CHAPTER SIX

ISLAMIC BANKING AND FINANCE:

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6.1 INTRODUCTION

The Sudanese economy was an infant and directionless in the 1950s and 1960s, the era after the independence, and since the country was a British colony, took the free market (capitalist system) in 1953-1969; then planned economy controlled by the central government and with socialist thoughts in 1970-1983; opened with Islamic features 1984-1992 and pure Islamic at the socio-economic political system from 1990s; especially, after the new constitution (1998). There were intensive conflicts regarding the implementation of Islamic laws in general, and the Islamic banking system in particular in the Sudan, among the intellectual graduates and Islamic scholars; some were with socialist thoughts, and majority with free and fast Islamic views; which later on, the situation balanced to the Islamic thoughts since the majority of the population is Sunni Muslims.

The Islamic banks and Islamic financial Institutions, in the Sudan, played a pivotal role in the financial sector in the 1980s and 1990s and stems from the principles laid down in the Holy and Noble al-Qur'an,[1] and al-Sunnah al-

Nabaweeyah,[2] with respect to the charging of interest (usury),[3] Islamic banks operate according to the principles of Islamic Laws (al-Shariyah al-Islamiyah), which validate the introduction of interest free banking, and profit-loss-sharing scheme (***PLS***). The major distinguishing characteristics that segregate the conventional banking of pay and charge interest on loans and deposits, which Islamic financial institutions totally not to practise.

In this chapter, we would like to highlight some points, which are related to Islamic banking and Islamic finance in the Sudan. This section gives an introduction of the historical background of the Islamic banking in the Sudan. Section two presents Islamic economy and capitalist economy. The third section studies meaning and rationale of prohibition of riba (usury) and profit in Islamic terminology. In the fourth section, we discuss Islamic financing modes and their economic characteristics. The fifth section is presenting the related economic literature. Section six is concerned with the idea of Islamic banks in the Sudan. The seventh section explains Islamic banking practice and business. Lastly, the performance of the Islamic banks is discussed in the Sudanese context.

6.2 ISLAMIC ECONOMY AND CAPITALIST ECONOMY

The Arab peninsula (al-Jazirah al-Arabiyyiah) was active in trade and banking particularly the town of Makkah al-Mukkaramah, which was the main centre, [*O'Leary, 1927; p.182*][4] and also paradise of stockbrokers and middlemen bankers, during the Jaaheeliyah (ignorance) era that was the economic activity [*Lammens, 1929; p. 15*].[5] The Financing of those trade carnivals with amount of excess money (usury or interest) that was deep-rooted in the pre-Islamic era, actually, they mention the name of al-Abbas ibn Abdulmotalab the uncle of the Prophet Muhammad (pbuh) in the financing that time. Islam does not deny any economic activity or market forces and market economy, profit motive is acceptable, also Islam does not negate the private ownership. Disenchantment with the value neutral capitalist and socialist financial systems led not only Muslims but also others to look for ethical values in their financial dealings, and in the West some financial organisations have opted for ethical operations. Islam not only prohibits dealing in interest but also in liquor, pork, gambling, pornography and anything else, which are deemed to be Haram (forbidden) by Shariy'ah. Islamic banking is an instrument for the development of an Islamic economic order. Some of the salient features of this order may be summed up as:

- While permitting the individual the right to seek his economic well being, Islam makes a clear distinction between what is Halal (lawful) and what is Haram (forbidden) in pursuit of such economic activity. In broad terms, Islam forbids all forms of economic activities, which are morally or socially injurious.
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- While acknowledging the individual's right to ownership of wealth legitimately acquired, Islam makes it obligatory on the individual to spend his wealth judiciously and not to hoard it, keep it idle or to squander it.
- While allowing an individual to retain any surplus wealth, Islam seeks to reduce the margin of the surplus for the well being of the community as a whole, in particular the destitute and deprived sections of society by participation in the process of Zakah (alms).
- While making allowance for the ways of human nature and yet not yielding to the consequences of its worst propensities, Islam seeks to

prevent the accumulation of wealth in a few hands to the detriment of society as a whole, by its laws of inheritance.

- Viewed as a whole, the economic system envisaged by Islam aims at social justice without inhibiting individual enterprise beyond the point where it becomes not only collective injurious but also individually self-destructive.

Yet the basic differences exist between capitalist economy and Islamic economy, there are no restrictions on the private ownership and profit motive and if it so, are subjected to changes, this attitude has allowed interest, gambling, and speculative transactions tend to concentrate wealth in the hands of the few. Hence, Islamic economy recognises private ownership profit motive and market forces without any monopolies that harm the economy in the capitalist system. The Islam has put certain divine restrictions being imposed by the almighty Allah, are: the prohibition of *riba* (usury), gambling and hoarding, dealing in unlawful goods and services, and the prohibition of short-sales and speculative transactions; all these prohibitions combined have cumulative effects on maintaining balanced distributive Justice and equality of opportunities in the society.

6.3.1 MEANING OF RIBA IN ISLAMIC TERMINOLOGY

The theory of Islamic banking is derived from the noble and holy al-Quran and the Prophet's (pbuh) exhortations (al-Sunnah) against exploitation and the unjust acquisition of wealth, defined as *riba*, or, in common usage, interest or usury. Profit and trade are encouraged and provide the foundation for Islamic banking. The *riba* (interest or usury) was debated among the Islamic jurists as well as the Islamic economists, since financing involves deficit or consuming units. The word *riba* as a noun literally means in Arabic, an increase or excess over the principal, and as a root it means the process of increasing. Riba has been understood throughout Muslim history as being equivalent to interest paid on loan. Riba applies to usury on lending money, and its meaning in this sense in the Qur'anic verses:

> *"...And you see the earth barren, but when We send down water (rain) on it, it is stirred (to life), and it swells and put forth every lovely kind (of Growth)" [al-Qur'an 22:5]. "'...'lest a nation should be more number (arba) than another nation ", [al-Qur'an 16:92].*

Despite of the slightly differences among the Islamic jurists of the four major schools (Hanafi, Maaliki, Shaafeei and Hanbali), the Islamic definition of riba, though they agreed that, it is an excess or an increase over the principal amount of money or goods. Hence, riba means usury which is of two major kinds (a) riba al-Nasiah i.e. interest on lent money, and (b) riba al-Fadl, i.e. taking superior thing of the same kind of goods for inferior quality in greater amount and, which relates to the purchase and sale of commodities, Islam strictly forbids all kinds of usury.[6]

Pierce (1984)[7] states that: "*in order to understand the principles of financing in Islam, we have to see the distinction between riba (interest) and Bai' (sale) which of crucial importance, prohibited interest in common*" [*Pierce, 1984*], we have to know that; Muslims do not take or give interest. The history has shown that, the usury system was not fully prohibited long before Islam, the Greek, the Roman and the Egyptian civilizations, money was explained in ancient time in terms of morality, the Mosaic code forbade the lending of money in an interest; and with the influence of religious teachings of the

Greek philosophers; **Aristotle** (384-322 BC) believed that, to lend money at an interest was wrong and **Saint Thomas Aquinas** (1273-1225 BC) from Roman Empire was believed that money was barren and interest was an unjust payment, [*Ghosh and Ghosh, 2000; p.5*],[8] and the interest was approximately 12 % from the capital not the person himself as it was during those eras. But the Jewish and the Christian communities prohibit the interest among themselves only, but after the General committee of the famous French revolution in October 1789 which passed a resolution regarding rate of interest under specific law.

6.3.2 RATIONALE OF PROHIBITION OF RIBA

The essential feature of Islamic banking is that it is interest free. Although it is often claimed that there is more to Islamic banking, such as contributions towards a more equitable distribution of income and wealth, and increased equity participation in the economy [*Chapra, 1982*],[9] it nevertheless derives its specific rationale from the fact that there is no place for the institution of interest in the Islamic order. Islam prohibits Muslims from taking or giving interest (*riba*) regardless of the purpose for which such loans are made and regardless of the rates at which interest is charged. To be sure, there have been attempts to distinguish between usury and interest and between loans for consumption and for production. It has also been argued that riba refers to usury practised by petty moneylenders and not to interest charged by modern banks and that no riba is involved when interest is imposed on productive loans, but these arguments have not won acceptance. A part from few dissenting opinions, the general consensus among Muslim scholars clearly is that there is no difference between *riba* and interest. In what follows, these two terms are used interchangeable. The prohibitions against *riba* are founded on the Islamic concept of property that results from an individual's creative labour or from exchange of goods or property. Interest on money loaned falls within neither of these two concepts and is thus unjustified. The following Aayat (verses) from the Noble al-Qur'an as a proof of the prohibition of riba in the Muslim society:

> *"And that which you give in gift (to others), in order that may increase (Your wealth by expecting to get a better one in return) from other people's property, has no increase with Allah; but that which you give in Zakat (Sadaqa–charity etc.) Seeking Allah's Countenance, then those, they shall have manifold increase." [al-Qur'an 30:39].*

The first revelation, from surah al-Rum emphasizes that usury derives wealth of God's blessing.

> One more proof from surah An-Nisa: *"for the wrong - doing of the Jews, we made unlawful for them certain good foods which had been lawful for them and for hindering many from Allah's way, and their taking of Riba though they were forbidden from taking it and their devouring of men's substance wrongfully (bribery). And we have prepared for the disbelievers among them a painful torment." [al-Qur'an 3:130]*

The second revelation condemns it in Juxtaposition with wrongful appropriation of property blessing to others.

> Another Aayat from surah Al-Imran: *"O you who believe! Eat not Riba (usury) doubled and multiplied, but fear Allah that you may be successful " [al-Qur'an 3:130].*

The third revelation enjoins Muslims to stay clear from usury for the sake of their own welfare.

> *"Those who eat Riba (usury) will not stand (on the Day of Resurrection) except like the standing of a person beaten by Shaitan (Satan) leading him to insanity. That is because they say: Trading is only like Riba*

(usury), whereas Allah has permitted trading and forbidden Riba (usury); so whosoever receives an admonition from his Lord and stop eating Riba shall not be punished for the past; his case is for Allah (to judge); but whoever returns (to Riba) such are the dwellers of the fire. They will abide therein". "'Allah will destroy Riba (usury) and will give increase for Sadaqat (deeds of charity, alms etc). And Allah likes not the disbelievers, sinners"." O you who believe! Be afraid of Allah and give up what remains (due to you) from Riba (usury) (from now onward) if you are (really) believers "And if you do not do it, then take a notice of war from Allah and His Messenger but if you repent, you shall have your capital sums. Deal not unjustly (by asking more than your capital sums), and you shall not be dealt with unjustly (by receiving less than your capital sums)". [al-Qur'an 2:275-279].

The fourth revelation establishes a clear distinction between interest and trade, urging Muslims to only take their principal sum, and to forgo even, this sum if the borrower is unable to repay. The above-mentioned verses guide and direct the Muslims need not to practice among themselves or with the other communities the sin of charge or give interest.

Al-Sunnah al-Nabaweeyah, viz the sayings and direction of practice by the Prophet Muhammad to the Muslim community; in all forms of life; and of course the riba is totally prohibited by the Prophet (pbuh) in the following Ahadeeth: This hadith is regarding prohibition of riba al-Fadl:

Narrated Abu Saeed al-Khudari (Allah be pleased with him): once Bilal (Allah be pleased with him) brought Barni (kind of date) dates to the Prophet (pbuh) and the Prophet (pbuh) asked him "*from where have you brought these? "Bilal replied; "I had some inferior kind of date and exchanged of it for once Sa'a of Barni date, in order to give it to the Prophet to eat; There up on the Prophet said, " Beware! Beware! This is definitely Riba (usury)!! This is definitely Riba (usury)! Do not do so, if you want to buy a superior kind of dates sell the inferior for money and then, buy the superior kind of dates with that money*".

In another hadeeth, narrated by Abdullah ibn Mas'ud (Allah be pleased with him): that the Prophet (pbuh) said:

> "*Woe worth (imprecation of Allah) the consumer of the usury and the giver of it and its witnesses and writer of the usury*".

And the other one narrated by Ubadah Ibin al-Samit (Allah be pleased with him): The Prophet Muhammad (pbuh) said:

> "*gold is to be paid for gold, silver for silver, dates for dates, salt for salt, like for like, equal for equal, payment being made hand to hand; suppose, if the classes (commodities) differ, then sell as you wish if payment is made hand to hand,*" [*Sahih Muslim, Hadith 3853*].[10]

Hereupon, we can say, the riba comes as an excess or an increase over the principal amount of money while profit comes from Bai' (Sales) of goods. Islam prohibited monopolies of profits, and warned of too much profit. The most important thing in the Islamic financing system is that, the tax and Zakah (alms) are not considered to be part of production and services and should be taken before the final account (profit and loss sheet) [*Taayil, 1988; p. 18*].[11] It must be mentioned that economically speaking it would be irrational to exchange a ten kgs of wheat with twelve kgs of the same quality of wheat in a spot exchange. Therefore, same Islamic jurists (Fuqaha) have pointed out that *riba al-fadl* has been prohibited because if left otherwise it can be used as a subterfuge for getting *riba* al-Nasi'ah [*al-Jarhi and Iqbal, 2001*].[12] As a matter of fact all the six mentioned commodities in the fore-mentioned hadiths were used as a medium of exchange at some time or other. Hence, it has been generally concluded that all commodities used as money enter the sweep of *riba al-fadl*. Therefore, Islam has prohibited the *riba* (usury) because the people worship money [13] and be selfish, and that Islam would like to establish a good relationship (brotherhood) among the mankind. Islam would like to make the people to be more productive and active rather than to wait for the interest that comes from their lent borrowed money. Usually, people who are in need of money go for borrowing from the rich, and some times may not be able to repay their debt (borrowed money) in time, here Islam has prohibited *riba* because of the heavy burden on the needy people when the rich ask for more interest if the principal amount plus the interest are not paid in time as well as it is one type of creation of money by individuals. Riba has an impact on the socio-political economic crises in the society as well as in the state. Inflation, the gap between the poor and the rich, the inequality in the distribution of wealth in the hands of a few, all are the problems that are created by *riba.*

Traditional School of economic thought, sought the regulation of the usury, Keynes (1936) [14] has favoured the laws of restriction to the laws of restitution to the usury. He called that the classical school has repudiated as childish and deserves to rehabilitation and honour:

> *"I mean the doctrine that the rate of interest is not self-adjusting at a level best suited to the social advantage but constantly tends to rise too high, so that a wise government is concerned to curb it by statue and custom and even by invoking the sanctions of the moral law".... "Provisions against usury are amongst the most ancient economic practices of which we have record. The destruction of the inducement to invest by an excessive liquidity-preference was outstanding evil, the prime impediment to the growth of the wealth, in the ancient and medieval Worlds." [Keynes 1936; p. 531].*

Keynes explained, how the mercantilists perceived the existence of the problem without able to push their analysis to the point of solving it, in his book, he has mentioned that Adam Smith was extremely moderate in his attitude to the usury laws, and mentioned some other economists (Bentham) who defended a moderate application of the usury laws.

The recent economists also have written about the usury regulation, among them; Blits and Long (1965),[15] who advocated the regulation and favoured prohibition of the usury, and have mentioned that, the laws and moral codes regulating interest charge can be traced from Babylonian code of Hammurabi (1800 BC), from Deuteronomy of old Testament, through the Roman and etc., and they observed that most of the states need change for promotion of their capital markets and others [*Blits and Long, 1965, pp. 608-619*].

An essential conclusion leads itself at this point: It is the important differentiation between the principle for the prohibition of interest on loans and that of permissibility of wage and rent on human and physical capital. Wages are earned in exchange for man-hours given to an employer; so is rent, which is earned in exchange for services of physical capital measured in units of time too. Hiring human or physical capital is done like selling a commodity, at a price (*wage or rent*) fixed at the time of the contact regardless of the value of the final product which this land or labour are utilized to manufacture. Furthermore, the owner of physical or human capital is a risk taker similar to any other taker, and entitled to the fixed price of his capital in exchange for delivering the goods.

On other hand, interest is prohibited neither because capital is not factor of production, nor because it is unproductive unless it is combined with labour, but because a lending relationship does not expose the lender to the full implications of the right of ownership. The creditor is not exposed to a risk similar to that which a seller of commodity or labour or land services is exposed to. Entitlement to a fixed share of the value added is associated with taking venturous human and/or physical capital. In other words, because the loan, being a right owed the creditor, is guaranteed, it cannot be entitled to a fixed price. Unlike labour owner or physical owner, the loan owner does not expose himself to the risk, which is intrinsic to the ownership right.

Lastly, if capital is given on a loan basis, such as seeds in agriculture, raw material in industry or a sum of money in any kind of business, does it still contribute to the value added? From Islamic point of view, the answer to this question is a definite "*Yes*"! But the entitlement of ownership of output is another matter. Giving capital as a loan does not change its nature or role with respect to production process; it rather changes the inter-personal relationships between owner of capital and owners of other factors of production. The borrower, who carries responsibility for any risk related to borrowed capital, is the person who deserves title of the product and profit/loss associated therein.

6.4 PROFITS IN ISLAMIC TERMINOLOGY

In the conventional economics, the terms profit, rent and wage are considered to be important to the production factors; in one way or another all are fixed in relation to time except profit. The distinction between value added and ownership of the product is very crucial in explaining the difference between rent and wage on one hand and profit on the other hand. Rent and wage represent the share of labour and land in value added, whereas, profit is the share of venturous party. A venturous party may be the owner of land, labour, or capital. He may be a fourth person, an organizer or an entrepreneur. But wherever the venturous party provides capital labour, or land, the factor of production so provided becomes also a venturous factor who's sole return becomes profit or loss. However, the term 'profit' has a precise meaning; it may be defined as a net income of a business after all other costs-rent, wages and interests etc. have been deducted from the total income. Pure profit is a reward for services of an entrepreneur and it is regarded as a reward for risk bearing and also reward due to special monopolistic position.

In the classical works on fiqh (Islamic philology), one always finds that profit is earned by labour, capital, or guarantee. Guarantee is acceptable of responsibility to perform a job or to pay for purchased merchandise. Therefore, it is a responsibility for labour or capital, which is a special case of providing capital and labour. Hence, the fiqh sources of profit become only two, labour and capital, as each of them embodies intrinsic liability. Alternatively, one way express the same by stating that earning profit is cause only by guarantee, since both capital and labour entail a form of guarantee which is inborn in the very ownership of human or material capital.

Islamic literature dismissed interest (usury) that is prohibited by the Supreme Being (the almighty, Allah) as it is clearly written in the noble al-Qur'an. Rent and wage are treated as one and same as the term ujarah or ajr (an Arabic word stand for rent or wage), then profit is defined as the increase in value of assets (fixed or mobile) actually realised in exchange. In the holy and noble al-Qur'an the work profit is used:

> *"These are they who have purchased error for guidance, so their commerce was profitless. And they were not guided." [al-Qur'an].*

6.5 ISLAMIC FINANCING MODES

The Islamic financial system employs the concept of participation in the enterprise, utilising the funds at risk on a profit-and-loss-sharing (**PLS**) basis. This by no means implies that investments with financial institutions are necessarily speculative. This can be excluded by careful investment policy, diversification of risk and prudent management by Islamic financial institutions. It is possible, that investment in Islamic financial institutions can provide potential profit in proportion to the risk assumed to satisfy the differing demands of participants in the contemporary environment and within the guidelines of the Shariy'ah. The concept of **PLS** principle as a basis of financial transactions, it is a progressive one as it distinguishes good performance from the bad and the mediocre. This concept therefore encourages better resource management. Islamic banks are structured to retain a clearly differentiated status between shareholders' capital and clients' deposits in order to ensure correct **PLS** principle according to Islamic Law. Fundamentally, the interest free financial institutions organised their operations on the basis of **PLS** principle, which is permitted in Islam, or would rather to say, the whole practice of Islamic finance is based on modes that do not involve interest. As a general rule, they involve the carrying out of investment and/or the purchase of goods, services and assets. Theoretically, there are a large number of Islamic modes of financing. We will limit ourselves here to a very brief review of the basic modes being used by Islamic banks in the Sudan, emphasizing at the same time that the door is opened to devise new norms, provided that they confirm to the rules of the Shariy'ah. Therefore, offer a wide range of services of financing including *mudarabah, musharakah, murabahah, Ijarah, Istisnaa', Bai' Salam,* and *al-qard al-Hasan,* as all are modes of financing, [*Anwar, 1989; p.9*], [16] in brief, we explain them as follow:

6.5.1 MUDARABAH

To resolve the dilemma of *riba* from a legal and religious point of view, Islamic banking employs so many common terms; one of them is the term *mudarabah* or silent partnership, *mudarabah* is also known as *qirad* and *mugaradah.* It refers to contract between two parties in which one party provides the capital to the other party for the carrying on of some trade. It is special kind of passive partnership, as a profit sharing principle, in which one partner deposits its capital (rab-al-mal 'financier') while the other one (mudarib 'agent') uses the capital for the purpose of investing in commercial enterprise. If the project is profitable both share the profits on an agreeable ratios at the beginning of the contract, say (50% - 50 %) or (60% - 40 %), loss if any, unless caused by negligence or violations of the conditions of the contract, is borne by the financier since the client loses (the loss of the manager being the opportunity cost) his efforts and labour. The bank or the financier has no right to participate in the management which is the sole responsibility of the client (mudarib) [*Muslehuddin, 1996; p. 25*].[17] The contract defines what the client has to do with the money, and may deduct as expense etc., there are conditions where the client guarantees to return the funds i.e. if he neglect or if breaches the conditions of the *mudarabah*.

The *mudarabah* mode of finance is applicable and acceptable by Islamic banks and Islamic financial institutions, in which capital is provided through the bank and the business is managed through the client. Mudarabah as a mode of finance applied by Islamic banks, on liabilities side, the depositor serves as *rab-al-mal* and the bank as the *mudarib*. On the assets side, the bank serves as the *rab-al-mal* and the businessman as the *mudarib*. However, the investment manager is often allowed to mix the *mudarabah* capital with his own funds. [*al-Jarhi and Iqbal 2001*]. Although it has been widely suggested in the theoretical literature on Islamic banking that *mudarabah* can be a viable basis of financial intermediation in an interest-free framework, there are certain difficulties with its contemporary application. For example, the legal system operating in the country should provide legal safeguards to the provider of capital so that he can finance projects on the basis of *mudarabah*. Despite it is used in the Sudan since the 1980s, but its share is very less with compared to other financing techniques, specifically *murabahah*.

6.5.2 MUSHARAKAH (SHARING - EQUITY PARTICIPATION)

The word *musharakah* is derived from the Arabic word sharikah meaning partnership. Islamic jurists point out that the legality and permissibility of *musharakah* is based on the injunctions of the holy and noble al-Quran, al-Sunnah and Ijmaa' (consensus) of the Islamic scholars (jurists) [Saiyyid

Sabiq].[18] *Musharakah* (active partnership) is an Islamic mode of financing operation designed by Islamic banks and Islamic non-banks financial institutions satisfy the criteria:

> *"they share in a third, after payment of legacies he or (she) may have bequeathed or debts, so that no loss is caused (to anyone). This is a commandment from Allah; and Allah is Ever All-knowing, Most-forbearing.", [al-Qur'an 4:12]. "..."He has wronged you in demanding you ewe in addition to his ewes. And verify, many partners oppress one another, except those who believe and do righteous good deeds, and they are few "...." [al-Qur'an 36:24*].

Here, we can say *musharakah* contract means sharing according to the Islamic terminology, which means join ownership of two or more partners, in a particular property (business enterprise) and it is of profit/Loss sharing principle. The major peculiar to the contract of *musharakah*: firstly, the capital is shared by all partners (bank and other partners); secondly, the profit proportion must be pre-agreed up on ratios, at the time of effecting the contract; thirdly, the ratios of profit of each partner must be determined in proportion to the actual profit accrued to the business; fourthly, in case which all Muslim jurists are unanimously agreed on point is that each partner should suffer the loss exactly according to the ratio of his or her invested capital; fifthly, all partners have the right (are entitled) to take part in the management of the project (business) and work for it, but not necessarily required to do so and this is a normal principle of *musharakah*; sixthly, the *musharakah* is continuous if the partners last on business and it can be terminated at any time provided after giving the partner or partners a notice to this effect. Also under a limited *musharakah* the client gains time by agreeing to re-purchase equities. Then *musharakah* as a mode of financing is workable and acceptable to the banks and non-banks financial institutions, successfully works in the Sudan, [*Awad, 1988*].[19]

The application of using *musharakah* technique contract in domestic trade by al-Barakah Islamic Bank (Sudan), to finance the sale and purchase of goods in the local Sudanese market. *Musharakah* financing of domestic trade operates in the following manner:

> *The bank enters into partnership agreement with the client for the sale and purchase of local goods whose specifications are given by the client. The total cost of the goods is divided between the parties and both parties agree to contribute their shares of the cost of goods. A special Musharakah account is opened at the bank immediately after the signing of the contract, which specifies all the transactions pertaining to this account. It is the responsibility of the partners to arrange the purchase and sale of the goods in question. Profits are distributed as follows: An agreed percentage of the net profit is given to the client with the remainder distributed among the partners of the Musharakah agreement in the same proportion as their capital contribution. In case of a loss, the partners bear the loss exactly in proportion to their capital contribution. [al-Barakah Islamic Bank Brochure – Sudan]*[20]

6.5.2.1 Letter of Credit on Musharakah Basis

Al-Barakah Islamic Bank (Sudan) also employs *musharakah* technique to finance the imports of goods. The contact is essentially the imports of goods. The contract is essentially the same as the one discussed above in terms of the sale and purchase of domestic goods, but differ in some details. The Bank opens a letter of credit in favour of the importer and pays the full amount to the exporter after receiving the shipment documents. The cost of insurance is charged to the transaction account. The importer is responsible for the import, clearance and final sale of the goods in questions [*al-Barakah Islamic Bank, Brochure*].

6.5.2.2 Application of Musharakah Technique in Financing Agriculture

Islamic banks in the Sudan and particularly the Sudanese Islamic Bank have developed yet another application of *musharakah* technique which has tremendous potential for rural and agricultural development. The Sudanese Islamic Bank (**SIB**) has, on an experimental basis, been providing finance to farmers by means of a *musharakah* agreement. The method adopted for this kind of financing is as follows:

> *The Sudanese Islamic Bank and the farmer enter into a Musharakah contract under which the bank provides the farmer with certain fixed assets, such as ploughs, tractors, irrigation pumps, sprayers etc. and some working capital, such as fuel, oil, seeds, pesticides and fertilizers. The farmer's equity is confined to providing of land, labour and management. Since it is a partnership contract, there is no need of collateral or guarantees other than personal guarantees. Profits are shared between the farmer and the banker in such a way that the farmer is first paid 30% of the net profit as compensation for his management, and then the remaining 70% is shared between the bank and the farmer on a pro rata basis based on each partner's respective share in the equity. [Sudanese Islamic Bank, Brochure].*[21]

6.5.3 MURABAHAH (MARKUP OR COST PLUS)

Murabahah as an Islamic mode of financing is one of several Islamically permissible contracts of sale and purchase. Most of Islamic banks and Islamic financial institutions in the Sudan are using it and most of their financing operations are based on it. *murabahah* (markup) means sales contract at a profit margin added to real cost of commodity sold. Markup is different from interest; it is a concept of financing raw material, machinery, equipments and consumer durable goods and also short-term trade financing [*Ahmad, 1992*].[22] Where as interest is related to money. Since the publication of, *murabahah* has emerged as a principal distinct from variable rate of return principle of Islamic financing. It has become the backbone of contemporary Islamic banking; this type of deferred payment on purchases, similar in practice to an overdraft and the most preferred Islamic banking arrangement in the Sudan. To resolve the prohibition on interest, an interest-bearing overdraft would be changed to a *murabahah* contract. In his presentation of *murabahah*, Hamoud (1985)[23] quotes Ibn Qudamah, who defines *murabahah* as follows:

> "*Murabahah selling for the cost of price plus specific profit, provided that both the seller and the buyer know the cost price: the seller says my capital or the cost price is hundred and I sell it to you for a profit of ten, this is permitted and there's no doubt about its legitimacy. No scholar is reported to have regarded it with dislike (karahah)*".

Hence, Murabahah means markup, the bank purchase or imports the commodity that the market is needed, or a perfect study of the market conditions or a proposal from the bank's client who approaches the Islamic bank to purchase or to import specific commodity, the client not only gives the specifications of the goods but also provides information about the price, nature of availability of the goods in the market, then, the client purchases it from the bank [*Taayil, 1988; pp. 94-98*]. Here, the bank, after being convinced of the availability of the project, informs the client of the margin of profit the bank would like to make on the original price [*Ahmad, 1992*]. Then, the bank as well as the agent should agree up on the place, time, and other conditions of the delivery of the commodity as well as the repay of the cost to the bank, if the client proves that the cost charges are not correct, the deal can be cancelled or he can choose to pay only the cost and forces the bank to forfeit its profit, [*Anwar, 1989; p. 9*]. It is noteworthy that the profit margin charged over the price is mutually agreed upon charged between the client and the bank. Furthermore the sale item has to be in possession of the bank before it is sold to the client on the basis of murabahah.

Murabahah is merely one type of sale and not a mode of financing; it replaces the work interest in transactions. *Murabahah* as a mode of finance; is being allowed by Islamic laws (Shariy'ah), and Islamic scholars with a condition that interest bearing should not be there. Here we can summarise the basic characteristics of *murabahah* as a mode of financing: firstly *murabahah* is not a loan which is given on interest, but, it is sale of a commodity for deferred price which includes an agreed profit added to the cost of the commodity, secondly, *murabahah* should fulfil the conditions that are necessary for a valid sales, thirdly *murabahah* can not be used as a mode of financing except where as the client needs funds to purchase some commodities and not for the payment of the salaries, bills of the electricity, telephone or paying the price of commodities already purchased; fourthly, the financier should own the commodity before he sells it to his client; fifthly, the commodity must come into the possession of the financier physically or constructively, that means must be in his risk for a short time; sixthly; in *murabahah* the sale can not take place unless the commodity comes into the possession of the seller, but the seller can promise to sell when the commodity is not in his possession, [*Taayil, 1988; pp. 106-107*]. This is reflected in the practice of *murabahah* at Faisal Islamic Bank of Sudan where the method is adopted. More light is thrown on the nature of *murabahah* transactions by the contract forms used for such transactions in al-Barakah Bank of Sudan.

6.5.4 IJARAH "LEASING"

Islamic law permits the leasing of certain assets whose benefit can be obtained by the lessee against the payment of some agreed rent. "**Ijarah'** is a term of Islamic fiqh lexically means to give something in rent, in Islamic jurisprudence the term *Ijarah* is used in two different situations:" [*Usmani, 1999; p. 157*].[24] Firstly *Ijarah* is to employ the services of a person on wage, here the employer is called *mustajaar*, while the employee is called *ajeer*. Secondly, *Ijarah* relates to usufruct of the assets and properties and not the services of human being, in the sense means to transfer the usufruct of a particular property to another person in exchange for a rent claimed from him, in this case the term Ijarah is analogous to the English term leasing, here the lessor is called *mujee*r and the lessee is called *mustajeer*, and the rent payable to the lessor is called ujarah. [*Usmani, 1999; pp. 157-158*]. The second type of *Ijarah;* is being used by the Islamic banks and financial institutions as a mode of financing and investment. *Ijarah* has its Islamic rules, where all famous Islamic schools of jurisprudence agreed upon, but *Ijarah* as a mode of financing has been accepted by the Islamic banks and financial institutions even though it is not originally a mode of financing. As a form of financing used by the Islamic banks, the contract takes the form of an order by a client to the bank, requesting the bank to purchase a piece of equipment, promising, at the same time, to lease it from the bank after it has been purchased.

Thus, this mode of financing includes a purchase order, a promise to lease, and a leasing contract. But it is simply a transaction meant to transfer the usufruct of a property from one person to another for an agreed period of time against agreed considerations. When the interest-free financial institutions were established in the Sudan, they found that *Ijarah* (leasing) is emerging as a popular mode of financing among Islamic banks through out the World, on the other hand, they realised that it is a lawful transaction according to Shariy'ah and it can be used as an interest-free mode of financing, [*Ahmad, 1992*]. Al-Barakah Investment Company uses the technique of *Ijarah* to finance the purchase of large capital item such as property, industrial plants and heavy machinery. It involves direct leasing where investors in the scheme receive regular monthly payments, which represent an agreed rental. At the expiry of lease the lessee purchases the equipment.

The differences between the contemporary financial leasing and the Ijarah which are allowed by the Shariy'ah are as follow: the commencement of lease, different relationship of the parties, expenses consequent to ownership, the liabilities of the parties in the case of loss to the asset, variable rentals in the long term lease, insurance of the asset, and the residual value of the lease asset. Ijarah is simply a transaction meant to transfer, and it has been accepted by the Islamic banks that played an important role in developing a new Islamic financing techniques by the means of issuing Islamic related opinions, that have guided the Islamic financial institutions in understanding the different modes of Islamic financing in contemporary banking, [*Usmani, 1999; p. 163*].

6.5.5 BAI' SALAM (SALES)

Salam is a sales contract in which price is paid in advance at the time of contracting, against delivery of the purchased goods/ services at specified future date. Not every commodity is suitable for a *salam* contract, it is usually applied to fungible commodities. Islamic banks can provide financing by way of a *salam* contract by entering into one or two separate *salam* contracts. It is where as bank could buy a commodity by making advance payment to supplier and fixing the date of its delivery. It can then sell the commodity to a third party either on a *salam* or instalments sale basis. To be valid from the Shari'yah point of view, if the bank uses two contracts basis, the second contact must be independent, i.e. not linked to delivery in the second contract [*al-Jarhi and Iqbal; 2001*]. The basic conditions for the validity of sale in Islam are that; the commodity intend to be sold must be existed physically or constructively, the seller should have acquired the ownership, and it should have come into possession of the seller. But there are only two exceptional cases in views of Islamic law: one is Bai' *salam* (purchase with differed payment) and the other is Istisnaa' (manufacturing) [*Usmani, 1999; p. 185*]. Both of them are sales of special nature, and these kinds of sales can be used for the purpose of financing. Although sale-based liability of creating finance has been widely used by the Islamic banks:

> *"That is because they say; "trading is only like Riba (usury)" whereas Allah has permitted trading and forbidden Riba "usury".[al-Qur'an 2:275].*

At the time of the revelation the Arab had two common transactions i.e. Bai' (sale) and *riba* (usury), the Islamic jurists usually mention the following from among forms of permissible deferred sales that created obligations: Firstly, Bai' Salam or Bai' Salaf which is a contract of sale, used mainly in agriculture finance, whereby banks pay in advance to agricultural producers while the delivery of the commodity takes places in the future (purchase with deferred delivery) that means the price is paid at the time of contract, but the commodity of the sale becomes due as debt in kind, and secondly, Bai' Mua'jjal is a contract of sale, whereby a product is delivered on the basis of a deferred payment in instalment or a lump sum payment.

6.5.5 AL-ISTISNAA' (MANUFACTURING)

It is a contract in which a party orders another to manufacture and provide a product, the description of which, delivery date, price and payment date are all set in the contract, this type of contract is of a binding nature, and the payment of price could be deferred [*Usmani, 1999*]. Islamic banks are using two contracts of al-Istisnaa' al-Tamwili (manufacturing financing), first is concluded between the beneficiary and the bank, in which the price is payable by the purchaser in future, in agreed instalments and the bank undertakes to deliver the requested manufactured commodity at an agreed time. The other contract is a sub conduct concluded between the bank and a contractor to manufacture the product according to prescribed specifications. The bank would normally pay the price in advance or during the manufacturing process in instalments, and the later undertakes to deliver the product to the bank on the date prescribed in the contract, which is the same date as that stated in the first contract. The original purchaser (i.e. the bank's agent) may be authorized to receive the manufactured product directly from the manufacturer [*al-Jarhi and Iqbal; 2001*].

6.5.6 AL-QARDH AL-HASAN (BENEFICENCE LOAN)

Since interest on all kinds of loans is prohibited in Islam, then, a loan in accordance with Islamic principles has to be, by definition, a benevolent loan (*qardh al-hasan*), i.e. a loan without interest. It is a pure loan without any rate of return or rate of interest, it is also made of financing and is not considered to play substantial role in the financial market of an economy. It is kind of a loan granted only as a favour of the benefit of the borrower. It may consist of paid money or valuable at its similar or substitute becomes payable immediately or on demands and it is the only loan that is permissible in Islam and its reward from Allah the Almighty therefore there are no conditions in q*ardh al-Hasan*, i.e. gift beside the repayment of the loan, or other sort or type of favour. It has to be granted on the grounds of compassion, i.e. to remove the financial distress caused by the absence of sufficient money in the face of dire need. Since banks are profit-oriented organisations, it would seem that there is not much scope for application of this technique.

However, Islamic banks also play a socially useful role. Hence, they make provisions to provide *qardh al-Hassan* besides engaging in income generating activities. There may be slight variations among different Islamic banks in the use of this technique. The Faisal Islamic Bank provides interest free benevolent loans to the holders of investment and current accounts. On other hand, Islamic banks give qardh al-Hasan for productive purposes in various fields to enable the beneficiaries to start independent lives or to raise their incomes and standard of living; recently, Bank of Sudan has banned qardh al-Hasan. The *qardh al-Hasan* repayment should take place at the specific time agreed-upon otherwise a time should be given to the debtor for but that is without any pre-conditions. The Islamic banks can offer *qard al-Hasan* as a part of their /Islamic social obligations, the *qard al-Hasan* approval from the noble al-Qur'an [2:280-282] and from al-Sunnah also. Therefore, most of the Islamic banks agree in forwarding the beneficence loans to those people who have shares in the capital with the banks, and who have suffered from damage, theft, fire or for specific purposes i.e. demise, marriage or housing and due to some circumstances and the bank can charge a fee or commission. The bank, which finances the project should do pre-study of the proposal of *qard al-Hassan*. Here we have studied in precise the Islamic financing techniques and we would like to see their role and effects in the macroeconomic fields and the following are their characteristics.

6.5.7 CHARACTERISTICS OF ISLAMIC MODES OF FINANCE

The structural economic characteristics of the Islamic financing modes from economic point of view have not been the subject of rigorous study, despite of large Arabic written literature. These factures are (a) nature of financing (b) role of the financer provider in the management and use of funds (c) risk bearing by he finance provider (d) uncertainty of rate of return on capital of the finance provider and the cost of capital to financer user. Table 6:1 shows all characteristics of Islamic financing modes, and also in table 6:4 as compared to the interest based financing. Table 6:2 has shown the superiority of the Islamic financing and Islamic banking system may turn out to be better suited than the interest based financing.

Nature of financing the Islamic modes of financing can be classified according to the nature of financing involved in each mode. *Mudarabah* and *musharakah* are regarded as non debt modes since the finance user is not obliged to repay back the total amount of financing that he pays according to profit or loss that he makes out of the use of financing these non debt modes do not carry burden and the user pays according to benefits he gets. In the case of Bai al-*Salam* and *murabahah* that are considered to be debt based modes of financing, the finance user is obliged to pay back the entire financing since is predetermined and this evolves a debt burden on the user irrespective of how much benefits he gets. The *Ijarah* mode of financing is considered to be non-debt mode of financing since only rent is paid. These modes of financing are different as compared to interest based financing.

Role of Financier in Management: In *mudarabah* and *Bai al-Salam* modes financing, the financier has no role to play in the management in use of the funds (table 6:1) on the other hand, *musharakah* financing mode gives an opportunity to the financier to have a role and interferes in the management of the funds, while in *murabahah* and *Ijarah* Islamic mode of financing, the finance providers have full control over the use of funds that are deployed by them. In the conventional interest based financing, the financier has no role to play in management of funds at all.

Risk Bearing by Finance Provider: *mudarabah* and *musharakah* mode of financing, the entire capital invested by the financier is at stake (risk bearing). The financier in *musharakah* will bear the financial loss in proportion to his capital in the invested project while in the case of *mudarabah*, the financier is to bear all the financial loss of the project, thus we can say the financier entire capital in stake until the project or the enterprise is completed and the finances have been recovers. In the case of *Bai al-Salam* financing mode, the risk bearing arises from the future prices of the commodities involved in the contract. But, in *Ijarah* financing the entire capital remains under stake since the financier is responsible for all risk of the asset. While in *murabahah*, the risk bearing is less than that of other Islamic financing modes, and it is up to the stage when the commodities are delivered. The interest based financing, the story is for away different than in the Islamic financing techniques.

Uncertainty of Rate of Return on Capital: In the fore-mentioned discussion, all the Islamic financing modes involve in risk bearing by the financier since the financier has to bear the risk of loss to his capital if he allows his money in any of these Islamic financing modes, this means that any return that he may expect, ex ante on the money has some elements of uncertainty, and the financer use has nothing to do with the risk bearing that faced by the financier, since these risk keep the rate of uncertain. There is complete uncertainty in the case of *mudarabah, musharakah, Ijarah* and *Bai' al-Salam,* but in the case of *murabahah* mode (markup based) the uncertainty only for short time period of the contract i.e. until the commodities have finally been handed over to the finance user.

Cost of Capital*:* According to Fahim Khan (1991)[25] the amount that the finance user ends up paying to the finance owner over and above the original finance obtained is referred as cost of capital as it is shown in table 6:1 the *mudarabah, musharakah* and *Bai' al-Salam* Islamic financing techniques, the cost of capital remains uncertain (ex ante) until the completion of the project contract, but in the case of *Ijarah* (leasing) and *murabahah* (mark-up based) financing techniques, the cost of capital fixed and predetermined.

Relationship Between Cost of and Rate of Return on Capital: From the table 6:1 and in the case of *mudarabah* and *musharakah* modes of Islamic financing, the cost of capital and rate of return are explicitly the same (perfect correlation). However, in *Ijarah* (weak correlation), *murabahah* (strong but perfect) and *Bai' al-Salam* (no correlation), the cost of capital and the rate of return are explicitly divergent. The foregoing discussion has provided us with strong ideas to say that the Islamic financing modes are superior to the interest based financing and are workable and acceptable in the case of our study and even in other developing as well or the developed countries i.e. (Luxemburg, Switzerland, the UK and the USA. etc. have 261 Islamic banks-offices spread all over the world with capital of US $250 billion).

6.6.3 SURVEY OF CONTEMPORARY ISLAMIC LITERATURE

Although Muslim economists and economic writers have discussed the economic principles of Islam earlier, exclusive attention to the subject is a twentieth century phenomenon. There was a great spurt in these writings during the fifties and sixties, which are related to the emergence of a number of independent Muslim countries and the rise of powerful Islamic Movement. [*Siddiqi, 1983*].[26] At this stage general idea on the Islamic banking and finance is supplemented by efforts of a number of writers.

Empirical studies of Islamic baking have been increasing in recent years. Khan's (1983) study covered Islamic banks operating in United Arab Emirates, the Sudan, Jordan, Kuwait, Bahrain and Egypt. Khan identified two main types of investment accounts: (a) the depositor authorised the banks to invest the money in any project, whereas in (b) the depositor has to choose the project to be financed. On instrument side, the banks under study had been restoring to *murabahah, mudarabah, musharakah* instruments. The profit rates of the Islamic banks studied are very competitive with those of conventional banks. The rates of returns of Islamic banks range from 9% to 20% and the deposit rates of returns range from 8% to 15%, which are very similar to those offered by conventional banks. Khan (1983) finds that Islamic investments are concentrated in trade finance and real estate investment. The case studies by (Darrat, 1988; Hassan 1999; Niehaus 1988; Farhat et al 2002; Agarwal and Yousef, 1996 etc.) of Islamic banks operating in Bangladesh, Egypt, Philippines, Malaysia Pakistan, the Sudan and Southeast Asia, documented similarities and differences between Islamic banking in those countries. In summary, previous empirical research and fieldwork on Islamic banks documented the phenomenon of concentrated assets in short-term and medium-term investments, but did not offer any explanation as to why such concentrations in short and medium term investments occur.

6.7 MEANING AND DEFINITIONS OF ISLAMIC BANK

Islam possesses its own paradigm of economic relations within the context of an entire Islamic system based on injunctions and derives from the noble al-Qur'an and al-Sunnah. The Shariy'ah specifies the *inter alia*, rules that relate to: (i) allocation of resources, (ii) property rights, (iii) production and consumption, (iv) working of markets, and (v) distribution of income and wealth. Similarly, rules and requirements have been specified that define the framework within which the monetary and banking system can operate, [*Iqbal and Mirakhar, 1987; p.1*].[27] Here, before we define what on Islamic bank is like, we know that commercial banking is based on a pure financial intermediation model, they are prohibited from trading and their shareholding is severely restricted to small proportion of their net worth. By contrast, universal banks are allowed to hold equity and also carry out operations like trading and insurance, which usually lie beyond the sphere of commercial banking. Universal banks are better equipped to deal with information asymmetry than their commercial counterparts; many economists have given their preference to universal banking, because of being more efficient, [*al-Jarhi and Iqbal, 2001*]. The foresaid discussion leads us to say that many Islamic modes of financing involve trading, and it may be possible for Islamic banks to establish trading companies that finance the credit purchase of commodities as well as assets. We may, therefore, say that Islamic banks are closer to universal banking model.

The Islamic Bank is an organisation, which deals or operates in the field of financial business with the objective of building an individual Muslim as well as an Islamic society, and its development gives changes to its advancement on an Islamic basis, which follows the permissible norms (Halal) and unlawful norms (Haram). The third definition of an Islamic bank was given by Dr. Gharib al-Jamal: we mean by Islamic banks or Islamic financial institutions those organisations which operate in banking business and that abide by

Islamic rules and regulations i.e. avoid to deal in usury benefits not to charge or make payment on interest-base, since it is not permitted, and also to keep away from any business opposed to rules of al-Shariy'ah al-Islamiyah, [*Taayil, 1988; p. 54*]. As it has been mentioned that, Dr. Ahmad al-Najjar [28] has defined the Islamic bank as:

> *"The Islamic Bank, that is the banking and financial institution that collect finances and invest then within the belt of al-Shariy'ah al-Islamiyah (Islamic Laws) which serve in building of complete Islamic society, and the relation of equal distribution and employment of the finance in an Islamic way".*

Al-Jarhi and Iqbal as give a comprehensive definition of Islamic bank:

> *"An Islamic bank is a deposit-taking banking whose scope of activities includes all currently known banking activities, excluding borrowing and leading on basis of interest. On the liabilities side, it mobilizes funds on basis of a mudharabah or wakalah (agent) contract. It can also accept demand deposits which are treated as interest-free loans from the clients to the bank, and which are guaranteed. On the assets side, it advances funds on a profit-and-loss sharing or a debt-creating basis, in accordance with the principles of Shariy'ah. It plays the role of an investment manager for the owners of time deposits, usually called investment deposits. In addition, equity holding as well as commodity and assets trading constitute an integral part of Islamic banking operations. An Islamic bank shares its net earnings with its depositors in a way that depends on the size and date-to-maturity of each deposit. Depositors must be informed beforehand of the formula used for sharing the net earnings with the bank."* [*al-Jarhi and Iqbal; 2001*].

The foresaid definitions highlight the following features: (a) the first definition concentrates on the collections of idle money as savings for the purpose of investment, and highlight the social responsibility and equal distribution of income and wealth (b) the second definition focuses on the role of the Islamic bank in building an individual Muslim along with the Muslim society according to Islamic norms and their advancement and development (c) the third one highlights the Islamic banking business and the forbidding of usury. Hence, Islamic banking does not approve interest-based system and accepts profit loss share system in banking business and promotes the dealing in permissible activities. Islamic banks have faced various types of problems in the path of their banking business during the practical experiments to prove their soundness, and due to the new principles in which the Islamic banking system depends upon.

6.8 ISLAMIC BANKS' IDEA IN THE SUDAN

As it is known that, Venice (1157) Florence (1170), and Barcelona (1401); were the first cities in the world, to start the organized conventional banking business, Banco Di Rialto (1585) was established in Venice as the most modern bank that time and followed by the Bank of Amsterdam (1609). Deposit and exchange banking flourished in Europe, and move to Egypt when the National Bank of Egypt was established in the year 1898 as the first bank in North Africa and the Arab countries. The first private interest-free bank, Dubai Islamic Bank, was set up in 1975, by a group of Muslim businessmen. Two more private banks were instituted in 1977 under the name of Faisal Islamic Bank (Egypt and Sudan). However, small scale limited scope interest-free banks have been tried before (Malaysia in mid-1940s and Pakistan in the late 1950s), neither survived. The Savings bank (Islamic Bank) was well-organised established in Egypt in the year 1963 at Mit Ghamr in Egypt was very popular. However, this experiment led to creation of the Nasser Social Bank in 1972, though the bank is still active, it objectives are more social than commercial, and hence, all these events and ideas moved to the Sudan, since both countries are closely related to each other for a long time via the ancient civilisations (Egyptian-Nubian) and River Nile Valley. Dr. Kamıl Al-Baqir the then Vice Chancellor of Omdurman Islamic University (first idea of Islamic banking system) ordered the establishing of the first department to teach Islamic economy in the year 1966, and long before that, he also put the idea of Islamic banks.

The then Dr. Ahmad al-Najjar and late Dr. Muhammad Abdallah al-Arabi[28] put the first studied proposal to start an Islamic bank at Omdurman, and then the proposal had been forwarded to the Presidential Council (the late President of the Sudan) and it had been handed over to the Bank of Sudan for the purpose of implementation and applying it practically, but due to the political circumstances of 1966; the project could not be implemented and later on Prof. al-Najjar left to the Kingdom of Saudi Arabia and took the proposed idea with him and put it in front of the late king Faisal ibn Abdulaziz who had helped the committee to put the idea in to practical life. It is evident that Islamic finance was practiced predominantly in the Muslim world throughout the Middle Ages, fostering trade and business activities. In Spain and the Mediterranean and Baltic States, Islamic merchants became indispensable middlemen for trading activities. It is claimed that, European financiers and businessmen later on adopted many concepts, instruments and techniques of Islamic financing.

At the establishment of the Organisation of Islamic Conference (**OIC**), the revival of Islamic banking coincided with the worldwide celebration of the advent of the 15th Century of Islamic calendar (Hijri) in 1976. At the same time financial resources of Muslims particularly those of the oil producing countries, received a boost due to rationalisation of the oil prices, which had hitherto been under the control of foreign oil corporations. These events led the Muslims to strive to model their lives in accordance with the ethics and philosophy of Islam. The **OIC** economic committee spread the idea of Islamic banks to the most of the Muslims countries and communities; and also established the Islamic Development Bank (**ISDB**) in 1974 with head quarter at Jeddah, Saudi Arabia, as a regional development bank, to encourage economic growth in the Muslims countries and Communities. The **ISDB**, adhering to the Qur'anic principles forbidding usury, does not grant loans or credit, would rather finance the industrial development projects by holding equity or granting loan on nominal commission rate, in addition to that, the **ISDB** extends loans which assist the member countries in financing essential imports.

The Sudanese government as a member of **OIC** has taken pure Islamic steps in the Republic (1990s); the financial sector has been seriously discussed. The differences in the nature of the Islamic financing techniques have implications for the economy at the macro level since the Sudanese government has decided to implement the Islamic laws in all modes of life in the sixteen northern, central, eastern and western states and with exemption to the ten southern states where the majority is non-Muslims. The Islamic financial system becomes a matter of acceptance to the Sudanese society especially after the success of the Islamic banks and their expansion all over the country in the 1980s and 1990s, the mass spread of the Islamic socio-economic institutions helped the government to change the interest-based economy in to interest free economy through the Islamic financial system, riba (usury), profit, the Islamic modes of financing, and the working and performance of the Islamic banks in the Sudan from 1980/81-2001.

6.9 ISLAMIC BANKING PRACTICE AND BUSINESS

Generally speaking, all Islamic banks agree upon basic principles of interest-free practices. However, there are many differences in their application and that due to the laws of the country, objectives, circumstances and experience of the individual banks, and the need to interest-based banks. But in the case of the Sudan, the story is different, since all Islamic banks were working under the umbrella of **BoS**. They were interacting with the conventional banks during 1978-1984 by that time the government declared the stoppage of usury system in the banking operations. The fundamental difference between Islamic and traditional banking systems is that in an Islamic system deposits are regarded as shares, which do not guarantee their nominal value. The appeal of the Islamic banks, as well as government support and patronage, enabled these institutions to acquire an estimated twenty percent of the Sudanese total deposits. Politically, the popularity and wealth of Islamic banks have provided a financial basis for funding and promoting Islamic policies in government. In the following section, we will describe the various features common to banks.

6.9.1 ISLAMIC FINANCING IN BANKING BUSINESS

As we have studied the Islamic financing modes in this work, we would like to see how Islamic banks in the Sudan have adopted them. These modes of financing can be broadly categorised into three areas: investment financing, trade financing and lending financing. Investment financing: Is done in several main ways, especially, *musharakah* mode where a bank may join another entity to set-up a joint venture, both parties participating in various aspects of the projects in varying degrees, and as it is known profit-loss-sharing schemes are to be shared in a pre-arranged way. It is similar to the Joint Venture concept. The venture is an independent legal entity and Islamic bank may withdraw gradually after the initial period. The other one also, the investment financing can be done through *mudarabah* mode. There is also financing on the basis of an estimated rate of return, under this scheme, the bank estimates the expected rate of return on the specific project it is asked to finance and provide financing on understanding that at least that rate is payable to the bank. Right now all commercial banks in the country are using investment financing and are functioning smoothly and perfectly despite of so many obstacles. Trade financing: the main mode of Islamic financing to the projects of trade financing is *murabahah* (markup) that dominates the scene right now in the country financial markets. *Ijarah*, hire is purchase where the bank purchases an item for the client and automatically becomes the owner of that item, this is some of the Islamic financing modes use in trade financing.

6.9.2 DEPOSITS ACCOUNTS

The Islamic banks have three kinds of deposits accounts i.e. current, savings and investments in brief we study them below as follow:

(1) **Current or Demand Deposits Accounts** are virtually the same as in all the contemporary banking system, with exception to the charges and payment of interest rate. In current accounts the deposits are guaranteed.

(2) **Savings Deposit Accounts**, most of the Islamic banks use and operate the deposited money of their depositors with their permission and give guarantee of getting the full amount back from banks, but no profit is promised. Islamic banks in the Sudan compensate their clients in such process from the profits gained by banks. In others, savings accounts are treated as investment accounts but with less stringent conditions as to withdrawals and minimum balance, capital is not guaranteed and Islamic banks invest money of such accounts in relatively risk-free short-term profitable projects, lower profit rates are expected and too only on a portion of the average minimum balance because of the high level reserves needs to be kept at all times to meet withdrawal demands of the depositors, and this is one reason of high liquidity of the Islamic banking system.

3 **Investment Deposit Accounts** are accepted for minimum six months. The investors in advance agree to the concept of the profit-loss sharing system, the capital amount is not guaranteed, but the expected rate of return is high if any, in comparison since the invested money is to be used and utilised in high-risk long and medium terms projects. In the Sudan, Bank

Deposits Security Fund was established to compensate the depositors of investment accounts with the commercial banks; the fund's surplus of SDD 319 million was invested in investment deposits of commercial banks and Government Musharakah Certificates (**GMCs**). During the year 2000 the approved of both deposits compensation and the financial accounting charters have been completed. The total compensation amounted to SDD 77.3 million was paid to 2,475 beneficiary depositors.

6.10 PERFORMANCE OF ISLAMIC BANKS IN THE SUDAN

The development of Islamic banking in the Sudan is a very interesting phenomenon. It is no exaggeration to say that it is the most exciting phenomenon in Islamic banking. Its rapid growth within unfavourable economic conditions has attracted the attention of many financial institutions in Islamic as well the western World. Islamic banking facilities are currently offered by almost all the banks and financial institutions including **BoS**, here, the whole banking system has been Islamised but, there is no dual banking system as in the case of Malaysia (Islamic and conventional banks). Growth of Islamic banking – there are many factors that contribute to the successful spread and growth of the Islamic banking in the Sudan:

(i) the support and encouragement of the central monetary authorities to Islamic baking – using of **CMCs** and **GMCs**.

(ii) rapid emergence of Islamic banking in the country – *mudarabah.*

(iii) intensive competition for foreign capital.

In order to promote Islamic banking, the Government issued Islamic banking Act of the Sudan in 1984, which subsequently amended, it provides strict but flexible regulations and supervisions for financial transactions in Islamic banking. The Islamic banks in the Sudan have been operating slowly but steadily. These banks help in the development of sound banking and financial systems, and they play a big role in the economic development and growth of the country.

The Faisal Islamic Bank, whose principal patron was the Saudi prince, Muhammad ibn al-Faisal Al Saud, was officially established in the Sudan on 18 August 1977 by Faisal Islamic Bank Act, and started its Islamic banking business in May 1978. The '*open door*' policy enabled Saudi Arabia, which had a huge surplus after the 1973 organisation of petroleum exporting countries (**OPEC**) increases in the prices of petroleum to invest in the Sudan. Members of the Muslim brotherhood and its political arm, the National Islamic Front, played a prominent role on the board of directors of the Faisal Islamic Bank, thus, strengthening the bank's position in the Sudan. Other Islamic banks which followed it are al-Barakah, al-Gharab, al-Shamal, al-Tadamon, Sudanese Islamic Banks and the Islamic Co-operative Development Bank .

As a consequence, both al-Ansar and al-khatmiyyah religious groups and their political parties, the Ummah National Party and the Democratic Unionist Party, formed their own Islamic banks. The Faisal Islamic Bank enjoyed privileges that denied to other commercial banks (such as full tax exemption on assets, profits, wages and pensions), as well as guarantees against confiscation or nationalisation. Moreover, these privileges came under Ja'afar Numeiri regime's protection from 1983 onward as he became committed to applying Islamic doctrine to all aspects of the Sudanese life. The spread of Islamic banks in the country in 1981 and 1982 has played big role in increasing the number of banks as well as their branches means more than 40% of the total commercial banks branches in the country. Islamic banks assist in increasing the savings and investments, specially the mobilisation of funds, plus to that their socio-economic obligation, the introduction of Islamic banks in the country helps in the roundup of the idle money of those who were not interested to deposits the money with the interest based banks. The introduction of interest-free banking by these banks helps in the abolishment of charging and payment of interest rates by the banking business and replaced by the Islamic financing modes.

Table 6.5 shows the flow of credit by Islamic modes of financing, the percentage change of credit extended by *murabahah* mode of financing rose from 33.7% in 2000 to 39.5% by the end of December 2001, this was mainly due to easy application of this mode and the clients preferences. The *musharakah* has slightly decreased from 42.9% to 31% in the same period. Thus, the total flow of credit by Islamic modes of financing was SDD 101,324.5 million in 2000; and had increase to SDD 146,381.9 million in 2001.

Concluding Remarks

Islamic banking is a very young concept, in the Muslims World as well as in the Sudan, but the idea is attractive even in non-Muslim countries (i.e. Germany, China, Luxembourg, Switzerland, the U.K and other). Whereas, more than 261 Islamic banks branches spreading all over the World, with their capital amounting to US $ 250 billion. Despite of successful acceptance there are problems, which are mainly in the area of financing, [*al-Jarhi and Iqbal, 2001*]. Minor changes in the practices of Islamic banks can get rid of all their cumbersome, burdensome and sometimes doubtful, forms of financing and of a clean and efficient interest-free banking. The modified system will make use of only two forms of financing such as loans of services charges and mudharabah mode of financing, both of which are fully accepted by all Muslim economists and Islamic economic writers. Participatory financing is a unique characteristic of Islamic banking, and can offer responsible financing to socially and economically relevant development projects.

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Table No.: 6.1

Comparative Features of Islamic Financing Techniques

Features	Techniques: Mudarabah	Musharakah	Ijarah (leasing)	Bai'al-Salam	Murabahah (markup)
Nature of Financing	Investment Based	Investment based	Leasing based	Combination of debt and Trading	Combination of trading and debt
Role of the Capital Provider in Management of Funds	Nil	Full Control	Full control on the use of the finance	Nil	Full control on the use of the finance
Risk bearing By the capital Provider	i. To the full extent of the capital As well as Of the Opportunity Cost of Capital	Same as in Mudarabah	i. To the full extent of the capital as well as of the opportunity cost of capital	i. To the full extent of the capital as well as of the opportunity cost of capital	i. To the full extent of the capital
	ii. For the entire period of the contract	Same as in Mudarabah	ii. Until the asset completes its life or is finally disposed of	ii. Even after the expiry of the contract until the goods are finally disposed of	ii. Only for a short period until the goods are purchased and taken over by the finance user
Uncertainty of Rate of Return on Capital	Complete uncertainly	Complete uncertainly	Complete uncertainty	Complete uncertainty	uncertainty only for a short period of the contract
Cost of capital	uncertain Ex-ante	Uncertain ex-ante	Fixed and predetermined	Uncertain ex-ante	Fixed and predetermined
Relationship of cost of Capital and Return on Capital	perfect correlation	Perfect correlation	Weak correlation	No correlation	Strong correlation

Source: Adapted from: M. Fahim Khan (1991): Comparative Economic of some Islamic Finance Techniques". (page: 18).

Table3 No: 6.2

Risks Faced by Islamic and Conventional Banks

	Conventional	Islamic
Credit Risk	A	A (high)
Maturity Mismatch	A	A (high)
Currency Risk	A	A
Interest-rate Risk	A	N/A
Liquidity Risk	A	A (high)
Risk of Trade and Investment transaction	N/A	A

A = Applicable **N/A = Not Applicable**

Table3 No: 6.3

Credit to non–government sector by mode of financing, 1994–2001

	1994	1995	1996	1997	1998	1999	2000	2001
	(In billions of Sudanese Dinars)							
Murabahah	6.1	10.4	18.1	21.7	25.5	36.2	34.2	57.87
Musharakah	6.1	6.7	10.9	9.5	9.9	22.7	43.45	45.33
Mudarabah	0.4	0.5	0.7	2.3	2.8	3.0	3.58	9.15
Salam	1.1	0.7	1.4	3.5	3.1	3.7	3.40	7.30
Other	1.3	0.7	3.1	4.8	5.6	8.1	16.74	26.74
Total	15.0	19.1	34.2	41.8	46.9	73.7	101.33	146.39
	(In percent of total)							
Murabahah	40.8	54.4	52.9	51.9	54.4	49.1	33.7	39.5
Musharakah	40.5	35.1	31.9	22.7	21.1	30.8	42.9	31
Mudarabah	2.9	2.7	2.0	5.5	6.0	4.1	3.5	6.2
Salam	7.1	3.9	4.1	8.4	6.6	5.1	3.4	5
Other	8.7	3.9	9.1	11.5	11.9	10.9	16.5	18.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bank of Sudan (1998–1999–2001) Annual Reports.

Table3 No: 6.4
Islamic Financing Modes in Comparison to Interest Based Loans:

CHARACTERISTICS	Pure Financing (PF)	Sharikh (S)	Sale Based Financing (SF)	Renting (R)	Qard	Interest Based lending (I)
Separation of Management and Ownership	Yes	No	No	Yes/No^{+}	Yes	Yes
Ownership	Yes	Yes	No	Yes/No^{+}	No	No
Restriction to Productive projects	Yes	Yes	No	No	No	No
Work makes Property grow	Yes	Yes	No	No	No	No
Purchase of Profit Making	Yes	Yes	Yes	Yes	No	Yes
Fixation of return	No	No	Yes	Yes	No	Yes
Declaration of profit to Financer and user of Funds	Yes	Yes	No*	No	No	Yes
Owner of Property Bears loss	Yes	Yes	Yes	Yes	No	No
Condition of specific use	Yes	No	No	Yes	Yes	Yes

Notations: Yes/ No^{+} = two sets of ownership-cum-management
No* Except in Murabahah.
Sources: Kahf and Khan (1991) p. 34.

Table3 No: 6.5

The Islamic Banks in the Republic of the Sudan (2001)

Sr. No.	Name of the Bank	Shareholders	Date of Registration starting of Business	Number of Branches	Authorised Capital (In Millions)	Paid-up Capital (In Millions)
(1)	Faisal Islamic Bank (Sudan).	Joint Ownership (Arab and Sudanese)	18/08/1977 May 1978	33 branches	n.a	SDD 2,000
(2)	al-Tadamon Islamic Bank.	Joint Ownership (Sudanese Nationals)	1981 1981	22 branches.	n.a.	SDD 4,947
(3)	Islamic Co-operative Development Bank	Public Shareholders	1981	19 branches	n.a	SDD 5,046.221
(4)	al-Gharb Islamic Bank. (Western Sudan).	Joint Ownership.	1982	30 branches	n.a	SDD 3,000
(5)	Sudanese Islamic Bank	Joint Ownership	1982 1983	45 branches	LS 3,000	LS 2,3200
(6)	al-Baraka Islamic Bank (Sudan).	Joint Ownership (Arab and Sudanese)	26-02-1984 14-03-1984	23 branches	US $ 200	US $ 42.6
(7)	al-Shamal Islamic Bank	Joint Ownership Sudanese Nationals	1983 1990	12 branches	US $ 20	US $ 20

Sources: Bank of Sudan Annual Reports.

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