# Islamic Banking and Financial Development

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Islamic banking is a departure from traditional banking and represents a change in financial development of the country in which it is practised. This corresponds with the accepted definition of financial development as relating, inter alia, to "...changes in financial structure over shorter or longer periods of time." (Goldsmith, 1969, 37).

Khatkhate and Riechel consider "...financial development as a generic term that embraces structural, functional, instrumental and process-related aspects of a financial system.."(1980, 478). The introduction of Islamic banking normally features all of these aspects.

To examine Islamic banks solely in terms of whether or not their introduction can be defined as financial development is of course an idle exercise. What makes the exercise worthwhile is to expand the analysis to a consideration of the link between financial development and economic development. The relationship of economic growth to financial development is universally recognised by development economists.

Whilst the introduction of Islamic banking creates an interesting environment for economists to study, there remains the burning issues of development. Banks have an major role to play.

The financing of local development is something that banks in LDCs should be involved in whether they be Islamic banks or otherwise. This paper considers these issue within the context of the intruduction of an Islamic mode od banking operations.

Leaving aside the controversy over whether financial development is supply lead demand following (as it is outside the scope the scope od this paper), the evidence shows that finacial development in the countries where Islamic banking is practiced was the result of both. In the Arab and Gulf countries it was largely in the nature of demand following paricularly in the wake of the accumulation of surplus liquidity as a result of the boom in oil prices in the seventies. By the end of 1980 the banks in the Gulf region (mostly Bahrain) held assets of over US$336 billion up from only $23 bilion in 1978 (Levi, 1983). At the other end if the scale there are contries like Pakistan, Sudan and Egypt where financial development was more in the nature of supply leading, as the financial institutions were established first and then through a network of branches, stimulated savers and investors. Further expansion of these institutions may be thought of as demand following as additional branches were opened in response to need. In Pakistan a specific feature of demand creating growth in institutions, was the heavy demand for rural banking as a result of large remittances from Pakistani workers abroad.

Commercial banks are viewed as the most important financial institutions in LDCs (Drake, 1980). They play a significant role in monetization of developing economies. Other financial intermediaries play a role, but the provision of chequing facilities by commercial banks has increased the significance of their role. Successful financial development depends largely upon how well financial institutions mobilise savings and channel them into productive investment. In the case of traditional banking, interest rates play an important role in tapping savings. In Islamic banking, however, the case is different, as no indentified or predetermined rate of return is guaranteed. Depositors take the risk of losing part or even the whole of their deposits, although this risk exists whatever the from of financial institution.

## MOBILISATION OF SAVINGS

Most economists view a definite relationship between the behaviour of savings and positive real rates of interest. In the words of Pryor, "... the simple story is that if there is no interest rate, aggregate savings would fall." (1985, 208). However, Islamic economists take a different stance.

"Savings is largely a function of income and consumption patterns and the urge to make a profit is not the only, nor even the major, motive for savings" (Siddiqui, 1983, 93). The implication of Siddiqui's writing is that religious beliefs also have an influence on savings behaviour in Islamic countries. If this is so, economic planners need to pay attention to the availability of an "Islamic option" within the banking system.

As regards its attitude towars banking, the Muslim population can be regarded as being composed of three broad categoreis. First, a category that considers interest to be totally prohibited in Islam.

Their dealing with banks operating on the basis of interest would be a violation of Shari'ah, hence amounting to a sin. They avoid keeping their savings in banks, preferring to keep them either in the from of liquid cash or precious metals, jewellery and real estate. It has been observed that "the demand for precious metals and stones may be stronger in Islamic countries than elsewhere because orthodox Islam, which forbids the acceptance of interest, may discourage the holding of many types of financial assets. "(Drake, 1980, 127). This segment of the population will only consider saving through an Islamic bank (Bruce, 1983, 142).

Secondly, there is that section of the population which accepts that the teaching of Islam forbid interest but continues to keep its saving in traditional banks for safety and because they have no alternative. Howeer, they either do not take interest from the banks or after receiving it distribute it amongst the poor and needy. This latter approach has been suggested by Maudoodi, who considers that to leave the interest with the banks means strengthening the hands of "exploiters" (Maudoodi, 1983, 435). The amount of unclaimed interest by Muslims around the world may be significant. In the case of Malaysia the amount runs into millions of Malaysian dollars a year (Bruce, 1983).

The third category of the population comprises those who are Muslims but do not consider the present form of banking altogether un-Islamic or are willing to accept the income so earned for their personal use. Accordingly, they can be regarded as having profitability as a criterion for keeping their deposits in a bank.

The real task before the Islamic banks has been one of building up the confidence of the first two categories who accept the teachings of Islam with regard to interest. The banks have to show that funds will be employed strictly in accordance with Islamic principles. This seems to be the reason why most Islamic banks have in-house religious advisors who examine investment projects from the Shari'ah point of view before aproval for funding. With regard to our first category of the population "a pre-condition, however, for any change of behaviour from hoarding and 'real assets' savings to 'financial savings' was the creation of financial institutions which would not violate the religious principles of large segments of the population." (Scharf, 1983, 79). The phenomenal increase in the deposits of various Islamic bank, particularly in Sudan and Egypt indicate that these banks have successfully demonstrated their integrity and exploited opportunities to expand the banking system.

However, there still remains considerable scope to integrate our first two categories of society more fully into the process of capital formation and overall economic development. The majority of those who accept the teachings of Islam, with respect to interest, live in rural areas where the banks do not have complete access. Islamic banks can increase significantly their sphere of activity by expanding their branch network in rural areas.

Expanding the network of branches and assuring the populatin that their deposits will be utilized in accordance with Shari'ah is unlikely to be sufficient for the successful operation and development of Islamic bank. The problem of risk and return enters the debate. Islamic banks offer permitted returns to Muslims provided they accept the possibility of incurring losses, even though this possibility is generally notional. However, as Islamic banks are in a formative phase of their life, continuous losses at this stage would threaten their ability to grow. The experience of Islamic banks so far shows that they are quite mindful of this aspect. This may be the main reason for investing so heavily in Murabaha and other trade related activities. Real estate is also seen as a safe investment. Since presently the Islamic banks are not well versed in the techniques of project appraisal, they tend to avoid more complex projects. But this policy cannot be continued unabated. To meet the long term development objectives of Muslim countries the banks will be required to finance development projects. It is therefore imperative that these banks acquire skills in projects appraisal to facilitate the financing of viable projects whilst minimising risk to their depositors. Islamic banks also need to be more mindful of diversification and portfolio risk reduction. These points will be returned to in the section below.

Additionally, Islamic banks should more seriously consider the establishment of loss-compensating reserves. Islamic banks are generally distributing profits at a rate much higher than comparable interest rates offered by conventional banks within the same country (Tahir, 1986). Instead of operating with high payout ratios the banks should consider making larger transfers to loss-compensating reserves which will come into use in the eventuality of overall losses.

Regarding the third category of the Muslim population who use traditional banks and accept the interst, we have already suggested that profitability and high rates of return are sought by such savers. As such Islamic banks are obliged to compete with the traditonal banks for their savings. This makes the task of Islamic banks all that more difficult when the are newly established, working in competitive or even hostile conditions and at the same time limited in the scope of their investment strategies.

## INVESTMENT OF FUNDS

Trading activities and real estate business have claimed a major share of the investible fund of Islamic banks. Such an investment pattern is unlikely to meet the development needs of poor Muslim countries. However, in view of the limitations within which they operate, such investment patterns appear to be inevitable. Lack of experience in investment and competition from traditional banks has meant that newly formed Islamic banks have faced a dilemma. High risk investment could lead to failure, not merely of a bank or a banking system, but of an ideology. The banks were thus extremely cautious in their operations. They selected sectors which were comparatively easy to evaluate and which involved little risk.

In Gulf states we can observe heavy investment in real estate. Such an investment strategy can be viewed as acceptable as the emphasis in development of these states is on building infrastructure or housing complexes. But if we consider countries like Pakistan, we can see a clear need for investment to be directed towards generating productive economic initiatives. Yet over 85% of the Islamic bank invesment is in Murabaha and other trade related low risk activities. This is not entirely the fault of the banks: "most companies do not want to share profits and most banks do not want to risk sharing losses in businesses they cant control". (Financial Times Survey of Pakistan Banking 7 October 1986). There is a reluctance to divulge financial statements which are a necessary part of direct investment on a profit and loss making basis by the banks.

Pakistani banks also tend to resist investing directly because of the fall-back guarantees they offer depositers even if losses are incurred (being contrary to Islamic principles this has come under severe criticism from orthodox thinkers). Both the banks, as well as the borrowers, are hesitant to enter a deal because of these difficulties. As a result, the banks have accumulated an unusually high level of liquidity during the first six months of Islamic banking experience in Pakistan (Aftab, 1986).

Whilst Islamic banks have invested certain funds in Modaraba, this mode of Islamic financing has yet to play its role as a reliable base for the economic and sosial development of Muslim countries. Modaraba may well prove to be the most stimulating form of investment as it permits talented entrepreneurs to enter business without a need to supply their own capital. It is also the most risky form of investment from the point of view of the bank. In Modaraba the entrepreneur does not share losses in financial terms, but may lose the reward for skill and effort in the event of a trading loss. A more flexible approach to the acceptance of borrowers under a wider range of Islamic investment models, including Modaraba, si required to face the challenges of development.

Islamic banks are evidently attempting to integrate the roles of commercial and development banks. The need for development banks arises when traditional commercial banks fail to respond to the needs of particular sectors or geographical regions. Islamic banks can assist in this respect, particulary by attempting to integrate the enormous rural populations of Muslim countries into the development process. This can be achieved for example by promoting venture capital, cottage industry, handicrafts and other small rural based industries. By working on these lines the Islamic banks can more fully meet their objectives as financial institutions with a social purpose. Attention to those sectors which do not receive adequate support from traditional banks is seen as an important feature of Islamic banking. For example the Nasser Social bank of Egypt has operated a scheme which has provided finance to independent taxi owner-drivers helping large numbers of taxi drivers to own their cabs (Euromoney, November 1981).

Islamic banks more easily fit the role of development banks, as the range of Islamic financial instrument enable them to become directly involved in investment activity. Where it is evident that entrepreneurs are reluctant to enter into Modaraba or Musharika contracts, the banks can themselves bridge the gap through their own subsidiaries, or other organisational or structural·framework, to cope with this activity. An example of this is the Pakistani Bankers' Equity formed in 1979. Being the first registered Modaraba company, this organisation provides finance for industrial projects as well as arranging the flotation of separate Modaraba. Other Islamic banks in the Gulf have also established subsidiary investment and holding companies. The most prominent amongst these in the Dar Al Mal Al Islami which has been active in number of areas including setting up insurance operations which comply with Islamic restrictions on insurance schemes (Scharf, 1983, 82).

The role of the public sector also requires consideration in this context. The question to be addressed is whether Islamic banking encourages government intervention in the financial market. Certainly in countries like Pakistan, where Islamic banking is being promoted as a state policy, such intervention is much more evident.
If the private sector is reluctant to become involved with Islamic financing schemes offered by the banks,
it seems inevitable that the government itself takes responsibility to undertake large industrial and aqricultural projects on the basis of equity participation with the banks. Where governments do not wish to make long term commitments to the management of such enterprises their involvement can be viewed as short term, with eventual sale to the private sector. Such an approach could be a succesful means of estabilishing large scale Islamic bank financial where there is a relutance of the private sector to participate initially. However, there is little evidence to suggest that this is likely to be a successful strategy.

## AGRICULTURAL CREDIT

The significance of agricultural credit for the development of the rural sector can hardly be overemphasised. It can be used to achieve, inter alia, two primary goals: first to improve the lot of small farmers by reducing the growth of their borrowing; and seccondly the cost of modernising cultivation techniques (Eshag, 1983, 127). But provision of agricultural credit for the rural sector has long been a problem for developing Countries. A major and perpetualproblem has been the misuse of agricultural credit of consumption rather than productive purposes. Islamic banks can attempt to overcome this by advancing interest free loans to needy farmers for consumption purposes in accordance with the Islamic principle that those in genuine need be provided with such loans. For productive purposes the Islamic banks can provide credit in kind for seeds, fertilizers, pesticides, tractors etc. Functionally the banks can conveniently provide this service as they are well experienced in trade financing under the Murabaha schemes. There are also opportunities for the banks to become involved in the financing of agricultural marketing operations. After conversions to an interest free basis the Agricultural Develpment Bank in Pakistan has already started operations along these lines.

## SECURITIES AND BOND MARKETS

One major problem for Islamic banks is how to deal with long-term and short-term financial instruments, bonds, debentures and equity securities of both government and private sectors. Governments and commercial banks through various of these instrument and commercial banks invest heavily in them as well as private sector securities. If the banks invest only in equity based securities, their sphere of activity must be limited. Islamic banks functioning in Gulf and other Arab countries have comparatively larger manoeuverabilities and are avoiding investment in interest bearing securities and bonds. Traditional banks also function in that region and are meeting the reguirements in so far as these instruments are concerned. But in Pakistan, where interest has been eliminated from banking, no alternative has yet been adopted.. The commercial banks are dealing with these instruments and the Government is still borrowing agains them. Even in 1986 after the complete switch over to interest free banking, the Government of Pakistan released three kinds of interest bearing bonds (Daily Dawn, Karachi, 11.2.1986). Islamic economists have yet to resolve this issue. Kahf (1978) concedes that there is no room for a bond market in an Islamic economy. To meet public debt requirements the suggests that the government raise additional taxes from the affluent or obtain complusory loans. This is unlikely to slove the needs of developing Muslim countries as the wealthy are subject to conventional taxes as well as Islamic Zakat taxes. Siddiqui (1981) suggests that to meet the public sector debt requirement, goverments can issue loan certificates. These certificates would not be interest bearing but would entitle holders to income tax concessions. However he does not elabotate on the linkage between the level of tax concessions and the amount of the loan.

If this was predetermined it could be construed as another form of interest. Rosa (1986) has also considered the amplication for Islamic banking of the operation of bond markets. He categorizes Islamic financial policies into : (i) discriminatory, consisting of simultaneously instituting new forms of equity finance while banning most forms of bond finance; and (ii) non-discriminatory, consisting of the introduction of new forms of equity financing only, with no changes made to the exisiting forms of bond financing. He is of the view that discriminatory policies will seriously curtail bond activity and hence domestic resource mobilisation.

Karsten (1982) suggests that lending to goverment for income yielding project can be based on a profit or loss sharing basis in accordance with Islamic principles. For other categories of goverment borrowing, he suggests that bonds be issued with a return tied to the annual rate of nominal GDP growth. He admits that this is a very rough proxy for return on capital but, as these bonds potentially offer positive real rates of return, they may induce savings. This is a novel suggestion but as yet there is no evidence of any government putting it into practice.

The whole area of government and bond financing is currently under review in Pakistan at present but, so far no clear strategy has emerged. The structure of bond financing both in the public and private sector needs resolving in the context of Islamic banking, as failure to deal with it may have an adverse effect on financial development. If this area can be resolved there are bright prospects for secondary market activity in bonds, as well as in equities, in Islamic countries where capital markets are seen as playing an increasingly important role (Kitchen, 1986, 144).

From the above we can observe that financial development is taking place in a technical sense. We can also observe that there is tremendous scope within the system to permit greater flexibility in banking with the possibility of more rapid economic development taking place. There are at present many unresolved issues and the emergence of conservation investment practices which can hinder this development. We move on now to consider the future of Islamic **banking.**

## FUTURE PROSPECTS FOR ISLAMIC BANKS

The Islamic banking movement as we know it today is a recent phenomenon, perhaps about ten years old. Pakistan's complete switch over was achieved only in 1985. Obviously such a short span of time is inadequate to warrant any realistic assessment and prediction of future developments. Nevertheless, the expansion of the movement both in terms of numbers of banks and in size of operations has attracted much attention with several writers expressing opinions on likely future developments.

Scharf (1983) is quite optimistic about the future. She considers that the establishment of Islamic financial institutions throughout the Muslim world has proven that banking according to the Shari'ah is not only feasible, but also profitable. Whilst there are tremendous apportunities for developing the movement, it remains to be seen how the Islamic banks exploit them. She considers that they could easily concentrate on specific groups of enterpreneurs such as small and medium sized innovative enterprises. This group often has difficulties in mobilising funds for innovation and expansion, due to lack of security and international market connections to sell their products. She also puts forward the novel idea that Islamic banks should expand their sphere of activity to the industrialised countries of the North because, even though loan capital is available to entrepreneurs in the North, this is at high fixed rates of interest. Since even medium scale entrepreneurs find it difficult to raise sufficient risk capital, this has acted as a brake on productivity and economic growth in these countries. Greater economic activity in the North will have a spin-off effect on developing nations.

Abdeen and Shook (1984) also view the future of Islamic banks promisingly, de spite the fact that they are operating in a limited sphere and that Shari'ah restricts their financial and business practices. They consider that the phenomenal growth in assets and deposits recorded by Islamic banks in recent years is an indicator of the tremendous opportunities in this field. But they feel that continued expansion depends on the ability of management to cope with the complexities of modern banking and particularly their ability to handle investment and long term strategic issues.

Karsten (1982) adopts a cautious approach in assessing the future as detailed information on their performance to date is limited. Whilst generally optimistic, he is somewhat sceptical about countries making a complete switch to interest-free banking whilst there are so many unresolved issues, particularly the question of how to determine the reward for short-term financing.

Since these observations have been made, the Islamic banking movement has continued to grow. There are currently 60 Islamic banks operating at a national level in various countries and eight operating on an international basis (Ahmad, 1987b). Most notable amongst the international operators is the Islamic Development Bank operating as a large scale provider of funds for economic development throughout the Islamic world and the Dar Al Mal Al Islami referred to above. This has led conventional banks, both within and outside the Muslim wordl, to seriously consider the challenge posed by this growth. In a recent survey of Islamic banking, South magazine reported that "Islamic banking - as the system is widely known - was first ridiculed in the West as a 'fundamentalist phenomenon', then just tolerated. Now, after careful scrutiny, it is being adopted in Wstern financial institutions and other interest based commercial banks in the Muslim world. Islamic bankers have survived the credibility crisis and are no longer basking in the glory of divine revelation. With US$15 billion worldwide under their control, they are pragmatic and scientific" (South, November, 1986).

Whilst the growth of the Islamic financial system, is a challenge to Western interest based banks, the adoption of Islamic financial modes by Western banks is also a challenge to the Islamic banks. Traditional banking has huge resources, wider opportunitites, better skilled and trained staff. If they enter into competition, the Islamic banks will struggle to withstand that challenge. So far the Islamic banks have something of a monopoly, and if there is any competition it is amongs themselves. Devoutly religious Muslims are likely to consider only Islamic banks for banking service. But if they understand that other banks are also following the 'Shari'ah injunctions in banking, they are likely to seek the bank that provides better facilities and gives good return on their deposits. Western and other foreign banks and financial institutions are fully capable of exploting the available opportunities and reporting better profits. This has happened in Pakistan where the rate of return on deposits in local Pakistani banks is declining relative to the returns paid bay foreign bank branches.

In these circumstances it become imperative for the Islamic banks to expand their activity in areas where traditional banks have not been inclined to go, or where they do not intend to enter. Rural banking has already been identified as one such area where there is scope for expansion. Besides providing a full range of normal banking facilities, cottage and handicraft industries and small-scale farmers can be encouraged to seek finance from Islamic financial institutions. The banks must also grasp the opportunities offered by the Modaraba and Musharika modes of finance and become directly involved in the financing of industrial, commercial and agricultural activities. This innovative approach will put them at an advantage, as traditional banks may be unwilling or unable to compete in these fields. For example U. S. banks can not do 'Musharika' busineess because of U.S. legal restraints (Elliot, 1986). Islamic banks have to face up to the challenges of these forms of financing, not only to reap the potential financial rewards but also to retain legitimacy. Too heavy a reliance on 'Murabaha' and the principle of mark-up has come under severe criticism from different quarters. The government of Pakistan, which has taken a lead in promoting Islamic banking, admits that there is a weak Shari'ah legitimacy for mark-up (Pakistan Economic Survey, 1984-85, 16). But some circles have gone much further to term the whole exercise as mere semantics since according to them "it's as if you put the word 'Islamic' on a beer bottle and say it's okay to drink it' (Newsweek, July 28, 1986, 22). Perhaps much of this criticism stems from political differences. As far as Western critics are concerned, "even sceptics have accepted that Islamic banks are not merely trying to give interest another name'. (Scharf, 1983, p.90).

Until recently writers on Islamic banking have said little about the moral standards of bank clients, particularly those who enter into Modaraba or Muskarika contract with the banks. These schemes function on the basis of a trust between the banks and the borrower or entrepreneur. When funds have been advanced the sharing of profits or losses will be determined from the annual financial statements of the entreprise concerned. The quality of accounting systems, the honesty and integrity of the entrepreneur and the extent to which the reports have been subject to audit. In the case of large scale advances it can be assumed that sophisticated and reliable auditing techniques have been utilized. But in the case of smaller advances the reliability of the reports may be heavily dependent on the integrity of the entrepreneur. Declaring profits to the banks make them subject to taxation as well as being shared. Where the Governments of Islamic countries are keen to develop Islamic banking, one possibility would be to exempt from taxation the profits from Modaraba and Musharika projects or apply concessionary rates. This could boost this form of financing and the returns to the banks.

The question of the integrity of borrowers raises many issues which are currently receiving the attention of writers in this field (Ahmad, 1987a). This emphasis is not neglected in the Islamic banking community. The International Association of Islamic banks defines, for purposes of membership, an Islamic bank as being formed for the purposes of "building Islamic solidarity and ensuring justice of distribution and employment of funds in accordance with Islamic principles." (Abdeen and Shook, 1984, 169-70). Herein lies much of the potential for growth. It can also be used to explain how the rapid change-over to a complete Islamic financial system in Iran has been apparently so successful (Abdallah, 1987).

Islamic bankin gtherefore can be seen to have tremendous potential, not only in terms of its ability to attract the savings of devout muslims, but also as successful financial institutions. Many unresolved issues remain, but these are matters which can be tackled as the movement expands. In terms of financial development, the banks are clearly breaking new ground and technically developing the system. This development has potential to generate further economic growth if the banks utilise innovative techniques. "Radical changes and radical thinking are required for the success of the Islamic financial system." (Ishaque, 1987, 10)

## APPENDIX 1
## PRINCIPLES OF ISLAMIC BANKING

The underlying principle of Islamic banking is the unequivocal prohibition of usury by the Holy Quran.

'Shari'ah' permits trading but forbids 'Riba' i.e. interest. In trade, besides taking risk, the trader puts his skill, effort and time to transform the character of a traded commodity. There is some difference of opinion with regard to the interpretation of the Quranic injuction against Riba. The pragmatic view is that usury involves exorbitant interest rates, as well as interest on consumption rather production loans. The Orthodox view considers interest in all forms and on all loans prohibited. The orthodox view has prevailed and the present Islamic banks have been established on the basis of that approach towards interest.

Modern Islamic banking therefore neither pays nor receives any fixed predetermined rate of interest. Rather, it is based on profit and loss sharing. As such investment and lending has a different connotation in Islamic banking. Loans to needy persons ate called 'Qard-e-Hassan' and are free of charge, the borrower has to return only the principal. Other consumption loans are advanced against an administrative charge. Investment takes the shape of 'Modaraha', 'Musharika' or 'Murabaha'. In Modaraba the bank participates with its finance, while the borrower uses his skill and effort. The profits are shared according to a pre-agreed ratio. Musharika is a partnership where the finance is provided partly by the bank and partly by the manager. Here again the profit is shared according to a predetermined ratio. In Modaraba the financier alone bears the losses, if any, while in Musharika both the bank and the borrower share them. Murabaha is a deferred sale based on mark-up in prices. There are a number of variations of these models as well as examples of leasing and hire purchase. Islamic banks also perform the usual sevices against a fixed commission or charge.

## APPENDIX 2
## BRIEF HISTORY OF MODERN ISLAMIC BANKING

The history of modern Islamic bank dates back to the 1950's when a small private Islamic bank appeared in Pakistan, but subsequently wound up. In the early sixties another small private Islamic bank emerged in Egypt and operated successfully. The first significant Islamic bank was the Nasser Social Bank established by the Government of Egypt. The seventies witnessed the emergence of several Islamic banks in various Muslim countries. Leading individual Islamic banks today are Dubai Islamic Bank, Nasser Social Bank, Kuwait Finance House, Faisal Islamic Bank of Egypt, Faisal Islamic Bank of Sudan, Dar Al Mal Al Islami, and the Islamic Development Bank. Assests, deposits and profits of these banks grew considerably over time. The success of these financial institutions gave birth to many others in vaious parts of the world. In

1979 Pakistan and Iran strated a novel experiment by switching over the entire banking system to profit and loss sharing. In Iran the changeover was achieved rapidly whilst in Pakistan a phased programme was adopted and in July 1985 the whole system was converted to an interest free basis. Being inexperienced the Islamic banks are very careful in selecting investment porjects. So far their main area of activity has been trade and real estate. They are, however, slowly moving towards financing big industrial and agricultural projects.

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