

International Conference on Applied Economics, ICOAE 2015, 2-4 July 2015, Kazan, Russia

Principles and instruments of Islamic financial institutions

Nikonova Tatiana ^a, Kokh Igor ^a, Safina Liliya ^{b1}

a Kazan Federal (Volga region) University. 18 Kremlevskaya St., Russia, Kazan 420008

b Volga Region State Academy of Physical Culture, Sport and Tourism, 33 Universiade Village, Russia, Kazan, 420138

Abstract

Islamic financial institutions are part of the modern world economy and subject to the same economic laws as any other traditional financial market participants. Statesmen and traditional banks see a promising business opportunity in Islamic banking and finance. The mechanism of Islamic capital market is differs from the well-known. Economic agents are guided not only by legal rules but also by the rules prescribed in the Holy Scripture, the Quran. Islamic finance provides a variety of financial products. The main instruments of financing used by Islamic financial institutions have some distinctive features: estimating the value of any asset on the basis of its real value, every contract is concluded exclusively on one type of financial services, a clear definition of the prices of goods/services, a clear definition of the share of each partner in profit/loss.

© 2015 The Authors. Published by Elsevier B.V. This is an open access article under the CC BY-NC-ND license

(<http://creativecommons.org/licenses/by-nc-nd/4.0/>).

Selection and/or peer-review under responsibility of the Organizing Committee of ICOAE 2015.

Keywords: Islamic economic model; Islamic financial institutions; Islamic financial products

1. Introduction

The geography of the Islamic financial business covers more than 50 countries, including countries of Europe, CIS, USA, Australia, etc, where more than 300 Islamic financial institutions operate nowadays. Their total assets exceed \$ 1 trln. with the annual growth rate of 10-15 % (Bekkin, 2009).

Islamic financial institutions are part of the modern world economy and subject to the same economic laws as traditional (non-Islamic) financial market participants. In practice, the role of Islamic finance is increasing every year. Consider some of the reasons causing this phenomenon (Srebnik, 2010).

First, in many countries there has been a rapid growth of the Muslim population. The Muslim community in Europe is becoming every year more and more to be taken into account by politicians as well as economists.

Secondly, there is currently a growing interest in Halal (allowed) financial products is observed among non-Muslims. Investments of European banks in sukuk (Islamic securities) aroused interest among private investors who would like to take into account ethical and/or religious aspects in their investment decisions. Choosing the Sharia-

compliant products, they can be sure they don't invest in unethical from the point of view of the religion industry. This can be important also for Christians and Jews: they can be assured that prohibited interest is excluded.

Thirdly, there is a wave of issuing licenses and permits, which allows you to start providing retail banking (mortgages, insurance and loans) in accordance with the Shariah. European governments changed their policy, they now calls to pay more attention to the needs of Muslim communities in Europe. The authorities have begun to respond to these needs that were not taken into account. The fear of alienating a significant part of European society and the threat of the destruction of stability has played a great role in the process of changing the official position.

Fourth, government officials and traditional banks saw in Islamic banking and finance promising business opportunity, and not a "handout" of ethnic minorities. In addition, a large number of professional investors want to include Islamic financial products in their portfolio for diversification purposes.

2. Restrictions in Islamic economic model

The Islamic economic model is primarily intended to optimize the operation of each party's financial processes. To improve the effectiveness and addressing inequities in economic relations provide the main types of constraints (Semenova, 2009):

1. The ban on usury. *Rhiba* (the surplus) is any unjustified increase of capital in the loan. Any transaction, which depends only on the term and amount of the deposit and not depends on the success of investments is prohibited because of *riba*. Thus, *riba* covers not only usury, but any interest in the usual traditional sense. The prohibition of *riba* is associated with the Islamic view on social justice, equality and property rights (Paldi, 2014). Islam encourages profits only as a result of activities, leading to the formation of any final product, condemning the use of percent in profit.

2. Division of profit, loss or risk. Due to the prohibition of interest, capital owner is not a lender but investor. Thus, there is risk sharing between the owner of capital and the user of capital, as there is no guarantee of regular income. However, in case of success of the project, the investor participates in the direct distribution of profits.

3. Money as "potential" capital. The money will become capital only if it is invested in some business.

4. Prohibition of speculative behaviour. Operations based on the random event or speculation (in Arabic known as "*maysir*") and not on the action of the parties aimed on generating income are considered to be invalid in Shariah. In this regard, in the Islamic financial system it is extremely complicated to use the derivative financial instruments which have significant risk level. The most of derivatives has no supposed delivery of real base asset, leading to the rapid development of speculation in the financial market. Buying shares with a relatively short holding period (exchange game) can be also attributed to speculation.

5. Sanctity of contract. The indefeasibility condition of the contract is the most important condition of the transaction.

6. Prohibition of uncertainty (*gharar*). When entering into a contractual relationship, the parties must fully disclose their intentions and information to each other, because the transaction that contains *gharar* will be prohibited. Any transaction where the subject of the transaction, the price or both are not defined and not fixed in advance will be considered suspicious by the Shariah. Islam condemns obtaining unilateral advantages by more informed party of the contract.

7. The ban on investments violating public interest. Investments inherently must comply with the principles of Shariah. Operations associated with certain types of products are prohibited; such products include pork, alcohol, arms, gambling and traditional fixed-income financial products. Islamic institutions can (depending on the views of the Shariah Council) to face challenges when investing in such activities as hospitality and entertainment industry. Also, the institutes have a black list of prohibited investments composed by the Shariah Council.

The mechanism of Islamic capital market is somewhat different from the well-known capital market. Economic agents are guided not only by legal norms laid down in the legislation of the country, but also the rules prescribed in the Holy Scripture, the Quran.

The transaction under Sharia law must meet six basic principles (Lepeshkina, 2013):

1. the interest is prohibited ("*riba*");
2. the risk should be shared;
3. the speculative behaviour is prohibited ("*maysir*");

Download English Version:

<https://daneshyari.com/en/article/981189>

Download Persian Version:

<https://daneshyari.com/article/981189>

[Daneshyari.com](https://daneshyari.com)