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Islamic Finance and Revitalization of the Traditional Islamic Economic Institutions

By Shinsuke Nagaoka

The commercial practice of Islamic finance emerged in the 1970s as a new financial system with interest-free products that differed from conventional finance. Although some bankers regarded it as ethereal financing at its early days,[1] Islamic finance progressively developed in terms of both numbers and popularity, not only in the Muslim world but also in international financial markets. Islamic finance is now entering a new development stage, enjoying rapid growth in both quality and quantity in the twenty-first century. The development of new financial products such as *sukuk* (Islamic securities) and commodity *murabaha* (an Islamic liquidity management instrument) is a response to customer demand and the need to improve competitiveness as against conventional finance. In addition to the scale of the market expansion in the Islamic world, some major Western commercial banks are also participating in the industry, and Western financial authorities are introducing legal and regulatory frameworks for promoting Islamic finance. External factors such as oil prices and economic growth in the Islamic world are also assisting in its development. Even the global financial crisis of 2007-2008 was considered a win-win situation for Islamic finance. The average annual growth rate after 2000 was over 20%, and the total assets of the Islamic financial industry reached $1.2 trillion[2] at the end of 2012, with 307 financial institutions providing Islamic financial services in 35 countries.[3]

Generally speaking, bankers and researchers involved in Islamic finance agree that all Islamic financial services must be based on the ideas and values of Islam. Islamic financial institutions have certainly attached a high degree of importance to this condition since the rise of the commercial practice. However, in order to be commercially successful, especially in situations where Islamic finance coexists with conventional finance, Islamic financial institutions must provide competitive financial products that are acceptable to all customers, both Muslim and non-Muslim alike. Thus, the practice of Islamic finance must maintain a balance between adhering to Islamic values and providing competitive financial products in order to survive. This balance has become even more important since the rapid growth in Islamic finance has improved its competitiveness.

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[1] Bloomberg *Portfolio Design Strategies*. Bloomberg Wealth Manager Strategies Series. 2005, p. 70. They used the term of "ethereal financing" because interest-free financing system with religious connotation seems not

[2] Islamic Financial Services Board, *Islamic Financial Services Industry: Stability Report 2014*, p. 14.

[3] *The Banker: Special Report, Top Islamic Financial Institutions*. November 2013, p. 3.

However, there have been difficulties in striking this balance. One industry survey showed that ideas for new financial products in Islamic banks were derived from products already offered by conventional banks or other Islamic banks,[4] implying that new product development prioritized marketability rather than compatibility with Islamic values. In order to judge the compatibility of the bank's products with Islamic values, each Islamic bank has its own *Sharia* advisory board consisting of prominent Islamic jurists, who are supposed to approve every new product under a. strict protocol. However, criticisms have been raised over the boards' deliberations. The Islamic jurists first break down each product into individual transactions and then examine the compatibility of each one with Islamic values. If all transactions are found to be compatible, the jurists give their approval with the statement "*Sharia*-compliant." Critics have pointed out the jurists' lack of a holistic perspective, by which they ignore the Islamic compatibility of the product as a whole. Mahmoud El-Gamal calls this approval process "*Sharia* arbitrage"[5] while critics use the term "*Sharia*-compliant finance." Islamic banks consider *Sharia* compliance when making decisions about new products, but Islamic values are not given priority;[6] so that the legalistic form of Islam, rather than the substance is accorded top priority.

The last few years have seen new trends in Islamic finance (which this article calls "new horizons"), that place a high priority on the aspiration of Islamic finance and on overcoming the current situation faced by *Sharia*-compliant finance. This article picks up the revitalization of traditional Islamic economic institutions such as *waqf* and *zakat* through the use of Islamic finance as one of these latest trends. Although these institutions still function in the contemporary Islamic world, their roles in national economic systems are diminishing. The attempt to revitalize them seeks to reevaluate their role in the sustainable development of the Muslim community and in tapping new markets for Islamic finance. The revitalization of *waqf* and *zakat* are two representative examples of this trend.

A *waqf* is an endowment (estate or cash) donated by an owner (*waqif*). A donor (*waqif*) specifies a property (*mawquf*) for the *waqf* and then specifies its purpose (specific or charitable) and appoints the recipient(s) of the benefits (*mawquf 'alay-hi*) and a trustee (*mutawalli*). The trustee arranges the management of the property and distributes the revenues to the recipient(s) (for eternity, in principle). Historically, *waqf* was prevalent throughout most of the Islamic world in the pre-modern era and played an important role in Islamic economies and societies. The practice of *waqf* has been declining in many regions due to colonization and Westernization. Some Middle Eastern countries abolished family *waqf* (*waqf ahli*) around the middle of the twentieth century,[7] and many Islamic countries nationalized the charitable *waqf* (*waqf khayri*), resulting in inefficient administration.[8] Several countries have recently attempted to revitalize *waqf* in order to generate additional revenues for socio-economic progress and the sustainable development of the Muslim community.

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[4] Habib Ahmed, *Product Development in Islamic Banks*. Edinburgh University Press, 2011, pp.147-148.
[5] Mahmoud A. El-Gamal, *Islamic Finance: Law, Economics and Practice*. New York: Cambridge University Press, 2006, p. 174.
[6] Ahmed, *supra*, p. 148.
[7] The *waqf ahl*i was abolished as follows: in Turkey, 1926; in Syria, 1949; in Egypt, 1952; in Tunisia, 1962–63; in Libya, 1973; in the United Arab Emirates, 1980 (Syed Khalid Rashid, "Current Waqf Experiences and the Future of Waqf Institution," *Awqaf*, Vol. 5, 2003, pp. 5-25).
[8] *Id*. pp. 9-14.

Singapore is the pioneering country in its revitalization of old estate *waqf* in terms of both practice and institutional infrastructure. Singapore's Islamic Religious Council (*Majlis Ugama Islam Singapura*, MUIS) is primarily responsible for the revitalization of old estate *waqf* in the country, while the *fatwa* committee at MUIS is developing a theoretical framework for its implementation. MUIS is raising funds for the rebuilding and renovation of these old estates using several methods, such as internal funding through the Baitulmal fund,[9] long lease (*hukr*),[10] and sales of existing properties.[11] Islamic finance is thus revitalizing old estate *waqf* through external financing.

A more direct engagement is seen in cash *waqf* (*waqf nuqud*), or otherwise known as "corporate *waqf*" (or "*waqf* of share" or "*waqf* of stock"). Unlike the practice in Singapore for the revitalization of old estate *waqf*, corporate *waqf* is an attempt to establish new *waqf* (estate or project) by accumulating capital through fundraising from investors. The investors receive certificates as evidence of having purchased a certain amount of shares of the newly established *waqf*, thus becoming donors (*waqif*). The accumulated capital is invested, as are other Islamic financial products. Interestingly, corporate *waqf* overlaps both traditional cash *waqf* and modern Islamic finance. Recent examples of this overlap can be observed in several countries, such as Malaysia, Indonesia, Sudan, Kuwait, the UAE, Turkey, and the UK.[12]

Zakat payment, one of the most important obligatory deeds in Islam, is performed by every eligible Muslim throughout the Islamic world. However, the role of *zakat* is not necessarily significant when aggregated in a national economy because very few countries have official entities responsible for collecting and disbursing *zakat* payments. *Zakat* collection and disbursement in most Islamic countries are performed by local communities. Since the rise of Islamic finance in the 1970s, Islamic banks and financial institutions have been very eager to open specific accounts for *zakat* payments. They collect *zakat* funds not only from their own revenues but also from customers' dividends earned on investment deposit accounts under the agreement. Thus, *zakat* can be significant for Islamic nations in its contribution to the growth and expansion of Islamic finance. Recently, the United Arab Emirates (UAE) has attempted to undertake an innovative collaboration between *zakat* and Islamic finance,[13] through the creation of a sovereign entity called the "*Zakat* Fund (ZF)" (*Sunduq al-Zakat*) for collecting and disbursing *zakat*. In 2010, the Abu Dhabi Islamic Bank launched a new service for collecting *zakat* on behalf of the ZF through the bank's ATMs,

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[9] The Baitulmal fund is the institution that acts as a trustee for Muslims. MUIS allocates funds for public and community projects and general welfare. Most of the funds come from the estates of the deceased (http://www.muis.gov.sg/).

[10] The concept of *hukr* grants the tenant of the *waqf* property priority of lease, the right of permanent lease, or the perpetual right to the usufruct of the *waqf*. The occupant pays either fixed rent or a variable rent during the lease period that changes as the value of the property changes. (see Ahmad Dallal, "The Islamic Institution of Waqf: A Historical Overview," in S.P. Heyneman ed., *Islam and Social Policy*. Nashville: Vanderbilt University Press, pp. 26-27).

[11] Shamsiah Bte Abdul Karim, "Contemporary Shari™a Compliance Structuring for the Development and Management of *Waqf* Assets in Singapore," *Kyoto Bulletin of Islamic Area Studies*, Vol. 3, No. 2, 2010, pp. 149-154.

[12] Murat Çizakça, *Islamic Capitalism and Finance: Origins, Evolution and the Future*. Cheltenham: Edward Elgar, 2011; Magda Ismail A. Mohsin, "Waqf-shares: New Product to Finance Old Waqf Properties," *Banks and Bank Systems*, Vol. 7, Issue 2, 2012.

[13] The following analysis of the UAE is based primarily on the author's own field research, conducted in September 2011.

mobile phones, and branches. In addition, the ZF installed its own ATM machines for collecting *zakat* in 2011. Using these ATMs, customers can not only pay *zakat* but can also indicate the category of disbursement. These attempts appear to be making *zakat* management more efficient and comprehensive. According to the author's own field research, the ZF has several plans to develop the management of *zakat* further to strengthen the ties between *zakat* and Islamic finance.

What do these new trends in Islamic finance imply in the context of Islamic economic studies and economic history? Before the emergence of these new trends, Islamic finance was functioning as an autonomous financial sector, although it had been contributing towards the development of economies and societies as an intermediary for monetary flows. As for *waqf* and *zakat*, although their respective roles in each national economic system are independent and shrinking, the practices of these institutions are still functional in the modern Islamic world. With the emergence of new trends, Islamic finance has become deeply ingrained in both economy and society by broadening the range and types of services available. In the renewal of *waqf* properties and *zakat* payment for example, Islamic finance has provided a significant vehicle for revitalizing these traditional institutions, and this has contributed to the socio-economic development of the Muslim community in ways that are both bottom-up and sustainable. It can be said that the involvement of Islamic finance in the economy and society are conducive to the organic integration of an Islamic economic system in the modern world. In this system, profits from businesses can be efficiently redistributed to society through Islamic finance. It therefore plays an important role in the system as a tool that embeds the economy into society, implying a counter-vision of the current capitalist system.

Based on the characteristics of the of these new trends in Islamic finance, this article poses the question of whether this Islamic economic system with organic integration in the modern world can be perceived either as a revival of the 'original' Islamic economic system in the pre-modern Islamic world, or as the emergence of a new sustainable system. Looked at from a historical perspective, it can be observed that the Islamic world had a similar integrated economic system in the pre-modern era. The open market policies pursued by the Islamic dynasties and the prevalence of economic institutions such as *waqf* and *zakat* constituted a highly integrated economic system. For example, large-scale *waqf* properties were usually established as a combination of commercial (markets, places of accommodation etc.), charitable (hospitals, asylums etc.) or religious (mosques etc.) real estate. When revenue was generated through commercial activities in the market, it was promptly distributed for charitable and religious purposes. In this case, the market took a part of the medium of the system and integrated the economy with society. It is easy to understand how an organic integrated model in the modern world has broad overlaps with the economic system in the pre-modern Islamic world.

On the other hand, one of the novelties of the emerging system is that it is based on modern technology, specifically cyber networks. Through this network, we can conduct transactions remotely and round the clock, for example, between Malaysia and the Gulf countries. In Singapore, MUIS utilizes the cyber network to gather information (population, age, income level etc.) on the Muslim community in the country, for the purpose of efficiently distributing revenues from *waqf* and *zakat*. This distinctly modern characteristic implies that the emerging system forms a transnational network that exists not at a real geographical level but at a meta-geographical level. Therefore, it can be concluded that the system is not just a revival of the antique economic system in the pre-modern Islamic world, but is also a new system that succeeds the golden heritage of the pre-modern era. For further discussion, it is worth mentioning that the meta-geographical nature of the emerging system is quite important for considering the future vision of the economic system for humanity. This is because the spirit of the emerging system, which embeds the economy into society, raises sympathy amongst many people in many regions and becomes very easy for these people to introduce or join in the system. This implies that there is not only a potential for the system to spread globally, but also a great potential to become an alternative choice for the next universal economic system with sustainable development.

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Shinsuke NAGAOKA is an Associate Professor at the Graduate School of Asian and African Area Studies, Kyoto University, Japan. He has been a visiting researcher at the Islamic Research and Training Institute at the Islamic Development Bank. He has M.A. in Economics (2004) from the University of Tokyo, and a Ph.D. in Islamic Area Studies, (2009) from Kyoto University. He has studied Islamic economics & finance from the interdisciplinary aspects; economics, history and *fiqh al-mu'amalat* (Islamic jurisprudence). His major publication is *A Study on Islamic Finance in the Modern World* (in Japanese, The University of Nagoya Press, 2011).