944 – 1971) fixed exchange rate system. The expansion of the world trade and financial transactions created the need for the international community to have another international reserve asset in addition to gold and the US dollar. Although the need for this new reserve asset decreased with the collapse of the Bretton Wood System, the recent events marked by the tremendous impact of the financial crisis on the global economy have revived the relevance of these SDRs in stabilizing the
international financial system. In 1978, they became one of the main reserve assets of the international financial system and since then their creation has increased gradually, even if their usage has been more between countries and the IMF than among the countries themselves.

At their first stage, the allocation of SDRs to the IMF member countries was proportional to their quotas in the Fund. However, these allocations have always been a matter of controversies and triggered important discussions among decision makers and scholars. The general allocations of the SDRs have been made only three times. The first allocation was for a total amount of SDR 9.3 billion, distributed in 1970-72, and the second allocated SDR 12.1 billion, distributed in 1979-81. On August 7, 2009, the Board of Governors of the IMF approved a general allocation of SDRs equivalent to US$ 250 billion to provide liquidity to the global economic system. In seek of equity; this new allocation took into account the fact that the IMF members which joined the Fund after 1981 have not benefitted from the previous allocations. This new allocation triggered by the 2009 G20 meeting in London was mainly endorsed by China which emphasized through its Central Bank Governor the need of the international system for a new international currency to replace the US dollar which cannot serve as a reserve asset for all countries, while it depends on the objectives of the monetary policy of the United States. As mentioned by Stiglitz (2011), this can lead to global volatility as a result of growing US current account deficits. The objective of having an international reserve asset that assures economic and financial stability may be achieved through the new allocation of the SDRs. Moreover the limitation of the SDRs to official use by the Central Banks and official institutions has limited their expansion. The international community should consider their usage by the private sector in the future.

The recommendations of some countries, leaded by China, to achieve a further increase of the SDRs allocation would have a certain number of benefits. According to Stiglitz (2011), it would reduce the problem of recessionary bias, by allowing central banks to exchange SDRs for hard currency, such as dollars or euros, and use it to finance higher imports. It would partially replace countries’ need to accumulate reserves. Given its relatively small scale, more SDRs would also help to sustain and accelerate recovery of the world economy, without leading to inflationary pressures. And by reducing the need for countries to set aside foreign exchange reserves, it would also facilitate some reduction in global imbalances.

3.2. Value of the SDRs

The SDRs is defined as a basket of the following currencies: euro, Japanese yen, pound sterling, and U.S. dollar. The U.S. dollar-equivalent of the SDR (which is
posted daily on the IMF’s website) is calculated as the sum of specific amounts of the four basket currencies valued in U.S. dollars, on the basis of daily exchange rates. The Executive Board of the IMF reviews the basket composition every five years (or earlier if judged necessary) in order to reflect the relative importance of currencies used in the world’s trading and financial systems. According to the IMF (2012), “in the most recent review (in November 2010), the weights of the currencies in the SDR basket were revised based on the value of the exports of goods and services and the amount of reserves denominated in the respective currencies that were held by other members of the IMF.” These changes became effective on January 1, 2011 and the next review will take place by 2015.

Zhou (2009) argues that the basket of currencies forming the basis for SDRs valuation should be expanded to include currencies of all major economies, and the GDP may also be included as a weight. The IMF Executive Board discussed in October 2011 possible reform options of the existing criteria for broadening the SDR currency basket, but finally the current criteria for SDR basket selection remained. According to the IMF (2010) both the composition and the rules underlying the review of the SDR basket need to be made transparent, simple, and automatic, in order to enhance the private sector use of SDR-denominated instruments. The report stresses also the necessity for the components of the basket to continue reflecting the importance of its constituting currencies in the world’s trading and financial system, while maintaining stability and continuity.

4. The Suggested Trade Based Special Drawing Rights (T-SDRs)

4.1. What are the Suggested T-SDRs?

The T-SDRs represent an amount of purchasing power facility created at the regional level and accepted by the OIC member countries for the settlement of their intra-trade transactions. The creation of T-SDRs takes place through the issuance of general allocation which we suggest that it takes place each three years taking into account the evolution of the OIC-intra-trade and the evaluation of the degree of utilization of the past issued T-SDRs. The first general allocation could be launched in 2014 with a value:

\[ S = 1\% \text{ Value of the total OIC intra-trade in 2013} \quad (1) \]

Let’s note that Keynes suggested that the total quotas of the IMF SDRs fund be set at 75% of pre-war world trade (around US$ 38 billion) (IMF, 2002). Therefore, the amount of this first allocation is small relatively to the scale of the OIC intra-
trade. In case of success during the three-year initial period, it could be decided to increase the amount of the subsequent general allocations. The first general allocation based on 1% of OIC intra-trade is approximately equal to ID 4.509 billion (US$ 6.742 billion) if taking into account the value of total OIC-trade in 2011.

4.2. Which Value for the T-SDRs?

In order to facilitate the emergence of quick and large acceptance of the idea of the T-SDRs, it is important to avoid the long process of negotiating its value vis-à-vis the currencies of the OIC member countries. In this regard, it is worthwhile to use the existing value of the SDRs issued by the IMF which is also the value of the Islamic Dinar the unit of account of IDB Group.

\[
1 \text{T-SDR} = 1 \text{SDR of the IMF} \quad (2)
\]

4.3. How to Allocate the T-SDRs?

First let’s recall that the IMF allocates its SDRs to member countries in proportion to their IMF quotas. “Such an allocation provides each member with a costless, unconditional international reserve asset on which interest is neither earned nor paid. However, if a member's SDR holdings rise above its allocation, it earns interest on the excess. Conversely, if it holds fewer SDRs than allocated, it pays interest on the shortfall. The IMF cannot allocate SDRs to itself or to other prescribed holders.” (IMF, 2012). The rule of the T-SDRs allocation should be designed in a manner that incentivizes a member country to enhance its trade within the OIC region. For the allocation of the T-SDRs we suggest two possible options.

4.3.a. Option I: Creation of an OIC regional financial institution responsible of the T-SDRs

We assume that the OIC countries decide the creation of a Regional Clearing House in charge of the issuance of the T-SDRS and management of the OIC intra-

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5 In 2011, as proxy for OIC intra-trade the total IDB-56 intra-trade equaled US$ 674.2 billion (Source: IDB-56 Trade profile, ERPD – Chief Economist Complex).

6 This valuation will probably attract defenders of this idea from economists like Joseph Stiglitz. According to the UNCTAD (2009) the Stiglitz commission recalled the UNCTAD Proposal (during the 1960s) to link the issuance of SDRs with the development financing by allowing the IMF to invest some of the funds made available (through the issuance of SDRs) in the bonds of multilateral development banks.
trade transactions paid via this new regional payment facility. We suggest that the allocation follows the following rule:

\[ S_i = \lambda_i S \]  \hspace{1cm} (3)

Where the weight \( \lambda_i \) assigned to country \( i \) represents its average share in the OIC intra-trade during the last three years. For example, if \( S = $4.5 \) billion, and country \( i \) has a share of 5% in intra-trade, then \( S_i = \lambda_i S = 0.05(4.5) = 0.225 \) billion. This rule is different from the one applied for the allocation of the IMF-SDRs and constitutes an original contribution in line with the spirit of the T-SDRs designed to favor the OIC intra-trade.

4.3.b. Option II: Assigning to IDB the role of issuing and managing the T-SDRs

In the case that IDB is assigned the role of issuing and managing the payment system based on T-SDRs we suggest that 1/5 of each general allocation to IDB and the remaining 4/5 allocated among the IDB member countries according to the following rule (which could be the basis of further discussion by the countries):

\[ S_i = \alpha_i \left( \frac{4}{5} S \right) \quad \text{with} \quad \sum_{IDB-56} \alpha_i = 1 \]  \hspace{1cm} (4)

\[ \alpha_i = \beta \lambda_i + (1 - \beta) \mu_i \]  \hspace{1cm} (5)

\( \lambda_i = \text{Share of country } i \text{ trade with OIC countries in total OIC intra-trade} \)

\( \mu_i = \text{Share of country } i \text{ financing in total financing portfolio of IDB} \)

Where the weight \( \alpha_i \) for country \( i \) depends on its participation in the OIC intra-trade captured by the share \( \lambda_i \) and the importance of the country in the total financing portfolio of IDB captured by \( \mu_i \). The values of the weights \( \beta \) and \( (1 - \beta) \) reflect the importance given to the country's contribution to intra-trade and its financing needs respectively. Figure 2 and table 1 present the values of the two parameters \( \lambda_i \) and \( \mu_i \) for a set of countries, (we used the IDB-56 intra Trade as a proxy for the OIC intra-trade).
Figure-2
Countries’ Shares in Intra-Trade and Financing Portfolio of IDB

Table-1
Sample of Calculation of the Shares $\lambda_i$ and $\mu_i$

<table>
<thead>
<tr>
<th>Country</th>
<th>Trade with IDB-56 (Million USD)</th>
<th>Share in IDB-56 - Intra Trade $\lambda_i$</th>
<th>Share in IDB-financing portfolio $\mu_i$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tajikistan</td>
<td>1,375.12</td>
<td>0.20%</td>
<td>0.33%</td>
</tr>
<tr>
<td>Gabon</td>
<td>1,200.26</td>
<td>0.18%</td>
<td>0.49%</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>10,077.00</td>
<td>1.49%</td>
<td>14.47%</td>
</tr>
<tr>
<td>Algeria</td>
<td>10,056.92</td>
<td>1.49%</td>
<td>2.88%</td>
</tr>
<tr>
<td>Pakistan</td>
<td>30,233.09</td>
<td>4.48%</td>
<td>9.56%</td>
</tr>
<tr>
<td>Egypt</td>
<td>23,633.88</td>
<td>3.51%</td>
<td>5.72%</td>
</tr>
<tr>
<td>Qatar</td>
<td>10,748.45</td>
<td>1.59%</td>
<td>0.88%</td>
</tr>
<tr>
<td>Iran</td>
<td>48,563.59</td>
<td>7.20%</td>
<td>6.58%</td>
</tr>
<tr>
<td>Libya</td>
<td>3,506.66</td>
<td>0.52%</td>
<td>0.87%</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>66,263.80</td>
<td>9.83%</td>
<td>5.10%</td>
</tr>
</tbody>
</table>
It is clear that the contribution of a country like Bangladesh in IDB-56 intra-trade is lower than its financial needs. The advantage of the allocation rule (4) and (5) is the balance it offers between the financing needs of the country and its contribution to the IDB-56 intra-trade. This balance is made through the weights $\beta$ and $(1 - \beta)$ placed on the two components (contribution to intra-trade and financing needs respectively). Table 2 presents the allocation shares for a set of countries for three different pairs $(\beta, 1 - \beta) \in \left\{\left(\frac{1}{2}, \frac{1}{2}\right), \left(\frac{1}{3}, \frac{2}{3}\right), \left(\frac{2}{3}, \frac{1}{3}\right)\right\}$. The first pair $\left(\frac{1}{2}, \frac{1}{2}\right)$ signifies that the same importance is given to the contribution to intra-trade and to the financing needs. The second pair $\left(\frac{1}{3}, \frac{2}{3}\right)$ reflects the choice to give more importance to the financing needs of the country relatively to its contribution to the intra-trade. The symmetric possibility is possible with the last pair $\left(\frac{2}{3}, \frac{1}{3}\right)$.

Table 2 shows that the choice of the weights $(\beta, 1 - \beta)$ have different level of impact on the share of the countries in the general allocation of T-SDRs. For a country like Bangladesh it is more beneficial to put more importance on the financial needs which is the case with the pair $\left(\frac{1}{3}, \frac{2}{3}\right)$. For a country like Saudia Arabia highly contributing to the intra-trade the pair $\left(\frac{2}{3}, \frac{1}{3}\right)$ it is more in line with its interests in
terms of benefiting of higher share in the T-SDRs. However, since the T-SDRs will finance OIC intra-trade indirect benefit could also come from the increase of the demand on Saudi exports coming from a country like Bangladesh. Therefore, the choice of the weights \((\beta, 1 - \beta)\) could be discussed at the level of IDB Governors. Table 3 illustrates the amount of the first general allocation received by a sample of OIC countries using the values of \(\alpha_i = \beta_i \lambda_i + (1 - \beta_i) \mu_i\) calculated in Table 2 and with the assumption that the first general allocation equals 1% of the value of OIC intra-trade in 2011 or ID 4.509 billion (US$ 6.742 billion).

**Table 3**

| Allocation \(S_i\) (Millions USD) Based on the Values \(\alpha_i\) of Table 2 |
|---------------------------------|----------------|----------------|----------------|
| Case 1 | Case 2 | Case 3 |
| Tajikistan | 17.98 | 19.48 | 16.48 |
| Gabon | 22.44 | 25.87 | 19.00 |
| Bangladesh | 538.02 | 683.87 | 392.16 |
| Algeria | 147.42 | 163.07 | 131.77 |
| Pakistan | 473.33 | 530.43 | 416.24 |
| Egypt | 311.02 | 335.81 | 286.23 |
| Qatar | 83.11 | 75.08 | 91.14 |
| Iran | 464.59 | 457.63 | 471.54 |
| Libya | 46.92 | 50.87 | 42.97 |
| Saudi Arabia | 503.41 | 450.29 | 556.53 |

Table 4 calculates the ratio of the T-SDRs received by the sample of countries relatively to their intra-OIC trade and show that given the amount of the first general allocation (1% of intra-OIC trade for 2011) it represents at most around 6.8% for Bangladesh and is less than 0.84% for Saudi Arabia. Going back to Table 1, the higher ratio of Bangladesh is due to its importance in IDB financing portfolio rather than its contribution to the OIC-intra trade.

4.4. The T-SDRs in Practice

This section is based on the assumption that the IDB Group will host a “T-SDRs Department” which exercises the role of a Clearing House and holds a T-SDRs account for each OIC country. The model can be easily adjusted to the case of a Clearing House Institution.
4.4.a) Allocation and transactions mechanisms

We suggest that in the initial three-year stage (launching stage), the use of the T-SDRs could be restricted to national monetary authorities. In the second stage, it could be extended to selected large financial institutions. In an advanced stage large OIC private sectors firms could handle their international financial transactions directly in T-SDRs.

The private sector of the member countries should continue dealing in any international currency in their international transactions. However, we suggest introducing a sort of an incentive mechanism for the private sector to pass through their national central bank for the settlement of an international transaction with another private firm in IDB member countries. This mechanism will rest on the daily announcement of the cost of the transaction between all the member countries and depends on their respective T-SDR balance. If the receiving country has a deficit of T-SDRs than the cost of the transaction through paying central bank should be lower than the normal cost of payment of international transactions and vice-versa.

In order to facilitate the acceptance of the T-SDRs we think that IDB shall not play the role of Designation mechanism (as it is the case of the IMF) but voluntary arrangement between countries are acceptable if they want to sell their T-SDRs for international currencies in accordance with the T-SDRs daily rate (which is the IMF-

### Table-4
Allocation in Percentage of the Country Trade with IDB-56

<table>
<thead>
<tr>
<th>Country</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tajikistan</td>
<td>1.31%</td>
<td>1.42%</td>
<td>1.20%</td>
</tr>
<tr>
<td>Gabon</td>
<td>1.87%</td>
<td>2.16%</td>
<td>1.58%</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>5.34%</td>
<td>6.79%</td>
<td>3.89%</td>
</tr>
<tr>
<td>Algeria</td>
<td>1.47%</td>
<td>1.62%</td>
<td>1.31%</td>
</tr>
<tr>
<td>Pakistan</td>
<td>1.57%</td>
<td>1.75%</td>
<td>1.38%</td>
</tr>
<tr>
<td>Egypt</td>
<td>1.32%</td>
<td>1.42%</td>
<td>1.21%</td>
</tr>
<tr>
<td>Qatar</td>
<td>0.77%</td>
<td>0.70%</td>
<td>0.85%</td>
</tr>
<tr>
<td>Iran</td>
<td>0.96%</td>
<td>0.94%</td>
<td>0.97%</td>
</tr>
<tr>
<td>Libya</td>
<td>1.34%</td>
<td>1.45%</td>
<td>1.23%</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>0.76%</td>
<td>0.68%</td>
<td>0.84%</td>
</tr>
</tbody>
</table>
SDR exchange rate). Let's assume that there are only two OIC countries participating to the T-SDRs payment system arrangement and that the first general allocation $S$ is allocated between them so that we have $S = S_A + S_B$.

**Figure-3**

The T-SDRS payment (clearing) system is centralized through an IDB hosted electronic platform. For each financial transaction in T-SDRS between the two countries A and B, IDB should be ex-ante notified in order to grant automatic authorization for the payment transaction and debit/credit the T-SDRS accounts when the transaction is electronically validated. The update of the T-SDRS account of each country should be realized in real time. This will ensure that the balance of the T-SDRS account for each country will remain within a pre-determined range.

For each transaction in T-SDRS, the initiating country should pay a commission of 1% of the transaction’s volume in USD. For each dollar received as a commission the IDB Group holds 0.6 US$ in the Lender of Last Resort (LLR) reserve, 0.1 US$ as revenue covering the operational costs and 0.3 US$ supplies the remuneration reserve which is used to remunerate the surplus of the T-SDRS accounts on a monthly basis as it will be explained in the next paragraphs. For example assume that country A imported some merchandises from country B with the value of 100 million T-SDRs to be paid through the T-SDRs payment system. Assume that 1 SDRs = 0.647 USD than the 1% commission which has to be paid initially by country A in relation to this operation is 647,000 USD which will be divided between the LLR reserve (388,200 USD), the operational cost (64,700 USD) and the remuneration reserve (194,100 USD).

In addition to the general allocation which is renewed each three years, the IDB issue new partial allocation on a monthly basis. These partial allocations are backed by the amount of the LLR reserve in US$. For each additional dollar in the LLR reserve the
IDB Group will create the equivalent in T-SDRS of 1.2 dollars. The LLR reserve enables the IDB to play the role of Lender of Last Resort when a member country is facing a balance of payment crisis such that if the level of its international reserves decreases below the threshold of 90 days of imports’ bill. In this case, the country could ask to convert its SDR allocation in US$ and commits to return back this “facility” to the LLR reserve once the situation of its international reserves exceeds 100 days of imports and within three months in all cases.

**Figure-4**

4.4.b) How to deal with deficit/surplus T-SDRs accounts: The potential role of T-SDRs ṣukūks

The countries shall not be authorized to overdraft but those among them with positive IDB-56 intra-trade balance will see the balance of their T-SDRS account increase above the initially allocated amount. The following configuration illustrates a situation where the bilateral trade balance between countries A and B is in favor of the latter. Country B holds more T-SDRs than the amount initially allocated to it where is the opposite holds for country A:

The T-SDRs balance of the countries is allowed to fluctuate for example between 20% and 150% of their initial allocation during the three-year period but each country should end the three-year period with a level equaling the initial allocation. This
mechanism brings flexibility and avoids the free-riding problem consisting in benefiting from chronic trade-balance deficit.

Figure-5

Countries with surplus of T-SDRs (like country B in the above case) should be offered an option to invest this surplus. Otherwise, they would not be incited to continue trading with OIC-countries on the basis of T-SDRs transactions and would rather prefer classical financial transaction in USD, euro or any other international currency that could generate remuneration when invested in the international currency markets (for example). One of the mechanisms is to remunerate the surplus of T-SDRs ranging between 100% and 150% with a return on a monthly basis and which is calculated proportionally to the remuneration reserve and the surpluses of the other countries. Another possible mechanism to provide remuneration for the surplus countries could be designed in relation to the project financing by IDB. Let’s assume that a country C ask IDB Group for infrastructure financing of an amount in US$ equivalent to (1.5 × ΔS₉) T-SDRs. Country C should be encouraged to issue sukūks in T-SDRs which enable it to raise capital in T-SDRs to finance the purchase of commodities and services (in relation to the project) within IDB-56 countries. IDB itself could finance country C through the purchase of T-SDRs sukūks using its IDB’s T-SDRs account. Although the sukūk are issued in T-SDRSthe principal is reimbursed in T-SDRs but the "coupons" which benefit to the investors should be paid by country C in USD.

Therefore, the identification of the characteristics of the project and the potential suppliers among the member countries becomes an essential stage in the structuring of the sukūks.
These T-SDRs ṣukūk will not only reduce the liquidity constraints on IDB Group but also enable the countries with surplus T-SDRs accounts to invest in T-SDRs ṣukūks. The consequence of this operation is that the T-SDRs account of country C will be credited by the amount of T-SDRs ṣukūk issuance. This capital will enable the country to finance the operations related to the project backing the ṣukūks (infrastructure in our case) only in T-SDRs. This is another multiplicative effect which will enhance trade within OIC region since country C will import services and merchandises which could be paid in T-SDRs. If the country needs to imports services or merchandises related to the project outside the OIC-region it should find a voluntary member country which purchase the T-SDRs and sells US$, Euros or any international currency. IDB should stand ready to assist in this regard, in collaboration with say World Bank and other international agencies. Otherwise, the country will use its foreign currency reserves. In all cases, this financing mechanism would reduce the burden on the foreign currency reserves.

4.4.c) Example

Let's illustrate the practical steps for the functioning of the T-SDRs payment system coupled with the issuance of T-SDRs ṣukūks by one of the participating countries. Assume that three countries denoted A, B, and C are participating to this system in addition to IDB. Country A which is initially (let's assume that the first general allocation will take place in December 2014) provided with an allocation of T-SDRs 300 million. In June 2015 the T-SDRs account of country A decreases to the minimum accepted level of T-SDRs 60 million (20% of the allocation).

In June 2015, the country needs financing of T-SDRs 100 million to build a road. The road will be realized in two years by a private contractor Ct from country C. The finalization of the first part of the road is expected by June 2016 and the contractor asks to be paid (the equivalent in its national currency CUR according to the spot exchange rate of June 2016) a first installment of USD 30 million at this date. The second and final payment of (the equivalent in its national currency CUR according to the spot exchange rate of June 2017) USD 30 million is to be paid upon the completion of the project expected by June 2017.

In June 2015 country A decides to issue Ḩistiṣnāʾ ṣukūks with a principal amount of T-SDRs 100 million and a markup of 150bps (30% to the benefit of the investors, 60% to the LLR reserve account, and 10% to cover the operational cost of IDB). The ṣukūks have to mature before the next general allocation (December 2017) and

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8 Since the country looks to finance the project through T-SDRs, than the selection of the contractor should be in line with IDB procedures.
semi-annuities have to be paid according to the following schedule: December 2015, June 2016, December 2016, June 2017, and December 2017. IDB and country B purchase the ṣukūks issued by country A.

**Figure-6**

In June 2016 and June 2017, the T-SDRs account of country A is debited of the equivalent in T-SDRs of USD 30 millions and that of country C is credited by the same amounts. Meanwhile, the central bank of country C transfers to its national contractor Ct the equivalent of the USD 30 million USD in its national currency CUR. The thresholds TH1 and TH2 of minimum T-SDRs available in the account of country A ensures that any eventual appreciation of the USD against the T-SDRs will be absorbed by the account of country A.

During the period of completion of the two stages of the road project (June 2015-June 2016) and (June 2016-June 2017) the T-SDRs account of country A is not authorized to fell below the respective following thresholds TH1 = 20% normal threshold (for A T-SDRs 60 million) plus T-SDRs 100 millions (project total financing) = T-SDRs 160 millions and TH2 = T-SDRs 60 million + T-SDRs 50 millions (second part of the principal amount).
Figure-7

June 2016 and June 2017. Country A's T-SDRs account is debited by the equivalent of USD 30 millions. The T-SDRs account of country C is credited by these amounts. The contractor Ct from country C is paid by its central bank the equivalent of USD 30 millions in local currency.

For each of the five semi-annuities, country A has to ensure that its account can be debited by T-SDRs 20 millions. In addition the markup calculated in USD according to the initial T-SDRs/USD rate (assumed to be 0.647 in June 2015) equaling T-SDRs 1.5 million x 0.647 = USD 970,500 has to be transferred in five installment (USD 194,100) to at the above mentioned dates to the remuneration account (USD 58,230), the LLR account (USD 116,460) and the operational cost account (USD 19,410).

The LLR reserve account covers any default of the country A in terms of transferring to the remuneration and operational cost accounts the mark-up coupons in USD.
5. Conclusion

The 5th OIC consultative group meeting on enhancing OIC intra-trade recommended the establishment of Trade Finance Support Schemes, as one of the driving factors, to accelerate the OIC intra trade. In this paper we suggested a possible schema of trade financial support. Indeed, we defended the idea of creating an OIC payment system for intra-trade transactions through the issuance of Trade-based Special Drawing Rights (T-SDRs) inspired from the SDRs of the IMF. We began by discussing the role of trade in the golden age of Muslim world and its resurgence. Then we presented the origin and current situation of the SDRs issued by the IMF.
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The 10th International Conference on Islamic Economics and Finance (10th ICIEF)

The 10th International Conference on Islamic Economics and Finance (10ICIEF) was held during 23-24 March 2015 in Doha, Qatar on the theme of “Institutional Aspects of Economic, Monetary and Financial Reforms”. The conference was jointly organized by Islamic Research and Training Institute (IRTI) of the Islamic Development Bank Group, the Center for Islamic Economics and Finance at the QATAR FACULTY OF ISLAMIC STUDIES (QFIS) of the Hamad Bin Khalifa University, and the International Association for Islamic Economics (IAIE).

The conference provided a distinct opportunity to discuss the diverse issues in Islamic economics through three plenary sessions and 39 parallel sessions where more than 158 papers, in English and Arabic, were presented and discussed. All the papers are available at http://conference.qfis.edu.qa/ and at www.irti.org events page.

The theme of the conference was set in relation to the needed reforms to address the continued prevalence across the globe of the adverse effects of the financial crisis. It provided an opportunity to discuss the role that can be played by Islamic economics and finance in addressing these perils. Among many other things, the discussions focused on institutional aspects of reform, such as culture, transparency, the quality of legal systems, and bureaucratic quality. In addition, the discussions took place on incorporating ethics and morality in economic and financial transactions for more durable solutions and policies.

The 10th ICIEF was continuation of the series of conference that started with the 1st ICIEF in 1976, held in Makkah al-Mukarramah. Over the last four decades, the series of this conference has played a significant role in enriching the literature and the agenda for contemporary research in Islamic economics and finance. The Eleventh Conference is planned to take place in Kuala Lumpur, Malaysia. As in case of all the past conferences, IRTI is one of the sponsors and co-organizer of the event.
Excerpts from the Communiqué issued at the end of the 10th ICIEF

Through policy-oriented research, Islamic economics and finance must be more ready than ever before to align the vision of the urgent need for more just, fair, and equitable sustainable development. In this context, as a platform for dialogue and discussions between academics, researchers, graduate students, policy-makers, and practitioners, the Conference contributes significantly to the process of mobilizing quality policy-oriented and basic research in the field of Islamic economics, banking and finance, with a focus on issues related to inclusive economic growth, equity, poverty alleviation and macroeconomic stability.

The participants recommended that for future conferences, focus should be on areas where more efforts should be made in the spirit for setting an agenda for future action, and should deliberate, among other issues, on how we can develop a framework for facilitating the Islamic economic and financial system to take its deserved place in solving the perennial economic problems of IDB member countries and Muslim communities. In this regard, the following specific recommendations were made during the conference:

- All the institutional reforms that are being carried out in different areas should be within the framework of Maqāṣid al-Sharīʿah to facilitate greater acceptability of policies by the public.
- Urge stakeholders to enhance institutional capacities for undertaking basic and applied research that can credibly guide policies and promote the discipline of Islamic economics and finance in scientific lines.
- Based on the Symposium on "Islamic Monetary Policy Instruments to Support Islamic Banking", IAIE will submit a request through the Islamic Development Bank (IDB) to the Council of the Islamic Financial Services Board (IFSB) for establishing a Working Group on the subject for resolving the challenge of the Islamic financial services industry with respect to liquidity management.
- In order to resolve pertinent architectural challenges of the Islamic financial services industry and effectively addressing the unresolved economic challenges in the IDB member countries and in Muslim communities, the IDB is urged to establish an Apex Forum of IDB Governors and IFSB Council Members.
- In order for the Islamic financial services industry to be sustainable and inclusive, within the scope of the "Ten-Year Framework and Strategies - Mid-term Review document" the stakeholder to pay special attention to a) institutionalizing the Islamic social finance for supporting small and medium enterprise development and b) actively encourage countries to develop their own national Islamic financial sector development strategic plans.

- As resolved by the "Islamic Economics and Finance Education Symposium", stakeholders to consider developing capacity building Technical Assistance programs for supporting Islamic economics and finance education around the world wherever there may be an interest.

- Stakeholders to consider supporting the proposal submitted by the International Islamic University Malaysia to establish a formal institutional framework for coordinating the Islamic Economic and Finance Education programs wherever it is possible so that talent development and curriculum offered are effective and meet minimum accredited standards.

- The Conference noted with appreciation the important initiative by Islamic Economics Institute (IEI) in developing a classification scheme for literature in Islamic economics and finance namely; "KAUJIE Classification Scheme" (King Abdulaziz University, Journal of Islamic Economics Classification Scheme). They resolved that writers and journals in Islamic economics and finance may start using it. They requested IEI to take necessary steps to implement the essential following stage of starting an indexing service using this Scheme.

- The Conference took note of the offers so far received by the IAIE to host the 11th Conference and entrusted the IAIE to proceed making necessary negotiations and logistic assessments according to the following priority:
  
  o July 2016 Conference to be held in Kuala Lumpur
  o October 2017 Conference to be held in Makkah Al Mukaramah
  o September 2018 Conference to be held in Jakarta
Policy Roundtable and Workshop-3  
On Maqāṣid al-Sharī‘ah Based Socio-Economic Development Index

Workshop #3 on Maqāṣid al-Sharī‘ah based Socio-Economic Development Indicators was held in Putrajaya, Malaysia on June 1 to 2, 2015, organized by IRTI and Islamic University College Selangor (IRCEIF, KUIS). Like its predecessor workshops, this event furthered the research on measuring socio-economic development aligned with the objectives of Sharī‘ah. The papers presented are available at KUIS website.
ABSTRACTS OF ARTICLES PUBLISHED IN
DIRASAT IQTISADIAH ISLAMIAH
IN VOL. 21 No. 1
تقييم المنتجات المالية الإسلامية وتحديات التطوير والابتكار
حالة منتجات إدارة السيولة

الأستاذ فيصل شياد

ملخص البحث

(Published in Dirasat Iqtisadiah Islamiah Vol. 21 No.1)

انطلاقاً من مبادئ الوسطية المالية، التي من أهمها العمل على إحداث توازن بين الصيغ القائمة على مبدأ المشاركة في الربح والخسارة وصيغ التمويل المبنية على الدين غير المرتبط بنمو الثروة، وضرورة تطوير أدوات وصيغ فعالة وعادلة في إدارة المخاطر وتوزيعها، كان لزاماً على المصارف الإسلامية تحسين خدماتها ومنتجاتها، خاصة مع شهود الصيغة الإسلامية تغيرات كبيرة تزامنت مع التطورات الاقتصادية والاجتماعية في المجتمعات الإسلامية، وتزايد حدة المنافسة في السوق المصرفية العالمية، بالإضافة إلى المتطلبات التقنية والقانونية على صعيد مقررات لجنة بازل. أدى كل هذا إلى ضرورة البحث عن منتجات جديدة تقوم على أسس شرعية وتحقق الكفاءة الاقتصادية، ويعتبر الابتكار والتجديد من أهم ما يميز المصارف الإسلامية.

1 جامعة سطيف الجزائر، نفرع علمي-الجامعة العالمية للمالية الإسلامية.

INCEIF
ويكرس تفوقها، و يجعلها تقدم الأفضل من جميع النواحي. والدعوة إلى ابتكار منتجات مالية جديدة وتطويرها هي دعوة للاجتهاد في المسائل المالية بما يحقق مقاصد الشريعة الإسلامية. ومن هنا تبرز الحاجة الماسة لتطوير المنتجات المالية الإسلامية. لذا سيحاول هذا البحث تقييم المنتجات المصرفية الإسلامية وكيفيات تطويرها وتحسينها بما يضمن بقاءها وتنافسيتها في الأسواق المحلية والعالمية.

كلمات البحث المفتاحية: الابتكار والتطوير، المنتجات المالية الإسلامية، الخدمات المالية الإسلامية، تقييم تطبيقات المرابحة المشاركة، منتجات إدارة السيولة، ماليزيا.

English translation to be added.
تأثير مقررات لجنة بازل على النظام المصرفي الإسلامي
أ.د. مفتاح صالح١- آ. رحالة فاطمة١

الملخص

في ظل التطورات التنافسية المتلاحقة التي تشهدها الأسواق العالمية في مجال المعاملات المالية، أصبح أي بنك عرضاً للعديد من المخاطر المصرفية. لذلك بدأ التفكير في البحث عن آليات لمواجهة تلك المخاطر، فكان أول خطوة في هذا الاتجاه تشكيل وتأسيس لجنة بازل للرقابة المصرفية، التي قدمت توصيّاتها الأولى بشأن كفاية رأس المال في يوليو 1988م فيما عُرف بالاتفاقية بازل1، وقدّرت نسبة كفاية رأس المال بـ 8 %، وأوصت اللجنة بنطبيق هذه النسبة اعتباراً من نهاية عام 1992م، ولكن رغم الإيجابيات التي انبثقت عن اتفاقية بازل1، إلا أنها كان لها نقصات استوجب إعادة النظر فيها، فجاء الإعداد لتعديل تلك الاتفاقية وإصدار اتفاقية جديدة مناسبة تتضمن إعادة النظر في أساليب إدارة المخاطر بما يحقق سلامة البنوك وآمنة القطاع المصرفي سيما بازل2، حيث قامت بإدخال مخاطر التشغيل وأضافت دعامتين جديدتين إحداهما تتعلق بعمليات الإشراف الرقابي والثانية تتعلق بانضباط السوق. وقد بدأ تطبيقها مع بداية عام 2007م، وجاءت هذه الاتفاقية بنظره أشمل وأدق لخطر البنوك.

ونظراً للاضطرابات المالية التي خلفتها الأزمة المالية العالمية 2008، قامت لجنة بازل بإجراء تعديلات واسعة وجوهرية على الدعامات الثلاث لـ«بازل 2»، تمتثل بإصدار قواعد ومعايير جديدة، شكلت معاً ما بدأ تسميتها -بازل 3-، حيث تلزم قواعد اتفاقية «بازل 3»

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١ أستاذ تعليم عال، دكتوراه الدولة في العلوم الاقتصادية، تخصص: نقود ومالية.
١٠ أستاذة باحثة، طالبة دكتوراه سنة أولى في العلوم الاقتصادية.
البنوك بتحصين أنفسها جيداً ضد الأزمات المالية في المستقبل، وبالتغلب بعفوفها على الاضطرابات المالية التي من الممكن أن تتعرض لها من دون مساعدة أو تدخل البنك أو الحكومة قدر ما أمكن، وتهدف الإصلاحات المقترحة بموجب اتفاقية بازل 3 إلى زيادة متطلبات رأس المال وإلى تعزيز جودة رأس المال للفئات البنكية حتى يتسنى له تحمل خلال فترات التقلبات الاقتصادية الدورية. ومن هذا المنطلق تأتي هذه الدراسة في محاولة تأثير مقررات بازل 3 على النظام المصرفي الإسلامي.

الكلمات المفتاحية: إدارة المخاطر، لجنة بازل، البنوك الإسلامية، النظام المصرفي، البنوك التقليدية، كفاية رأس المال، السيولة.

English translation to be added.
التمويل العقاري ومدى توافقه مع النماذج الإسلامية للتمويل

دراسة قانونية مقارنة بين النظامين المصري والسعودي

د. مصطفى أحمد إبراهيم نصر

مقدمة

تعد رغبة الإنسان في تملك عقار يأوي ويسكن عماد حياة الفرد ونقطة مراجعة وبدونه لن يستطيع العيش في أمان واستقرار.

ولذلك تلتزم الدول بالسعي جاهدة إلى محاولة إشباع حاجة الإنسان إلى السكن الكريم، ويتم ذلك بتوفير المسكن الاقتصادي لذوي الدخول المحدود، وفي ذلك توفر منظومة قانونية سليمة يرتكب إليها الأفراد عند اقتناء المسكن، وتسمى هذه المنظومة "منظومة التمويل العقاري" التي يطلع إليها الأفراد في أن تكون الحل الأمثل لهم لتوفير مسكن بإمكانية تم تكوُن محدودة وخصوصية في ظل الأزمة المالية العالمية التي لم تتعاف منها بعض الدول حتى الآن، وأدت إلى انكماش اقتصادي وانخفاض في معدلات النمو بالدول المتقدمة، مما أثر بالسلب على باقي الدول النامية.

2 أستاذ مساعد، القانون المدني بجامعة شقراء، المملكة العربية السعودية.
وكان السبب الرئيس في تلك الأزمة، في نظر بعضهم، هو تسرع الدول في تنظيم تمول السكن، ولكن تصيغ وماذج روبية تعتمد على الفائدة العالية أخذًا وعطاء، بالإضافة إلى تجارة الديون.

فكان لزاماً وضع حلول علمية وقانونية لتوفير سكن دائم وبصيغ تمول إسلامية جديدة تواكب ما يمر به الاقتصاد العالمي الآن، مما يؤدي إلى التخفيف من حدة الفقر المنتشرة، خاصة في الدول النامية، ويعود بالإيجاب على استقرار الاقتصاد الوطني.

وهذا ما جعلنا نتجه صوب الشريعة الإسلامية التي أمدتنا بالعديد من النماذج الجديدة علينا، تهدف إلى مدد العون للمحتاج (المستثمر) مع توفير ربح خلال للممول، مع المحافظة على أمواله من عدم سداد المستثمر أو تعثره.

وسوف يلقي البحث الضوء على منظومة التمويل العقاري المصري والسعودي من حيث تعريفها وبيان أهدافها، وكيفية تطبيقها في الواقع، وأوجه الربا الفعالة عليها، وكيفية مزاولة نشاط التمويل وحدوده، مع بيان النماذج الإسلامية المعروفة ومدى مطابقة النظامين لها، ليكون بين يدي الباحثين والمهتمين وواضع القانون دراسة شاملة عن هذين النظامين.

English translation to be added.
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ISLAMIC SOCIOECONOMIC INSTITUTIONS AND MOBILIZATION OF RESOURCES WITH SPECIAL REFERENCE TO HAJJ MANAGEMENT OF MALAYSIA (1996), pp.103
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STRATEGIES TO DEVELOP WAQF ADMINISTRATION IN INDIA (1998), pp.189
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The paper examines the practices of Central Banks, especially in the regulation and control aspects of Islamic Banks.

REGULATION AND SUPERVISION OF ISLAMIC BANKS (2000), pp.101  
M. Umer Chapra and Tariqullah Khan  
The paper discusses primarily the crucial question of how to apply the international regulatory standards to Islamic Banks.

Morteza Gharehbaghian  
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The study presents answers to a number of frequently asked questions about Islamic banking.

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The paper develops a microeconomic model of an Islamic bank and discusses its stability conditions.

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This is a case study of the experience of agricultural finance in Sudan and its economic sustainability.

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The paper examines various risks in equity and debt modes of financing and discusses the appropriate institutional model that can mitigate theses risks.

ISLAMIC CAPITAL MARKET PRODUCTS DEVELOPMENTS AND CHALLENGES (Occasional Paper No. 9), (2005), pp.93
Salman Syed Ali
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Sami Al-Suwailem
The book outlines an Islamic approach to hedging, with detailed discussions of derivatives, gharar and financial engineering. It accordingly suggests several instruments for hedging that are consistent with Shari‘ah principles.

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ROLE OF MICROFINANCE IN POVERTY ALLEVIATION: LESSONS FROM EXPERIENCES IN SELECTED IDB MEMBER COUNTRIES (Occasional Paper), (2008), pp.73
Mohammed Obaidullah
The book proposes a two-pronged strategy to poverty alleviation through micro-enterprise development based on the dichotomy between livelihood and growth enterprises. With a focus on provision of Sharīʿah-compliant financial services for micro-enterprises, it reviews thematic issues and draws valuable lessons in the light of case studies from three IsDB member countries – Bangladesh, Indonesia, and Turkey.

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This paper highlights the importance of microfinance as a tool to fight poverty. It presents the “best practices” models of microfinance and the consensus principles of microfinance industry.

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M. Umer Chapra
This paper asserts that comprehensive vision of human well-being cannot be realised by just a rise in income and wealth through development that is necessary for the fulfilment of basic needs or by the realization of equitable distribution of income and wealth. It is also necessary to satisfy spiritual as well as non-material needs, not only to ensure true well-being but also to sustain economic development over the longer term.

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This book attempts to analyse the essential aspects of social responsibility of Islamic Banks and the means to achieving them. Apart from encapsulating the Shariʿah formulation of the social responsibility and its relation to the objectives of Shariʿah, the book also addresses the linkage between social responsibility and the economic and social development of Muslim communities. Furthermore, it demonstrates the impact of the nature of social and developmental role which should be undertaken by Islamic banks, not only for achieving socio-economic development but also for making the earth inhabitable and prosperous.
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<td>QU’EST-CE QUE L’ÉCONOMIE ISLAMIQUE?</td>
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<td>Mohammad Umer Chapra</td>
<td>Ce livre développe avec habileté la logique islamique de la prohibition du Ribā, et démontre avec rigueur la viabilité et la supériorité du système de financement basé sur la participation au capital.</td>
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<tr>
<td>Munawar Iqbal, Ausaf Ahmad et Tariquallah Khan</td>
<td>Le but de ce document occasionnel est que les théoriciens et praticiens dans le domaine bancaire islamique doivent explorer les voies et moyens permettant au système bancaire islamique de soutenir son rythme de progrès au moment où il entre dans le 21ème siècle.</td>
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## TRANSLITERATION TABLE

**Arabic Consonants**

- Initial, unexpressed medial and final:

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- Vowels, diphthongs, etc.

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