Islamic Finance Project

Harvard Law School
Islamic Legal Studies Program

Tenth Harvard University Forum on Islamic Finance
Harvard Law School - March 24-25, 2012

Islamic Finance And Development:
A Short Report

The Tenth Harvard University Forum on Islamic Finance was held at Harvard Law School on March 24 and 25, 2012. This forum is a biennial event organized by the Islamic Finance Project of the Islamic Legal Studies Program at Harvard Law School to engage practitioners, scholars, and students of Islamic finance in a critical discussion of the latest developments in the field. This year's Forum, entitled "Islamic Finance and Development," included three plenary sessions on global economic development, the development of small and medium enterprises (SMEs), and faith-based investment and social responsibility. It also included two distinguished banquet speeches as well as four parallel sessions discussing various contemporary issues on Islamic finance and development.

Nazim Ali, Acting Executive Director, Islamic Legal Studies Program (ILSP) and Director, Islamic Finance Project (IFP) at the Harvard Law School formally welcomed the participants to the forum. In his opening remarks, he stated that IFP now in its 17 years of operation has continued to organize the biennial forum since 1997 with a humble beginning of just 5 speakers. But during this tenth forum, there were more than 50 speakers and several participants representing over 40 nationalities. This shows there has been a tremendous growth of interest in Islamic finance and economics –a trend that is also reflected in growing number of institutions offering shari'a-compliant products and services.

While marking the tenth anniversary of the forum, Ali thanked all the individuals who have been the backbone of the IFP initiative. In particular, he recognized the efforts and contributions of Thomas Mullins, William Graham, Sam Hayes, Frank Vogel and Iqbal Khan. The success of IFP and successive forums in particular could not have happened without the support of highly talented individuals not only in the United States, but also across the world.

The Islamic Financial Sector's Contribution to Global Economic Development

The Forum began with a keynote speech by Noah Feldman, the Bemis Professor of International Law at Harvard Law School. Feldman discussed three global developments that he believes will shape the Islamic finance industry in the coming years: the continuing challenges to the global economy, which demonstrate the relevance of unique additional benefits of Islamic finance and the need to demonstrate its religious legitimacy in order to attract a stronger commitment to the industry; the rise of serious political and ethical concerns for the poorest segments of the population and the countries in which they live, which makes the ethical dimensions of Islamic finance all the more relevant in low-income countries and to the field of developmental economics; and the developments of the Arab Spring, which initially offered tremendous hope but have fallen short of achieving many of its objectives. Feldman noted that recent public debates in Tunisia have shown that the future will bring more open and democratic discussions of Islamic finance and that the religio-ethical dimensions of the field will be at the center of this debate.

Samuel Hayes, Professor Emeritus of Harvard Business School, chaired the first plenary session on the Islamic financial sector's contribution to global economic development. He reiterated the importance of the context which Feldman articulated and introduced the presenters of the two discussion papers as well as the panelists.

Volker Nienhaus, Visiting Professor of the University of Reading, United Kingdom, was the first presenter at the session. Presenting his discussion paper, "Islamic Financial Sector: Is it Contributing to Economic Development?," Nienhaus argued that Islamic finance does indeed generate income and entrepreneurial activities in the real economy, but that its new secular approach to derivatives casts doubt on its true potential impact on development. In contrast to the three fundamental premises of Islamic finance – real-asset backing, prohibition of riba, gharar, and maysir, and risk-sharing – the reality of the industry is that most funds are directed toward short-term investments in real estate, which is a particularly bubble-prone sector. Nienhaus concluded that it is necessary to look beyond individual success stories and evaluate empirical evidence of the industry's success based on research that takes the differing contexts into account such as the capital-surplus countries (e.g., Saudi Arabia, Kuwait), Islamized financial systems (e.g., Iran, Sudan), countries with strong government support (e.g., Malaysia), and countries with small Islamic finance sectors (e.g., Turkey, Indonesia).

Neil Miller, Global Head of Islamic Finance at KPMG, Dubai, presented the second discussion paper at the session. Drawing on his paper "The Role of Islamic Finance in Development," Miller emphasized that the fundamental tension in Islamic finance is the misalignment between shareholder expectations and community expectations. To reconcile this disparity, Miller provided a series of normative parameters for evaluating the impact of Islamic finance on development, such as the differentiation between what Islamic finance is doing and what it ought to be doing. In assessing the impact of what Islamic finance is doing for development, he provided UN indices of development and outcome measures like rising living standards and questioned the extent to which such objectives are a feature of board decision-making. In assessing what Islamic finance should be doing, Miller asked whether law has a role to play in compelling engagement. He noted that the rules of the Quran are not always enough to change behavior because reforms in the industry can only be made if the shareholders are willing to impose such change.

Following their presentations, the four panelists presented their responses to Nienhaus and Miller's arguments. Abdulaziz Al-Hinai, Vice President of the Islamic Development Bank, Saudi Arabia pointed out that the central question of their papers is whether development is a private good or public good. This question takes on a new meaning in Muslim states where the government is often a main actor in finance, particularly after the Arab Spring and the demand it created for the establishment of Islamic financial institutions (IFIs) in North Africa. Abdulrazzak Elkhraijy, Executive Vice President of the National Commercial Bank, Saudi Arabia, respectfully disagreed with Nienhaus and claimed he placed too much emphasis on an idealized depiction of Islamic finance and that IFIs ignore the substance of Islamic Finance; instead, he argued, business is the substance itself and said that Islamic banks have fewer developmental implications than early writers on the field would have predicted. In response to Miller, he pointed out that there is a huge growth opportunity for IFIs but that most of these opportunities would lie in riba and derivative transactions. He recommended that Islamic banks change their direction to focus more on Socially Responsible Investments (SRI) and SME finance to develop the next phase of the Islamic finance economy. Saleh S. Lootah, Executive Director of the S. S. Lootah Group, Dubai, gave a brief account of the history of Islamic banks in the UAE and observed that the two presenters shied away from citing the specific Qur'anic verses that have guided the evolution of Islamic banking and emphasized the need to define credit in Islamic banking. Savas Alpay, Director-General of the Statistical Economic and Social Research Training Centre for Islamic Countries, Turkey, stated the need to move the discussion from whether Islamic finance can be conducive to development to how it can create an environment for sustainable economic growth by focusing on the question of coping with financial crises.

The Question and Answer session featured a lively exchange among the audience and the panelists, speakers, and moderator. Many participants were particularly interested in microfinance and asked about its role in development and Islamic finance. Alpay noted that microfinance is a crucial tool for reaching the poor segments of society, but that its current form is abusive. Hayes added that the cost of servicing a small borrower is very high compared to that of a larger company and there is a need for subsidies to make microfinance more accessible. Hayes also mentioned the cost of imposing ethical and religious constraints on investment activity and asked whether shareholders are ready to forego their returns for the sake of religious or social concerns. Another question concerned the governance structure of Islamic finance and the importance of the intermediary role of shari'a board members. Nienhaus noted that shari'a boards are needed for competitive purposes in differentiating companies, but that the standards of corporate governance should be revised and improved to include more transparency and possibly standardization. Hayes added that the absence of the board would put more of a burden on the individual investor to determine shari'a-compliance. Other issues discussed include the demarcation between form and substance in Islamic finance, the extent to which the Islamic character of the industry should be emphasized and regulatory issues facing the industry.

Islamic Finance and the Development of SMEs

Asim A. Khwaja, Sumitomo-FASID Professor of International Finance and Development at Harvard Kennedy School, chaired the second plenary session on the development of SMEs and introduced the topic as one that has received inadequate attention but holds substantial promise for the economy. The first discussion paper was entitled "Islamic Finance and Entrepreneurship: Challenges and Opportunities Ahead" and was presented by Bailey Klinger, Chief Executive Officer of the Entrepreneurial Finance Lab (EFL) at Harvard Kennedy School. In his presentation, Klinger introduced a new tool to predict credit risk based on an entrepreneur's ethics, honesty, intelligence, psychological profile, and business skills. In contrast to traditional SME screening that is high-cost, high-risk, backward-looking by focusing on "downside risk," and reliant on information that many SMEs do not have, the EFL test is computer-based and highly scalable, forward-looking in focusing on upside potential, and uses information available from everyone. Research on 22,000 entrepreneurs across 18 countries has shown that EFL testing can expand lending three-fold without increasing risk targets, and lower default rates by 25 to 40 percent. The tool is currently in global scale-up and the lab is particularly interested in IFIs.

Anass Patel, President of 570 Asset Management, France, presented the second discussion paper entitled "Hybrid Sukuk for SMEs: Financing the Real Economy Through Ethical Principles." In addressing the question of whether hybrid sukuk for SMEs can be a credible alternative to conventional loans, Patel had two main assertions: first, bank loans are not adapted to SMEs' position, as collateral is not the "Holy Grail" of risk mitigation for banks and as better rating tools are needed in light of Basel requirements; second, the profit and loss sharing approach for SME financing in France can work, given the success of the mudaraba sukuk program of 5 million euros for the development of shari'a-compliant SMEs. He concluded with the recommendations of further research on the nature of the risks that are tolerable by the issuer and the investors and on the level of asset-backing necessary for involvement in a participatory certificate.

After Klinger and Patel's presentations, the four panelists offered their comments. Mohamed M. Mahmud, Executive Director of the Madinah Institute for Leadership & Entrepreneurship, Saudi Arabia, noted that there is a growing public attention to the importance of helping small businesses but that more guidance and training is needed. Specifically, he suggested that the EFL test be integrated with career counseling programs and that remedial action be developed for low performers. Ibrahim Warde, Adjunct Professor of The Fletcher School, Tufts University, Massachusetts, pointed out that SME is an outdated term that does not necessarily make sense in the Islamic context, as the whole economy is largely composed of SMEs. He emphasized the need to encourage entrepreneurship and look for solutions within the bigger picture of the fundamental difference between traditional lending and profit and loss sharing rather than specific techniques. Yousuf Khayat, Senior Advisor of SEDCO, Jeddah, Saudi Arabia, lamented the tendency of Islamic banks to avoid SMEs and noted that hybrid sukuk are a good solution but face issues of feasibility. Daud Vicary Abdullah, President & Chief Executive Officer of INCEIF, Malaysia, emphasized the importance of education on changing perceptions about shari'a-compliant products, noting Malaysia's success in educating youth on riba and entrepreneurship.

During the subsequent Question and Answer session, the two papers generated significant interest among the participants at the Forum. A recurring issue was the question of what is required to make the EFL tools work in terms of adaptation and application. Klinger clarified that the tool is not meant to deny people access to financing but to minimize credit risk. The panelists agreed that some of the pedagogical tools could be tested within the U.S. among the Muslim communities of diverse backgrounds before utilizing such models in developing Muslim economies. There was also an acknowledgement of the current challenges facing shari'a-compliant SMEs. The desirability of SMEs, the kind of goals the governments have set and how Islamic finance can provide some sort of solutions were also discussed. Finally, the importance of education in understanding the basics of Islamic finance was unanimously emphasized, as this is expected to spur Muslim economic development.

Faith-Based Investment and Social Responsibility

The third plenary session was chaired by Kristen Stilt, Visiting Associate Professor of Islamic Legal Studies, Harvard Law School, and featured two discussion papers. Sajjad Shah, Vice President at Wellington Management Company, Boston, and Jahangir Sultan, Professor of Finance at Bentley University, Waltham, Massachusetts presented their paper, "Values-driven and Profit-seeking Islamic Investors." They emphasized the importance of policymakers and investment managers' understanding of the primary and secondary objectives of an investor. They divided investors into two groups: value-driven investors and profit-seeking investors. Shah explained the difference between values-driven investors and profit-seeking investors for IF, noting that values-driven investors value non-pecuniary objectives as primary goals before applying the risk-return assessment. They optimize their utility functions in the three-dimensional space of compliance to values, return, and risk, and mostly utilize negative screens to narrow down the allowable investments before filtering further to choose the best return for a given risk. Profit-seeking Islamic finance investors, on the other hand, view Islamic finance investments as a source of additional return due to its lower leverage and businesses with reduced externalities, rather than pursuing Islamic finance investments solely because they comply with religious values. The authors posited that a majority of Islamic finance investors are values-driven investors, as Islamic finance investments usually avoid entire sectors such as the financial sector (none of the financial stocks are part of the Dow Jones Islamic Finance Index), making such investments unattractive for investors looking just for return, irrespective of the nature of underlying business. They proposed the following framework to segment the Islamic finance investors in values-driven and profit seeker segments and to validate if the majority are values-driven: two shari'a-compliant portfolios, one with Islamic finance stocks scoring high according to the Greenblatt's methodology and the other with firms that rank very high on a corporate social responsibility index. The excess return would be calculated using the GARCH model with traditional Fama-French factors and Carhart's momentum factors and the excess return relationship of both portfolios across different time periods and market conditions, i.e., low volatility to high-volatility, would be determined.

Umar Oseni, Visiting Fellow at the Islamic Legal Studies Program, Harvard Law School then presented his paper, "Toward a New Global Paradigm: Faith-Based Investments and Socially Responsible Investments". Oseni described the relationship between faith based investments (FBIs) and SRIs and outlined the potential they hold to create bridges across different faith communities. The phenomenal rise in faith-based investments in the last decade has reinvigorated SRI initiatives, despite the differences between the two concepts. The propensity of faith-consistent investors to only invest in stocks that are compliant with their religious beliefs is now well-known and well-researched. Oseni commented on the vast potential of FBIs and SRIs as many major religions share similar goals in terms of community and global development, shareholder activism, protection of the environment, and upholding fundamental ethics. Oseni concluded his presentation by asking the audience to ponder four fundamental questions: How do the faith-based paradigms complement SRIs? Are the principles of SRIs common to all FBIs? How can the common values be used to build bridges across financial communities? How can the FBIs prevent a future global financial crisis?

These presentations were followed by comments from the panelists. Seamus Finn, Director of the JPIC Ministry, Missionary Oblates, Washington, D.C., commented that while there is significant overlap between SRIs and FBIs and that there should be a healthy dialogue between the two, it is important for FBIs to remain separate from SRIs. Finn further opined that the division of value-based and profit-based investors is not one that he finds articulated in that fashion in faith communities—faith-based people are profit-seeking and want returns while at the same time they want to maintain their religious and ethical values. Lastly, Finn commented on the need to define exactly what is meant by the term "development" before moving ahead with FBIs and SRIs. Amjad Saqib, Executive Director of Akhuwat, Pakistan, then commented on the discrepancy between the understandings of the concept of profit. In economic terms, profit is considered to be material gain but such a limited definition does not cover all the aspects of how SRIs and FBIs treat profit. Conventional concepts of profit are limited to space and time, and the person's material wealth. But today, profits need to be sought in a manner that benefits everyone and preserves harmony between man and nature. Saqib argued that FBIs have a transcendental dimension and any conventional economic framework that is time bound cannot be used to understand the complete reality of FBIs. Faith-based values of sacrifice, generosity, integrity, and justice provide an alternate approach to development that needs to be examined. Saqib provided the example of his microfinance organization, Akhuwat, as a successful demonstration of this approach. Akhuwat provides interest-free loans, with the funds coming from people whose main motivation is to share their resources with the needy. Conventional economic wisdom would suggest that philanthropic donation is not sufficient or sustainable, but Akhuwat's experience suggests otherwise as Akhuwat borrowers become donors and contributors to the organization once they become self-sufficient. David Wood, Director of the Initiative for Responsible Investment, Harvard Kennedy School, commented on the shared goals of FBIs and SRIs and the potential for faith-based investors to reach members of a community through impact investing. Partha S. Ghosh, Professor of the Practice, Tufts University, advised FBI and SRI communities against using the same language as conventional finance, and opined that the world is now looking for a new economic paradigm as there is a degree of discomfort rising against the current paradigm. Taha Abdul-Basser, Muslim Chaplin of Harvard University, wrapped up the panelists' comments by underscoring the issue of viability and the challenges associated with FBIs and SRIs, and the role of shari'a boards in implementing such mandates in the Islamic finance industry.

The panel concluded with a vibrant Question and Answer session on the differences and similarities between FBIs and SRIs, and the extent to which faith-based initiatives plan on working with SRIs. Seamus Finn reemphasized that there is a need for faith-based initiatives to maintain their distinct identities. Other important issues that cropped up during the discussion included the motivations behind investment decisions, and operationalizing FBIs or SRIs with special reference to positive and negative screens. While Abdul-Basser emphasized the imperativeness of negative screens within the ethico-legal paradigm of Islamic finance as clearly defined by shari'a scholars, Finn argued that there should be more focus on positive screens, which is reflective of current projects he has worked on. Wood emphasized the need to focus on impact investing, as the new direction in social responsibility and also has its source in faith communities. Finally, there was a call for follow-ups that would lead to further collaborations among people of diverse backgrounds to bridge the gap between the financial communities and establish a new economic paradigm. There was general agreement that there is a need for greater public dialogue utilizing social media and technology to engage the public on the moral purpose of capitalism.

Realizing the Potential of Islamic Finance

The first banquet speech was on realizing the potential of Islamic finance. In his speech, Mahmoud Mohieldin, Managing Director, World Bank Group, highlighted six challenges facing Islamic finance as the industry evolves into its next phase: improving regulatory oversight, rebalancing tax treatment, strengthening insolvency frameworks, promoting standardization, ensuring adequate liquidity, and establishing sound risk-management practices. He also described steps the World Bank Group has taken in supporting the evolution of Islamic finance. The World Bank Group has established an Islamic Economics and Finance Working Group to bring together key Bank staff working on the field, included Islamic financial institutions in upcoming Financial Sector Assessment Programs and collaborated with the IFSB and AAOIFI in areas of risk management, corporate governance and accounting standards. Mohieldin concluded with his hope that Islamic finance will continue to play a role in broadening financial access to support sustainable development.

U.S. Policy in a Changing Muslim World

The second banquet speech was on the U.S. policy in a changing Muslim world. Rashad Hussain, U.S. Special Envoy for the Organization of Islamic Cooperation (OIC), stressed the importance of strengthening relations between the U.S. and the Muslim world. He emphasized that the ongoing efforts by the U.S. government are primarily focused on fostering political stability and economic development in the Muslim world. He singled out the developmental achievements recorded by dedicated bodies such as the United States Agency for International Development (USAID) and mentioned that addressing the menace of poverty fueled by economic injustice and social exclusion has been the prime focus of USAID. According to Hussain, this vital role played by USAID and other agencies is meant to improve the lives of millions of people in the Muslim world. He further stressed that the rebuilding efforts in the post-Arab spring initiatives are enormous and are being addressed by the U.S. government. The developmental initiatives through different sustainable mechanisms to ensure peace in the region spearheaded by the U.S. strive to improve political stability, social justice, and economic empowerment. In order to keep up with the dynamic nature of the Muslim world and contribute to its development, Hussain has been preoccupied with far-reaching engagements in the Muslim world. According to Hussain, the transformative impact of U.S. foreign policy is yielding tremendous results in terms of development abroad.

Islamic Finance and the Arab Spring Movements

Parallel Session A was chaired by Ibrahim Warde and featured five papers that focused on the implications of the Arab Spring movements for Islamic finance. Kilian Bälz, Senior Partner of Amereller Legal Consultants, Egypt, focused his paper on the development of Islamic finance in Egypt after the 2011 revolution. He contended that the two main changes in Egypt have been the emergence of more open debates on Islamic finance and the growth of an entrepreneurial spirit as proved by the establishment of many new SMEs. The key challenge for Islamic finance, he argued, is not the state, but rather the relationship between formal and informal credit and the place of Islamic finance within that relationship. He concluded that Islamic finance has to adopt a developmental agenda in order to be successful in Egypt. Co-authors Mehmet Asutay, Reader at Durham University, and Ercument Aksak, Research Fellow, Durham University argued in their paper that Islamic finance has not shown positive outcomes on development indices but can do so by developing a knowledge-based economic frame. This would involve improving transparency and governance, expanding educational efforts and innovation, and investing in information and communication technology.

Subsequently, Laurent Weill, Professor at the University of Strasbourg Business School, France, posited that Muslim countries suffer from poor-quality institutions that hinder economic development. His research found that Islamic banks are less cost-efficient than conventional banks given their greater legal costs and that an improvement in the quality of institutions reduces the gap in efficiency, with the implication that the Arab Spring can lead to the expansion of Islamic finance if it enhances the quality of institutions. Following suit was M. Mahmud Awan, who proposed a new growth strategy for sukuk based on the securitization of privatized government assets. He argued that sukuk ownership certificates are a viable alternative to widely marketed savings bonds in developing Muslim countries and that low sukuk issuance countries like Pakistan, Nigeria, and Iran are most in need of privatization to foster public participation. The final presenters were co-authors Rauf N. Mamadov, Manager of PwC Consulting, Dubai and Zhamal K. Nanaeva, an independent financial researcher in Dubai. They argued that the Arab Spring has fueled greater demand for Islamic finance across the Middle East and North Africa, noting that Islamic finance assets in the region are projected to grow 138% by 2015. To seize this opportunity, the authors emphasized the need to upgrade research and development efforts, to apply innovative products that are already allowed and documented, and to encourage governments and central banks to become serious about mainstreaming Islamic finance.

The ensuing Question and Answer session touched on a variety of topics, including sukuk, the role of technology in expanding Islamic finance, continuous engagement and collaboration between shari'a scholars and economists, and the need for human resource development. Though there was a thought-provoking discussion on the dynamics of the relationship between shari'a scholars and economists and their respective roles in the development of Islamic finance in Arab countries, participants agreed that what is required is not a mere condemnation of inevitable human errors, but more positive engagement between the two groups. Such engagements have been spearheaded by the IFP in its annual Harvard-LSE workshops where shari'a scholars, economists, and practitioners are brought together in a closed-door session to discuss critical issues which underpin the development of the Islamic finance industry. Furthermore, participants agreed that situating the history of Islamic finance within the political economic context of the Arab world between the 1960s and 1970s was relevant in order to determine future projection of industry growth in the next 10 to 20 years. There is significant scope for expanding the industry, because apart from bridging the gap between East and West, it has also proved to be a veritable point of convergence between the Islamist and the secularist movements in most countries affected by Arab Spring. Meanwhile, when structuring Islamic finance products to be utilized in Arab Spring countries, participants agreed that the well-being and economic needs of the people should be considered apart from the usual issues of shari'a-compliance.

Global Perspectives on Islamic Finance

Parallel Session B was chaired by Shahab Ahmed, Associate Professor of Near Eastern Languages & Civilizations, Harvard University. Abdulqadir I. Abikan, Acting Dean of the Faculty of Law, University of Ilorin, Nigeria, presented his co-authored paper with Is-haq O. Oloyede, Vice Chancellor, University of Ilorin, Nigeria, "Rescuing the Nigerian Economy Through Islamic Financing: the Regulatory Challenges." He argued that regulatory challenges in Nigeria, such as religious rivalry and government corruption, have limited the productive use of finance in Nigeria. However, with more efforts to build education about the general acceptability of Islamic finance—whether through pilot projects, advocacy for sponsoring the bill for Islamic Finance Act, or investment in research and personnel training—products like muzara'a (sharecropping), musa'aqa (irrigation), and musharaka financing can be adopted to address economic development needs in Nigeria. Following this presentation, Nisar Ahmad, Junior Joint Director of the State Bank of Pakistan, presented his paper, "Sustainability and Outreach of Islamic Microfinance: a case study of Pakistan." After describing the state of Islamic microfinance in Pakistan, he presented his findings that the qard hasan (benevolent loan) model employed by the Akhuwat microfinance institution has achieved tremendous success in Pakistan in increasing economic assets, health, education, and social acceptance. Thereafter, Daniel Soloiman of Durham University presented his paper on "Growth Prospects for the Islamic Banking Sector in Oman." Although Oman has a favorable environment for growth in Islamic banking, he described Oman as the only country in the GCC that did not approve Islamic banking principles. Instead, the government has focused on its "Vision 2020" initiative to diversify the economy and reduce dependency on oil.

Afterwards, Brian Kettell of the American University of Sharjah, United Arab Emirates, shared his findings on Qatar's decision to limit Islamic banking. In 2011, the Central Bank of Qatar (CBQ) issued a directive to close Islamic windows operations in all conventional banks. After describing the distinctions between the three general categories of banking—conventional banking, full-fledged Islamic banks, and conventional banks operating Islamic banking windows—Ketell argued that the CBQ may have issued this decision because of the various difficulties in regulating mixed-mode banks or as a punishment for banks that failed to maintain the appropriate distinctions between conventional and Islamic finance operations. The final presenter was Craig Nethercott, Partner at Latham & Watkins LLP, United Kingdom, who spoke on "Products and Infrastructure—Saudi Arabian Achievements and Ambitions—a Glance at the Past and the Future." According to Nethercott, major trends in Saudi Arabian finance in the past decade include a movement away from conservative Hanbali perspectives to more Islamic financing activities, a number of new construction projects in the petrochemical, gas, and power sectors, and the increasing use of istisna' and ijara models to finance operations. Moving forward, he advised against the use of the Build-Transfer-Operate (BTO) model, as he anticipates that liquidity squeezes will remain a limitation of medium and large projects and as he expects a positive future in the development of products within the petrochemical sector.

In response to the foregoing presentations, the Chair of the session, Shahab Ahmed, noted that the panelists covered an array of case-studies from very wealthy countries to developing countries, and that each of the countries had unique issues that were symptomatic of the diverse set of challenges within the Islamic finance world. For instance, the three presentations dealing with Qatar, Oman, and Saudi Arabia were concerned with financial development, while those on Nigeria and Pakistan were concerned with economic empowerment and infrastructural development.

During the Question and Answer session, participants and the panelists discussed public-private partnerships as a way of allowing developing countries to benefit from the resources in wealthier Muslim countries though in a country like Saudi Arabia, there is still the debate of the real value proposition of the involvement of the private sector in infrastructural development. Another major issue discussed during the session was the question of sustainability for not-for-profit microfinance institutions like Akhuwat which rely on private donations. It was pointed out that while the rate of repayment of loans is about 99.85%, borrowers also make voluntary donations to the Akhuwat microfinance fund. On the motivations behind Qatar's decision to limit the Islamic banking operations, even though the Islamic finance world is still trying to disentangle underlying explanations, the Qatar authorities have not provided any clarification other than their initial press release. Finally, participants agreed that the new direction of the Islamic finance industry should include harnessing Islamic finance tools in rich GCC countries for developmental purposes in Muslim-majority countries like Indonesia and Pakistan. Although the Asian Development Bank has been promoting this idea, it has continued to face some regulatory challenges among developing countries.

Islamic Finance and Alternative Economic Thinking

Parallel Session C was chaired by Volker Nienhaus, Visiting Professor, University of Reading, United Kingdom. He began by introducing the idea of financial inclusion and explaining how Islamic finance can make a contribution in this area, possibly creating new entrepreneurs. He highlighted the need for a new approach in developing new Islamic finance products as a result of developments in the financial sector as well as highlighting the need to rethink the methodology used to develop such products. Zamir Iqbal, Lead Investment Officer, World Bank, Washington, D.C., presented his and co-author Abbas Mirakhor's paper, where they questioned the notion that more financial inclusion leads to more economic development, as studies have not conclusively proven this assertion. Iqbal identified a number of factors to explain financial exclusion and argued that microfinance has failed to deliver its underlying objectives and has performed modestly at best. According to him, the main reason underlying the failure of microfinance to maintain economic development over the long run is its high cost. Iqbal commented that the concept of inclusion in Islam has two parts: business/market-based risk sharing and charitable/redistributive components, like zakat and qard hasan. The latter redistributive instruments can be powerful tools to alleviate poverty and to sustain development in the long run, if properly institutionalized and governed. Iqbal concluded that there is theoretically no reason why the Islamic finance system should not be more inclusive of the poor than the conventional system, if properly implemented. In a related paper, M. Kabir Hassan, Professor at University of New Orleans, Louisiana, presented his and Rasem N. Kayed's paper on "Finance, Entrepreneurship and Economic Development in Islam." Hassan discussed the importance of entrepreneurship in Islam and compared the Islamic view of employment and economic returns with the Western model. He then argued that entrepreneurship in Islam depends on three factors: following the requirements of one's religious beliefs, active engagement of entrepreneurs through the use of partnership contracts, and investment in productive and socially desirable opportunities.

Mustapha Hamat of the International Islamic University Malaysia then presented his and Salim Al-Ali's paper entitled "Toward a New Approach in the Development of Islamic Finance and its Products: Issues and Challenges." The authors emphasized the need to have a pragmatic approach towards shari'a-compliance, highlighting the example of Malaysia and its central bank's Shari'a Advisory Council. They further opined that the buy-in of the political class through regulatory reforms is extremely important in order for Islamic finance to move forward in the future. As a way of establishing a path for moving forward and developing the industry, Abdulazeem Abozaid, Shari'a Trainer at Emirates Islamic Bank, Dubai, United Arab Emirates presented his paper on "Reforming the Methodology of Product Development in Islamic Finance." Abozaid opined that the focal point of experts in product development has been the form rather than substance in Islamic finance, which has been neglected in numerous ways like the deactivation of contract rules and misapplication. According to him, reasons for neglecting the substance include a desire to offer the same financing facilities as conventional banks, an unwillingness to bear genuine property and contract risks, and the legal constraints facing the application of shari'a rules in products. Abozaid argued that these reasons are invalid and that Islamic banks need to acknowledge that not every conventional product can be Islamicized.

This was followed by a presentation by Necati Aydin, Professor in the Department of Economics, King Saud University, Saudi Arabia on "Islamic Economics and Finance: New Paradigm or Old Capitalism?" Aydin highlighted the differences between Islamic economics and capitalist economics, noting that Islamic economics is not based on self-interest alone, but also on values like social, moral, and spiritual capitals, and provides for moderation in the fulfillment of sensual and egoistic desires. He concluded that Islamic finance has adopted the "experience machine" capitalism has created, without fully anticipating the issues that it creates. The final presenter in the session was Laurent Gheeraert, Professor at the Université Libre de Bruxelles, Belgium, on the topic "Does Islamic Finance Spur Banking Sector Development?" Through an analysis of shari'a-compliant institutions, annual reports, and complementary sources, Gheeraert found that Islamic banking significantly and positively impacts the development of the banking sector, and at the median level of Islamic banking penetration, credit/GDP is higher by 7% (with the sample mean credit/GDP at 32%). This effect is due to a complementarity between the Islamic and conventional financial sectors under certain conditions—when Islamic banking penetration was medium, there was significant complementarity, whereas there was no such complementary relationship when the penetration was low or high.

The session concluded with a Question and Answer session, which focused on institutionalizing zakat and the proper channeling and utilization of zakat funds. Kabir Hassan commented that poverty cannot be alleviated merely through zakat and that instruments like microfinance are needed. However, he cautioned against the phenomenon of poor borrowers using loans for consumption and then going to other microfinance providers to pay off the previous loans, leading to a debt-trap. Zamir Iqbal commented that institutionalizing zakat is not an issue of government involvement, but rather an issue of proper governance that the private sector can manage as well. Proper rules and regulations from the government that empower the community to run zakat funds are needed. It was suggested that zakat, as one of the key drivers of the Islamic economy, should be further enhanced with qard hasan (benevolent loans) and waqf (charitable endowment) in order to ensure sustainable economic development. Another important issue discussed during this session included some early mistakes made during the beginning stage of the Islamic finance industry in Malaysia. Such teething mistakes include the acceptance of deposits on a current/savings account where banks had to guarantee such deposits and then contrast that with an investment account. Meaningful reforms have since been experienced in the current stage of development of the Islamic finance industry. In addition, the issue of Islamic finance as a bridge between the East and the West was emphasized during the discussion.

Current Academic Research in Islamic Finance

Parallel session D was chaired by Mehmet Asutay of Durham University, United Kingdom. Muhammad Adli Musa of the University of Melbourne presented his and Abdullah Haron's paper on "Prophetic Guidance on Ethics & Prudential Framework for Institutions Offering Islamic Financial Services – In the Light of the Global Financial Crisis." The authors emphasized the importance of upholding the spirit of the law of Islamic finance and not merely the letter of the law. They recommended translating ethical principles like sincerity, justice, and proper moral conduct into a binding legal framework for Islamic finance that uses a principle-based approach in place of a rules-based approach, which tends to result in a "box-ticking" attitude towards compliance. Next, Syed Mizanur Rahman and Salman Ali from Indian Institute of Management, Ahmedabad, India, presented their paper, "Financing development activity and debt." The authors highlighted the need for more participation from the private sector so that governments do not need to tap into riba-based debt markets in order to finance development activities. Possible alternatives to debt markets were proposed, which included joint public-private activities like Build-Operate-Transfer (BOT) and Build-Develop-Operate (BDO) contracts, tax incentives, and CSR activities.

Ismail Cebeci, Visiting Fellow at the Islamic Legal Studies Program, Harvard Law School, spoke on "Integrating the Social Maslahah into Islamic finance: A Key for Social Development." Cebeci discussed the social objectives of Islamic banks that he referred to as "social maslahah" and identified reasons for the failure of Islamic banks to achieve them. External reasons for this failure include an overly capitalistic mindset, issuance of fatwas with no relation between the historical context and the current social context, and the reality that Muslim clients are not very different from other clients. On the other hand, internal reasons, he argued, included insufficient institutionalization, failure to implement the prohibition on interest, and the widespread narrow focus on murabaha exclusively. He recommended a balance between the use of murabaha and products like istisna', ijara, and takaful in order to better cater to the needs of the clients and further recommended the use of a framework of collective maslaha rather than a legalistic or individualistic framework.

Nida Davis, Doctoral Candidate at Georgetown University, Washington, D.C. presented her paper "Rethinking of Economic Paradigm: The Compatibility of Islamic Financial Principles with Capitalism." Davis argued that Islamic banking principles are not incompatible with capitalism or with the tenets of global finance and that they offer an enhanced form of capitalism rooted in humanistic ethical principles. She contended that Islamic capitalism is possible and does not require radical rethinking of existing economic paradigms, but rather requires radical transformation of the role of the Islamic state. Specifically, she argued that the concept of a "just" state is critical for ensuring the stability and success of a "just" Islamic finance. She posited that an "ethical" form of banking and finance cannot credibly operate in social or political conditions that do not provide for justice and that Islamic capitalism requires a modernized understanding of the early Islamic concepts of state coupled with liberal incorporation of individual freedom.

Subsequently, Bridget S. Kustin, Doctoral Candidate in Anthropology at Johns Hopkins University, Maryland, presented her paper, "Ethnographic Approaches to Understanding Client versus Institutional Priorities for Islamic Microfinance in Bangladesh." Kustin provided valuable insights from her research on Islami Bank Bangladesh Ltd. (IBBL) and its Islamic microfinance program. Kustin reported that two-thirds of IBBL's branches are currently located outside urban areas and that IBBL had not been giving microfinance loans to the lowest income population. IBBL would not operate in other villages where other microfinance institutions already exist, which limited competition. An interesting feature of IBBL's microfinance program was that loan collection officers would spend 15-20 minutes with clients teaching Islamic values such as offering prayers, teaching illiterate clients to read and sign their names etc., thereby incorporating educational development with microfinance loans. Kustin highlighted the two main microfinance products being offered by IBBL, namely qard hasan, which could be used to decrease disadvantageous or inconvenient reliance on social networks, and bai muajjal, fungible funds that promote financial stability for the poor. Kustin identified the ad hoc nature of these products as an issue that hinders their ability to replicate and expand, thereby suggesting the need for an all-purpose investment fund.

Finally, Houseem Bedoui, Doctoral student at Chair for Ethics and financial Norms – Paris La Sorbonne / King Abdul Aziz University, Paris, France, presented his paper, "Ethical Competitive advantage for Islamic Finance Institutions: How should they measure their performances?" Bedoui proposed a new mathematical performance model based on maqasid al-shari'a in which performance is a consequence and result of a predetermined objective and goal. Using five performance metrics of faith, human self, intellect, posterity, and wealth, Bedoui presented a general approach that could be applied by organizations to assess their different performances in the above categories with the aim of encouraging investments in SRI/CSR, waqf, and environmental activities. According to Bedoui, the market is well suited for starting ethical initiatives and that 2012 will be a key year for ethical investments.

The session concluded with a thought-provoking Question and Answer session based on the current academic research and interests in Islamic finance presented by the speakers. In response to a question on the role of government in zakat collection, the panelists were of the opinion that personal decisions about the allocation of zakat money are preferable, as that is more in line with the classical opinions on zakat and the interpersonal spirit of zakat. To a question on whether Islamic finance is really a better option than conventional banking, Kustin mentioned IBBL's success and its competitive, non-exploitative loan rates as an example of Islamic microfinance being a better option than conventional microfinance. Other panelists opined that Islamic finance has not overall been successful, which led to a discussion on the yardsticks by which success is measured, namely whether these benchmarks should be profitability, scalability, development, or adherence to shari'a. According to the panelists, in order to improve the relevance of the Islamic finance industry, social maslahah, which has been a missing block in the development of industry, should be introduced in the process of product development. Finally, the panelists emphasized that the issue of debt and borrowing in the traditional understanding of Islamic commercial practices is a philanthropic matter and not a business issue. This understanding calls for a reconsideration of the business objective of debt financing in the Islamic finance industry.

On a Final Note

The Tenth Forum concluded with a closing speech by Nazim Ali, thanking the audience, speakers, IFP staff and volunteers for their assistance throughout the conference and inviting them to join IFP again for future events. A few names were given special recognition for their assistance in the organization of the Forum: Umar Oseni, Sarah Akhtar, and Hassaan Yousuf. Special thanks were also given to the IFP sponsors: HSBC Amanah, Islamic Research & Training Institute of Islamic Development Bank, Kuwait Finance House, MASIC, and National Commercial Bank.

To continue the intellectual exchange after the conference, a subset of selected papers presented at this forum will be published in the form of a book similar to previous forum publications.