

Examination of Islamic Banking and its Challenges in Iran

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Abstract: In Islamic banking, no interest is taken since in interest the acquisition of money is through money not doing business and that is why it is also referred to as exploitation. Defending Islamic banking which is not only due to claims and religious feelings has various economic reasons in which the financial system based on participation in profit and loss leads to better accumulation of savings and use of banking financial sources in the best applications and thus leads to just distribution of income and fortification of the participation spirit among money owners and savers. While otherwise, there would be a negativist spirit. The success of Islamic banks in doing their role is somehow depended on their healthy cores of managers and their activities and their success in helping growth is due to the three following conditions: changing and improvement of methods and tools of financial providing for clearing any doubts about their Islamic nature, increase of effectiveness in absorbing financial sources and their use, increase of their role and share in the trend of social and economic growth. In this study, we examine the various Islamic banking contracts and their features and challenges

Key words: Islamic banking, economic growth, borrowers, interest, accumulation

INTRODUCTION

Islamic banks during one quarter of a century or perhaps more, in Islamic countries have accumulated the savings of those who due to their beliefs on illegitimacy of interest have avoided interaction with conventional banks. In Islamic banking not only receiving interest is forbidden (illegal interest namely) but also bonds, periodical contracts and certain banking deeds as prevalent in the West and namely in American banks do not exist. Also, based on rules of Islamic banking a person cannot exchange something that does not yet exist or doesn't own. This is a factor which based on some experts, reduces the chance of collapse of 'domino' like banks like what happened in the financial crisis in American and European banks. In addition, it should be noted that the relation of Islamic banks in trade and exchanges with other banking systems is relatively limited. Instead, these banks provide the interest for their survival from participating contracts in a way that they enter into a project as a partner and gain a share of the interest (Almaghrebi, 2010). Of course, if the projects fail, the banks' assets will also be lost. These banks use the new tools for providing finances based on Islamic contracts like murabaha, lease, participation, etc. regarding dependence on sources of society's savings, there is no difference between traditional banking in other countries and banking without interest but what distinguishes them is their nature and form. Basically, behavioral methods form in the framework of legal relations that occur between the bank and clients.

However, those types of banking operations that have similar rules and regulations whether in Islamic or otherwise environment shouldn't be different from each other since those behaviors or legal relations between the bank and clients that are not in contrast with Islamic rules are accepted in Islamic environment as well. Today, in all over the world it is talked about micro finance and efforts are done to match the banks' expectations (regarding guarantee) and financial needs of projects and small workshops (Komijani, 1993).

MATERIALS AND METHODS

Recently traditional banks have tend to the domain of small projects' financial fulfillment, however, with extreme caution and help of insurance companies and those for guarantying investment and also with care in definition of small projects to reduce the risks of financial providing but this has a long distance with what Islamic banks have done in this regard and there is still much opportunity for Islamic banks to play a bigger and more active role by use of financial tools based on participation in loss and profit.

Features of Islamic banks: Prohibition of payment or receipt of a fixed or advance amount of interest rate. The substitute of this is participation in loss and profits and thus, the interest rate can only be certain that real profits are gained in the contract (Anonymous, 2003). Necessity of doing banking operations in the form of Islamic financial ways. These ways affect both assets and bank's responsibility and can be divided into two groups:

- Those based on participation in profit and loss
- Those otherwise which gives a certain percent of the properties of the contract to the person

Investment savings: These accounts are not assured regarding the value of investment, the fixed interest rate and their losses and profits are divided based on the contract between bank and clients.

Ready savings: Some accounts are insured reading the value of capital but no extra amount is paid for them which is a reason why the value of investment is guaranteed. It is based on the supposition that these accounts are given as safekeeping and thus, they belong to the safe keeper at any time.

Without a doubt, we should note that in some systems (including Iran), what causes their readiness is not safekeeping but the nature of the contract which is on one hand, in debt of what it has taken and on the other hand the bank is obliged to reimburse of what it has taken and should refund once the client demands. Since, if it is safekeeping and the property is gone without bank's violation or excess, there is no responsibility on the bank. While in the borrowing contract, the indebted is in any way obliged to refund the property of the loan.

Types of contracts in Islamic banking: Mudaraba (local trade, export-import), civil participation (trading, productions, exports, housing and construction), loan based sales (raw materials, machinery, housing), self, lease in condition of ownership, loan (marriage, house repair, allowance for medicines, allowance for education), reward.

Mudaraba: A contract based on which one party as owner (bank) undertakes the investment providing (cash) with the condition that the other party trade with it and the gained profits be shared by both parties.

Civil participation: Combination of cash shares or non-cash belonging to various real or legal persons uncommon for the purpose of profiting based on the contract. Loan based sales (raw materials, machinery, housing). Assignment of the same property to a certain price in a way that all or part of the value is received in equal or unequal payments at certain deadlines.

Self: A contract based on which the bank buys the productions of a client and pays the price in cash and receives the goods in future.

Loan: A contract based on which the bank (as the loan giver) assigns a certain amount to people (as loan receivers) in specific conditions.

Reward: It means the obligation of person (forger or employer) in payment of a sum or certain forging in exchange for a certain job as in contract. Banks can proceed to do this for creating the needed facilities for growth of producing affairs of trades and services with concluding a contract as the agent.

Lease in condition of ownership: A lease contract in which it is stipulated that the client (tenant) in case of doing the mentioned acts will own the property at the end of the deadline.

Islamic banking in Iran and its challenges

lack of profit investment opportunities: The main problem of Islamic banking is lack of profit investment opportunities. Since, it is based on participation for financial fulfillment of projects and if the projects won't result in profits, not only the Islamic Bank won't get any profit but it also loses part or all of its investment if the project fails and there is no legal court for refunding that. Some have regarded Islamic banking as investment companies, since they won't insure the main capital and interest of savings and at the same time have accepted that in structural and formal views, there are many differences between Islamic banks and investment companies.

Mixture of civil and trading rights: It is a long time that in the wide law world, the trading and civil rights are separated and their points and requirements need certain proper regulations. The necessity of speed, care and security in trading needs certain tools for engaging in this domain which could not be easily drawn from the methods that civil rights suggest. Thus, the trade rights units while being simple and accessible provide the precision and security needed for merchants. Trading trends also play a principal role in trading relations. It is prevalent to say that the goal of civil rights is protection of the wealth and goal of trading rights is facilitation of wealth flow. Thus, the tools used in these two domains should be different. This is more felt in the area of banking rights and issues, since engagement of banks in complex and difficult civil issues, prevents them from their main tasks. An issue that has been hidden from the law compilers and among the contracts in the civil rights which each have their own complexities was used for banking operations.

Non-conformity of the contract from the parties' intention in the contracts mentioned in laws: In the financial and credit relations of the bank with clients, they refer to the bank for gaining loan or reimbursement of the original sum and that is the supposition of its relations and the bank

and the contracts of banking operations without interest is a tool for gaining the goal and it is not clear that either in this supposition, we can regard these contracts right lawfully? Since, regarding the Islamic laws this contract is an example that in its wrongness there is no doubt and this goes to another important issue and that is whether the contract conforms to the real will of the parties or their seeming will? And if the judge gains the real intention of the parties in conclusion of the contract and the real and seeming wills are different, can we still impose the effects of the seeming will over the contract? Unfortunately, the contracts of banking operations law without interest have led to the formality of the relations and contracts between the parties. Some in this case based on certain reasons believe on the formality of banking contracts. These reasons are:

- Lacking intention
- Determining a fixed interest
- Guaranteeing the original investment of the bank by client contrary to the nature of the company's contract which includes participation in profit and loss
- Receiving a pledge and guarantee with the explanation that contracts like *mudaraba* and participation are based on safekeeping and doing such in contracts that are based on safekeeping is contrary to legal and jurisprudence regulations (Golriz and Mayedi, 1998)
- Lack of bank's supervision on the performance of the partner in contracts like *mudaraba* and participation
- Obiging the *mudaraba* and participation (naturally are permitted contracts) with stipulation of statements in the contract or adherence to the peace contract
- Forceability of banking contracts that without any reason place the bank superior to the client

The fact is that the bank's duty is responding to loan requests not demanding partnership or sales. The problem of someone who refers to bank is lack of liquidity not lack of partner or seller. However, since our banking law doesn't permit commercial loan the applicant is practically forced to change the form of his request and hide his real intention (Collection of Article of 15th Islamic banking conference in 2010, the experience of two decades of Islamic banking and its challenges, theoretical, structural and operational aspects and compilation, Seyed Mohamad Tabibian in 2004 September, high banking institute of Iran).

Violatin of the prevalent concepts and definitions in banking: The other main flaw is that in this banking type, we have breached the standard and prevalent definitions

and concepts of banking system, since bank is a financial and credit institute that is the intermediary of sums and by keeping people's accounts and savings, fulfills the credit needs of them. Thus, bank is not an economic trading to be directly involved in economic and commercial issues but it's a monetary unit and an expertise that is founded for reaching its certain goals and like any other specialized unit, it should be faithful to its subject and goal and doesn't leave out of its global standard framework (Collection of articles and speeches of 9th Islamic banking conference in 1998).

The difference between Islamic and traditional banking and the reasons of their superiority: The thought that defending Islamic banking is merely due to religious beliefs and claims is wrong. Since, there are many economic reasons that a financial system based on participation in profit and loss leads to better accumulation of savings and use of financial sources in best possible applications and thus, leads to just distribution of income and fortification of the participation spirit among money owners and savers. While in otherwise, there is a negativist spirit.

RESULTS AND DISCUSSION

The facilities and capacity of Islamic banks for participation in developments: Islamic banks have more ability in absorbing investable cash sums, since they are based on participation: Regarding this hypothesis, it is necessary to point to some studies that show the changes of interest rates have no effect on the total volume of saving. Overall, those groups of economic studies that attended to the relation between changes of real interest rate and saving in developing countries show that this relation is either very weak or most of the times insignificant. But, regarding Islamic banks, the 'participation' tool shows that contrary to other banks, it is not an intermediary of savers and investors as separate groups of one another but it's an intermediary institute between the owners of extra sums (who are willing to invest based on participation) and merchants who need financial providing for setting and continuing their projects (based on participation too). While savers in traditional banks expect to receive interest, investing savers expect the reward and feedback of their invested sums and investment feedback is an 'interest' that is gained after investment. Thus, that is an income that is directly related with productive work and might be more or less. Thus, it is logical that people who want investing their extra sums, find stronger motives by expecting higher interests. However, this issue is not realized in

interest system, since in traditional banks there are many limitations for increase of interest rate including limits that the central bank imposes for realizing huge economic goals or limits made by trading banks following credit policies and ability to solvency. Thus, rates of interest in participation change with more flexibility compared with financial fulfillment conditions (with interest) and thus, there is more capacity for absorption of savings for investment in the Islamic banking system. New banking experiences in the west have also proved that systems of financial fulfillment based on risk spread more than systems based on interest. As experiences of financial markets in various countries show, successful participation companies based on divided interest have been able to absorb the savings of people for fulfilling their financial needs very well through distribution of shares.

Islamic bank has more ability to allocation of monetary sources to the best applications related with goals of social and economic growth: What is prevalent among people is that the interest system like a filter clears the ineffective projects and only supports those that have high feedbacks and thus the ability to refund the interest payment. Thus, first projects can gain the highest bank loans and are followed by less-promising projects. However, projects with low refund rate that have a lower feedback rate than the interest rate can't access bank sources and this is true regarding the final effectiveness theory in investment. It means, if the expected interest rate during the age of investment project is less than the determined interest rate, there will be no tendency to getting a loan from the bank.

Islamic Bank by allocation of monetary sources based on economic effectiveness and production directly affects the just distribution of national income while the growth as well but the issue of justice in economic growth is not attended by traditional banks.

Regarding the third hypothesis it is obvious to everyone that financial fulfillment from the banking system has gained a certain position among various types of financial fulfillment. It is also obvious that anyone who gains more financial sources will find more opportunities for increase of income and vice versa. From here, we can estimate the serious effect of unjust distribution of banking financial sources on the structure of national income distribution in any society.

Contrary to traditional banks, Islamic banks persuade positive behaviors that stimulate the growth trend: it is proved that the interest system due to persuasion of

negativist behaviors (and thus unjust distribution of national income to the benefit of lazy, passive and negative people and to the disadvantage of active, dynamic and risk-taking people who bear the fatigue of production) has a bad role (Moraghebi, 2008). The interest system from the beginning in late middle ages in Europe has caused the increase of those who without any hardships involved in producing activities and only by lending (lease) of their money, gain income and thus the income of producing activities is divided unjustly between the owners of cash (which is not clear whether they are the results of saving, heritage, legal or illegal) and those who work and produce and are involved in the increase of real wealth of the society, however, Islam and banking system based on participation doesn't accept this type of income distribution.

Tools of financial providing in Islamic banking and the necessity of its change: The activities of Islamic banks have disturbed the wall of traditional banks' activities and by new tools and methods (relative to banking based on interest) have been able to involve a wide group of savers and investors into the circle of banking activities. While, this group had no share in banking activities before. Those are mostly people who avoid deeds based on interest and have no reason to open account in traditional banks (especially, when their savings are medium or small). However, traditional banks don't concern about this group but Islamic banks persuade them to saving and investments. The fact is that no one can doubt about the rapid growth of financial sources of Islamic banks that are provided by this group (who are the owners of small and medium accounts and people who refrain from deeds based on interest). Also, Islamic banks have provided the opportunity for financial fulfillment of owners of small projects that in all over the world are usually depended on personal, familial and helps of friends with savings and in case of any problem would inevitably end up in the market of non-official and illegal interest giving, a market which in specialized studies its management is called borrowing snakes and often its rates are unbearable. Thus, even if some believe the non-efficiency of Islamic banks, they can't deny this important role of them. Maybe the most successful experiences of financial fulfillment of small investment projects belong to the Islamic bank of Feisal in Omdarman branch and Jirmin Bank, though there are successful cases in Indonesia, Bangladesh, Malaysia, Egypt and Jordan but Islamic banks for realization of their goals have a long way to go. The success of these banks in helping growth is due to the three following conditions:

- Changing and improvement of methods and tools of financial providing for clearing any doubts about their Islamic nature

- Increase of effectiveness in absorbing financial sources and their use
- Increase of their role and share in the trend of social and economic growth

Also success of Islamic banks in doing their role depends on two aspects on healthy cores of their managers and activities: adherence to Islamic Sharia and its goals in all contracts and efforts for the maximum effectiveness in jobs. When the required efficiency was obtained and success and high profits (in case of avoiding interest) based on loss and profit were realized, no one can doubt the economic justifiability of these banks and when this success is realized based on healthy Sharia rules, those who don't fear contracts with explicit illegal interest, won't criticize these banks that they are also acting based on illegal interest. Finally for success of Islamic banks in doing their role, there is need for preparing the grounds and public efforts in small and huge terms in which people try to revive the Islamic Sharia without exaggeration and excess, a ground in which regarding the knowing of Islamic culture and understanding its beliefs, especially in living area, gradual evolution could be possible. A ground in which legislators and central banks do the necessary supports for fighting interest so that those dealing with interest won't be preferred. A ground in which training and educational units help Islamic banks in the area of effective human forces' needs.

CONCLUSION

Among The features of Islamic banks, we can mention the following: prohibition of payment and receipt

of a fixed or pre-determined amount, necessity of doing banking operations in the form of Islamic financial methods, ready accounts, investment accounts

The challenges of Islamic banking are as the following: lack of beneficiary investment opportunities, mixture of civil and trade laws, non-conformity of the contract from parties' intentions in the contracts mentioned in laws, violation of definitions and concepts prevalent in banking.

By studying the banking system we notice that the banking system of the country is among two items: 1-what we see in today's banking system and is actualizing is exactly based on the Islamic rules of Sharia, there is no sign of Islamic banking in the banking system in the country and there is much distance and many voids until reaching the ideal form and perfect level of banking.

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