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Islamic Banking and Its Relationship with Western Banking (Universal - Anglo-Saxon)

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ABSTRACT

Since when Islamic Banking came to existence about 3 decades ago, the number and expansion of Islamic Financial Institutions throughout the world have grown enormously and the institutions that present such financial services own a remarkable and increasing share of the financial system of many countries. In addition to the growth of the geographical scope of Islamic financing, growth and expansion of this phenomenon over a vast domain of financial activities has also been huge from micro-banking to insurance and investment in capital market. Banking system based on principles of Sharia [Islamic rules] creates and uses financial services and products that match the executive principles and rules of Islam and particularly bans receiving and paying interest on the basis of a fixed and pre-determined rate. The essence of Islamic banking is that people have to participate in economic development and production. Of course this issue might not be an ideal for a bank, but it is an ideal for the banking system. This means that if our banking system wants to be active in this area, it will have to produce and inject venture capital and if it wants to inject venture capital, it will have to become close to Universal banking.

In this study, the methods to allocate resources and the relevant issues and challenges in Islamic banking, Universal banking and methods to pay credits/loans in this type of banking are studied and eventually the similarities and differences of Islamic banking in comparison with Universal banking are assessed from the viewpoint of the role that the banking system plays to finance the projects.

KEY WORDS: Islamic Banking, Universal Banking, Allocation of Resources, Retail/Usury Banking

INTRODUCTION

Islamic 'Sharia' (law) is the complete law for living and has presented a positive response for all the current demands and the entire challenges of this age. Emergence of banks in the West brought about many facilities for the people regarding economic transactions in the banks. Everybody tried to invest his money in banks to keep away their wealth from risks in one hand and to earn profit on the other hand. When the Muslim scholars understood the necessity of Islamic banking for people, they started thinking to establish the Islamic model of western banks for the Muslims so that the development of the known 'Sharia' enables the people to perform their transactions within the framework of the Islamic law. The main difference between copied banking and Islamic banking is in 'bank interest', i.e., Islamic banking wants to clear the society from the so-called disease of bank interest and to introduce Islamic banking. It is one of the prominent characteristics of Islamic banking. If one of the banks claims that it performs, having interaction with the Islamic banking, but goes toward bank interest on its transactions, it will not be considered as an Islamic banking at all. In fact it is one of the copying banks and there are currently many banks of this type around. Banks are one of the discoveries of the West and the Muslim Scholars started thinking that these banks have non-Islamic contracts when they found out about the necessity of usury-free/interest-free banks, they established the Islamic model for the copied banks so that Muslims and even non-Muslims perform usury-free transactions with the Islamic banks so that there is no usury and a development institute is established to be useful in the development of the society. When the banks were firstly established in the West, the main goal was merely financial profit, but the Islamic banking system was not like this and it tried to maintain the ethical principles and to develop the society and to provide the society with more benefits than in this by protecting wealth and gaining profit. Islamic banks want to be a trading institution in one hand and a charity organization on the other hand, whereas the copied banks are not like this and are only allowed to transact on the basis of interests. In fact such interest-based contracts are the cause of economic demolition of the society because in such transactions, the important thing is not the activity as profit is gained without doing an activity or making any effort. In fact the non-

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Islamic contracts make people get used to doing nothing and earning money and they lose the habit of working and doing business in order to earn their living. The concept of working will fade away and it will bring about many economic problems as the world is witnessing such loss in the international economic crisis and the economic system of Islam is strongly against such contracts. However, the Islamic banks are not like that and they do their best to protect the economy of the society and make it possible for all to work. That is why the Islamic banks are not only financial institutions, but also the overall development institutes for the society. That is why Islamic banks are superior to copying banks as Islamic banks in a certain society guarantee the overall development and could resolve many problems including economic and non-economic ones and for this reason, the copying banks are moving step by step toward Islamic banking system and have copied the game rules of the Islamic banks and have already accepted and will accept their failure. The economy of Islamic countries has recently been paid attention to by economics and entities active in financial and investment sector of the advanced countries of the world. Islamic banking has declared its existence in the world for three decades and has made remarkable growth since them.

Increased investment is the definite pre-condition of the economic development and the methods that different societies have adopted for financing investment projects play a significant role to facilitate investment and as a result to accelerate the economic development of the societies. Muslim economists proved that the method of financing based on profit and loss sharing (PLS) has higher efficiency in comparison with method of granting loans in return for receiving fixed return scheme (FRS) as far as reduction of production costs, increase of at stake wealth of the society, periodical business control and prevention of banks' bankruptcy are concerned. Meanwhile, some Muslim economists (this issue was raised in the PhD dissertation of Mr Vaqar Masoud Khan, 1983. Translation of part of it appears in the book called 'theoretical studies in Islamic banking and Finance' written by Mohsen S Khan, translated by Mohammad Ziaei Bigdeli) showed that the privilege of shared financing makes sense if firstly, the "information asymmetry" and the two risks from it, i.e., "adverse selection" and "ethical risks" are not serious in the society and secondly, the society is not experiencing insecure conditions.

Research History

Ahmad Al-Jalvani, 2004 formed the proportionate strategies to empowerment of Islamic banks in a paper called "Growing strategies of Islamic banks in confrontation with upcoming financing challenges" so that in the process of global financing, the profits of Islamic banks are maximized and their threats are minimized. This study shows that globalization has negative impact on internal level of the Islamic banks, but it leaves positive impacts on global level because globalization invites Islamic banks to compete.

Sadeqi and Naderi Kazaj, 2004 conducted a study in an article under the title of "Study of efficiency of usury-free banking in different countries and comparing the usury-free banks with usury banks in the world (using analytical method of data coverage)" and compared efficiency of the Islamic and non-Islamic banks. In this study, efficiency of 41 Islamic banks in 2000 and 46 Islamic banks in 2001 were compared using two models of fixed and variant return in comparison with the studied scale and the more efficient banks were identified. Also the efficiency of 46 usury-free banks as well as 64 usury banks in the world (in 2001) was calculated using fixed return method and these banks were compared with each other. The results indicate that the efficiency of usury-free banks of Bahrain and Qatar and generally, usury-free banks that are active in competitive conditions beside usury banks is higher than the banks that are active under usury-free banking system such as Iran, Sudan and Pakistan. In general in 2001 the efficiency of usury-free banks has been lower than usury banks.

Eivazloo and Meisami, 2008 concentrated on an article under the title of "Fixed Theoretical Study and Efficiency of Islamic Banking in Comparison with Common Banking" theoretically regarding two cases of economic profits which is expected from using divine law regarding usury sanction, i.e., stability and efficiency. The findings of this study show that Islamic financing is more stable and efficient than common financing and for different reasons it also shows more growth.

Mousavian, 2009 in a paper under the title of "Islamic banking, more stability, better efficiency" to investigate the reflection of using Islamic banking system instead of the common banking system studied its impact on variables of saving, investment, employment, production, general level of prices, income distribution and public welfare. The results of this study show that all major variables will have a better position when Islamic banking takes over and the banking and economic system will be more stable.

Theoretical grounds

Principles of Islamic banking

Islamic banking follows the same objectives of common banking in the world and the only difference is that it is claimed that banking operation happens in these banks according to the philosophy of Islamic transactions.

The most important principle in Islamic banking is to divide profit and loss from transactions and to prevent paying usury or interest. The most common concepts used in Islamic Banking consist of Muzaraba (sharing interest), Wadiah (to hold in trust), Musharakah (joint investment), Murabaha (contract based on cost price) and leasing (lease to purchase).

In a mortgage contract, instead of purchasing a property, the buyer is given a loan and the banks buy the property and sell it again to the buyer and receive the value of the property by installments.

The property is registered in the buyer's name from the beginning. This is called Murabaha.

One of the other concepts to do Islamic transactions is Ijara which is similar to leasing of real estates.

The credits/loans of Islamic banks to buy vehicles are also similar to leasing. The banks sell the vehicles in a higher price than the common price to the buyer, and the bank will stay the owner of the vehicle until when the installments are fully paid back.

Another type of the credits/loans granted by Islamic banks is the payment of credits to companies with a floating rate of interest. The floating rate of interest is considered as the special return rate of a company. In addition the company's profit is exactly equal to the profit of the company itself. This form of the concepts of services of the Islamic banking is called Musharakah when the financing bank is the creating firm in charge of project execution and they invest jointly following presentation of an economic plan. Thus the profit and loss are divided between them equally and the company should not be held responsible for the failure of the project and pay the costs and loss on its own.

Philosophy of Islamic banking

Islamic Sharia only found usury/interest 'Haram' /religiously forbidden, but has not prohibited other capital incomes. In other words, any pre-condition to receive profit from the principal capital and debt is found forbidden. According to Islamic principles, the executive method and use of capital in a project to create employment is highly important.

Inspired by Verse 275 of the second Surah of Holy Koran, Baqara Surah, prohibition of risk-free jobs and incomes cause the financial activities in Islam to be real properties with added value.

Islamic banking is based on sharing risks, physical trade of goods, direct involvement in trade and work, lease and building contracts using different contracts according to Islamic law. Islamic banking is also managing property in order to increase the general income. Sharing risks and its management to achieve the governance of contribution and cooperation to do projects is one of the goals of Islamic banking.

Interest in Islam is called reward and activities based on sharing risks and using resources to increase the value of capital are permitted.

The authorized financial transactions by the Islamic Sharia (Islamic law) should be based on presentation of goods, services and interests. This policy is noted because of having a better treatment and interaction with monetary and financial policies and creating more discipline.

In addition, Islam authorizes renting properties, lifelong right and right for a prescribed period as well as receiving rent.

Although modern banking in Iran which is 30 years old competes seriously with the common banking system and has a promising speed of growth and development, the competitive power and operational dimensions of this industry are still limited and small internationally. One of the reasons might be the lack of progress and sufficient growth of this system and the existing problems and obstacles in Iran and other Islamic states that are inventors of Islamic banking.

Different Contracts in Islamic Banking

Wadiah

In Wadiah, bank is considered as a protector and trustee for depositing.

In Islamic banking, everyone can deposit his money with the bank and receive it anytime he wants without any reduction or loss.

No interest is applied to this deposit and the bank will present a gift in return upon discretion of the deposit owner according to the amount of used deposit.

Murabaha

Murabaha lexically means bilateral agreement on the profit of a transaction. Murabaha is a contract upon which the seller declares his expected costs and profit.

Islamic banking has accepted this type of contract as one of its working techniques.

As a financial technique, the customer asks the bank to buy certain goods for him and the bank will do so by informing the customer of the amount of interest in addition to the costs of buying the goods.

Muzarabah

It is a sample of sharing financial resources when one party is responsible for financing and the other party is responsible for doing the job, owning the required expertise and management.

The gained profit is divided among the parties based on a former agreement, while any loss is only undertaken by the capital provider.

Under such circumstances, no penalty is paid or the loss of the company and the one responsible to execute the project.

In this contract, the loan grantor is called 'Rab-al-Mal' and the loan recipient is called 'Mazarib'. In Islamic banking, the entire capital is paid by the bank and the other party is responsible for trading and managing it.

No loss is shared in Muzarabah. In fact the bank is the owner of the property and the executive party is the worker or broker of the bank.

Sharing interest is like making an agreement to share.

In Muzarabah the capital owner is not entitled to interfere in managing and trading and the one in charge of the project has this responsibility.

The most important characteristic of Muzarabah is the possibility to agree on the shared interest in every ratio among parties. Muzaraba could be done individually and or collectively.

Musharakah

Musharakah is the relation that divides the profit and loss from doing the activity between the two parties according to a bilateral business cooperation contract.

Musharakah is an agreement in which the Islamic bank supplies the required capital and this capital is combined with the investment of the other side of the contract and the commercial company and all parties in this contract are entitled to interfere into the management of the commercial or industrial activity, while there is no need to do it.

In a commercial contract, the earned return is divided according to a former agreement, but the possible loss from it will be divided according to the proportion of the invested capital.

Ijara

The technical meaning of Ijara is to sell a certain lifelong right and right for a prescribed period in return for receiving a certain reward. It is generally used for hiring a service. Ijara is also used to get hold of a piece of land against payment of a fixed rent in cash.

Leasing

Leasing is one of the legal methods to earn income according to Islamic rules. In this method an actual property such as equipment, a car, a ship or a house could be rented by the owner/lessor to the tenant/lessee for a certain term against a certain price. The costs and profit in this transaction are mentioned clearly within the framework of a lease agreement. This method is used by many banks in Islamic countries. Islamic Development Bank (IDB), Islamic Bank of Malaysia and some commercial banks use this method in Pakistan.

According to leasing contract, an Islamic bank buys a property according to the specifications and demands of a customer and rents it with the parties' agreement under determined term and price to the customer. The details and nature of the rented property will also be considered when determining the amount and term of the lease agreement. During the lease term, the ownership of the property is held by the lessor (bank). The bank is entitled to transfer the ownership to the lessee. The property will be delivered to the bank at the end of the lease term.

Lease to Purchase

Leasing has many capacities in Islamic financial transactions and the Islamic banks experience and use its different methods gradually. Lease to Purchase Agreement is one of these samples. According to this agreement which is known as 'lease to purchase', 'sale by installments' or 'rent', the leased property will be owned by the lessee at the end of the leasing term and the paid installments are considered as the rent (capital interest) and the principal capital and at the end, the lessor (bank) is not the owner anymore.

This method is mainly used to buy house and car.

Qars Al Hasana

Qars Al Hasana is a superior loan. Qars Al Hasana is paid provided that no amount is added to it at the end of the term. This loan is granted without any interest for charity purposes or to remove the needs of short-term investments. The borrower is obliged to reimburse only the principal amount of the loan. This loan is allocated to needy people and the reward to pay it is given by God.

Islamic banks act differently to grant this loan. Some of these banks present Qars Al Hasana loan only for investment in their bank to the applicants. Some others grant this loan to all their customers. Some of the banks pay this loan only to needy students and some weak economic sectors of the society. Small producers, farmers and companies that are not able to supply their required cash from other sources are the applicants of these loans.

Characteristics of Islamic Banking

1. Sharing risk

One of the most important characteristic of Islamic banking is that this type of banking increases the degree of risk sharing between the two groups of investor in one hand an the bank and recipient of loans on the other hand because the lack of certainty is part of the nature of this world and the results of any project are not definitely clear. While the opposite is true in common banking, i.e., investor is sure about achieving a pre-determined rate of interest.

2. Emphasis on productivity

According to the principle of profit and loss sharing, the bank only receives return if the project is successful and there is some profit. Thus an Islamic bank is mainly concerned about the suitability of the project, economic justifiability of the trade and the employer's management ability and not his ability to reimburse.

3. Ethical dimensions

In Islamic system, all economic factors should be active within the system of ethical values of Islam and the Islamic banks are not an exception either. This means that they cannot finance the projects that are in contradiction with ethical values of Islam.

Challenges of Islamic Banking System

The most important challenges of this type are as follows:

1. Unrealistic nature of some of the transactions

One of the problems of the current banking is the unrealistic performance of some banks. For example, some loans are given for using Ja'aleh contract to repair the house, while the bank which is the operator of Ja'aleh only pays money to the applicant so that he repairs his house and this action is not in fact Ja'aleh. In some instances, the recipient of the money receives the loan without being the owner of the house or without spending the money for repair purposes. In Islamic banking, the customer and the bank operator should be precisely aware of the nature and purpose of the contract, otherwise the contract is null and void.

2. Problems in banking contracts

Quantitative growth of transactional contracts, information of the in advance interest rate in the beginning of the term and grant of the same rate as the materialized interest for the deposits whose expected interest rate is announced and receiving the same rate as the bank's share from the applicant of the loans, high interest of the investment deposits while the usury-free banking of the interest of deposits abides by the banking system to grant interest which is identified at the end of the fiscal year, information about grant of percentage of the additional interest of the banks for depositors and issues of this type have caused the bank customers and the public not to be necessarily satisfied with the banking development.

3. Short-term bank loans/credits

The economy of all societies follows successive terms of development and recession due to different reasons. Thus banks prevent granting long-term credits/loans not to take this risk (development or recession) and they often grant short-term loans/credits. Hence according to the conducted studies, it was noticed that apart from housing transactions, most of the transactions have between 6-18 articles an the average age of the total transactions does not exceed one year. Of course the short-term banking loans/credits will cause detrimental damages to the economy in practice as it will impede attraction of investment to big and infrastructural projects.

4. Governmental banks affect the laws

On 7 June 1979, the state banking system was established and according to it, 28 banks, 16 saving and loan companies and 2 national investment companies were established and their ownership was taken away from private sector and was granted to the government. The natural result of this attitude toward banking industry was that the law of usury-free banking operation became governmental in different occasions (for example, clause 2, article 1, article 8, 9 and 10). When the state economic status changed, particularly when the new interpretation of article 44 of Constitution was made, it became necessary to review the usury-free banking operation law and to revise the former view about banking industry.

5. Communication weakness of the state banking system with the world banks

The economic status of the current societies is still complicated and developing and if every bank or credit institution wants to work with high efficiency, it will need widespread and fast financial relations with other banks and credit institutions. The banks or credit institutions sometimes face liquidity shortage for some months, days or hours, while other banks or credit institutions have additional liquidity. The suitable solutions to use the resources of each other increase the efficiency and profit of all banks and credit institutions. It is necessary to consider a solution for relations among banks and credit institutions of Iran and other banks of the Islamic states in proportion with our country's status, and interactions could be made with other banks through conclusion of legal contracts.

6. Absence of suitable supervisory solutions

According to experts, usury-free banking operation is fundamentally and greatly different from common banking. Thus, it constantly needs frequent and precise supervision so that law is fully implemented. Thus in usury-free banking law, a special method and institution for supervision and control of banking transactions to check them against law and required measures to observe the religious principles of the contracts are adopted and encouraging and punishing tools to correctly implement the law of usury-free banking operation should be implemented.

7. Absence of suitable solution to research and develop usury-free banking

Economics in its general term, particularly monetary economy and banking are rapidly developing so that we are witnessing different modern monetary and banking markets directly per annum. A dynamic law should have the necessary solutions for research and development within itself so that the ones active in economy are not engaged with the long process of the legal term. The current usury-free banking law does not have such a characteristic and the law has to be reviewed for any type of change or development.

8. Complicated rules and regulations

When interest is taken away from banking operations, different contracts, particularly in the season to allocate resources and grant banking credits were added to the usury-free banking operation law. As a result, the number of banking contracts in one hand and implementation of the religious teachings of each of the contracts on the other hand and compliance with general policies of the regime from the third hand created complicated directives and instructions whose understanding are not only difficult for the customers, but also for many bank brokers.

British Banking and German Banking System

The UK and Germany as the two important European countries experienced 'industrial revolution' in the middle of the 18th and the 19th century respectively. If we do not want to get involved in infrastructural and important phenomena such as renaissance and big revolution of France, we could consider the events of industrial revolution in each of the European countries as the starting point of development in those countries. Thus when we talk about industrial revolution in the UK or Germany, we refer to the start of development process in these two countries. Many writers believe that the banking systems in Germany and the UK did not play similar roles in these two countries during industrial revolution.

Gerschendorn, 1962 believed that:

"Industrialization was made in the UK without any remarkable enjoyment of banking system for investment purposes, while German banks established the most sincere possible relations with the industrialists. (Sandeep Baliga & Ben Polak, "The emergence of the Anglo-Saxon and German financial systems", (2004))

In the UK, the banks preferred not to have anything to do with the loan-recipients (Sandeep Baliga & Ben Polak, 2004 were active holding 'hands-off approach'). For this reason, they were more inclined to keep their properties that had high liquidity. Collins, 1991 stipulated:

"The initial concern of the British banks (during industrial revolution of this country) was that the loans could be cashed. For this reason they prevented to pay long-term industrial loans and preferred to lend drafts and promissory notes instead. Surely the British banks prescreened the applicants before granting loans and chose the best and most secure among them and this issue helped them overcome the problem of adverse selection, but they were not inclined following grant of loan to engage themselves with the constant supervision over the activities of the loan-recipients (Sandeep Baliga & Ben Polak, 2004).

Sayer also believes that:

The ability to cash the paid loans is considered as the main principle of success in the British banks, while the necessity of industrial loans is to enjoy the necessary knowledge to interfere into the investment process and one could only enter into this area by holding a considerable number of experts who each have expertise in one or several industries. The directors of traditional banks in the UK were not trained for such a mission and that is why the old belief was formed that the bankers should only grant loans that are naturally able to be cashed (Sandeep Baliga & Ben Polak, 2004).

And finally Riesser, 1909 writes regarding the difference between British and German bankers that:

The British banks never showed interest in newly-established companies and the bonds that they issued, while the German banks had constant and ongoing supervision over development of companies that were established relying on their money and this was the thing that considered as a credit to differentiate the German banking system (Sandeep Baliga & Ben Polak, 2004).

The controversial behavior of the British banking system (in the 18th century) and the German banking system (in the 19th century) toward industrialists and their approach toward the issue of financing industry became the origin of two different banking systems in the West and they were known as "British Banking System or Anglo-Saxon or commercial" and "German Banking System or Universal". Also we noticed that one of the main aspects of difference between the two Anglo-Saxon and Universal systems is concerning the issue that how much the bank in both systems monitors the investment process that it has financed itself.

Mabid Ali Al-Jarhi, 2003 considered the main characteristics of Anglo-Saxon banking system as "mediation between owners and applicants of loans (loan recipients), payment of short-term loans and non-interference in the job of loan recipients (Mabid Ali Al-Jarhi, "The case for Universal banking as a component of Islamic banking",(2003), p.7). Also Calomiris, 2000 defined the Universal Banks as follows: "Banks in vast scale that run a widespread network of banking branches and present many different services. Their demands are different from companies and include loan and shares. Universal banks directly supervise the operation of the companies that are financed by them (whether by grant of loans or through partnership) (Ibid. p.7).

Although theoretically speaking both systems find themselves authorized to use financing methods (based on interest) and (based on partnership), in practice, Anglo-Saxon banking uses the first method (interest) more and the second method (partnership) less than Universal Banking. In other words, Anglo-Saxon banking was formed on the basis of taking more distance from the two phenomena of "adverse selection" and "ethical risks" and the attempts of the directors of banks who worked with this system is to keep away from the risks resulting from the phenomenon of "Information Asymmetry" and this is what made the Anglo-Saxon banking prevent entering into shared areas that naturally guarantee the risk resulting from information asymmetry.

In Universal banking, the phenomenon of information asymmetry and as a result, the risk of adverse selection and ethical risk is taken into consideration. The difference is that Universal banking strategy does not have a passive confrontation and absolute evasion of risk to confront this phenomenon. Universal banking considers the possibility to participate in investment projects as an opportunity for the bank and for the economy of the society and tries to minimize the risks resulting from it by having an active approach toward the issue and trying to make the most of using the advantages of joint financing method. The most important performance of Universal banking is to provide venture capital in the economy.

3. Islamic banking (in theory and in practice) – To which one of the two western banking systems is it closer?

3.1. In theory

There is no doubt that Islamic banking is much closer to Universal banking than Anglo-Saxon banking in its theoretical grounds. It is because of the method in which these two systems of western banking tackle with the joint financing method, and it was shown in the previous section that in Universal system opposite to Anglo-Saxon system, the use of this financing method is as common as a regularly-used method.

It is necessary to point to the difference between Universal banking and Islamic banking. As we know that there is a special type of financing, i.e., financing based on usury-debt in Islam. The fundamental difference between Universal banking and Islamic banking comes from here as the Universal banking reserves the right to use a secure financing method, i.e., grant of loan and receipt of loan and also keeps the properties with fixed interest rate such as bonds with fixed interest rates, short-term loans with fixed interest rate (and if necessary receipt of securities) and the like in its basket of properties and on the contrary, the Islamic banks are not entitled to keep this type of properties.

3.2. In practice

Theoretical obligation of Islamic banking to fully prevent keeping properties with fixed and pre-determined return should not be interpreted in this way that there is no secure and risk-free property in the basket of properties of the Islamic banks. Directors of Islamic banks are now completely aware of this issue that if they have excess reliance on the method to finance jointly (such as Muzarabah and the like), they will face the risk of bankruptcy. For this reason in addition to closed path of financing through grant of loan and receipt of interest, they have approached other methods such as 'purchase and sale by installments', 'lease to purchase' and 'issue of 'Sukuk bonds' (a kind of Islamic bonds) and the like. The only difference between these methods and 'usury debt' is their legal framework and according to Muslim economists, there is no natural difference between this type of transactions and loan grant based on interest as far as the prospects of their foreign and economic effects are concerned.

Mirakhor, Abbas writes in this regard:

"Muslim Economists agree in this regard that even among these acceptable methods, some are completely Islamic (i.e., they correspond with the Islamic goals both in shape and content) and some are weaker in this regard (i.e., that they are in Islamic form, but do not correspond with Islamic goals in content). The fundamental of this justification is that which method is stronger and which one is weaker (as far as correspondence with Islamic goals is concerned). The main issue is the assistance extended by that method to materialize the Islamic goals. Thus the only operational methods that provide the suppliers and users of financial capital with the possibility to participate in the risk and return could be considered as the strong Islamic tool. These scholars only find two types of these transactions completely Islamic among the accepted methods. One of them is Muzarabah and the other one is Musharaka. The other operational methods consist of Bei-al-Mojal (which is usually translated as sale by installments), rent, lease (lease to purchase), Bei-al-Salam (pre-purchase agreement), Ja'aleh (commission) and these will only be concluded when partnership in interest and risk (i.e., Musharakah or Muzarabah) are not practically possible. In other cases, the Islamic researchers do not find application of these methods proper and warn that the banking system might rely on weaker methods such as sale by installments due to their simplicity, minimum risk and having fixed pre-determined rate of return , while these methods maintain the existing status of traditional banking and rely on credibility of the customer and maintenance of the relation between the debtor and the creditor (Theoretical Studies in Finance and Islamic Banking, p 286)."

Methods of financing including the method of sale by installments as it was said have a completely different legal framework from "usury debt" and that is why they cannot be considered as "usury debt". Of course the difference between these transactions and usury debt is because they are usury-free (because the criterion of being usury in these transactions is only possible, particularly when they are accompanied by arrangements such as insurance and receiving securities. But legally speaking it is because the definition of orders and effect of 'purchase' or 'rent' is added to them and not the definition of the effects and rules of 'debt'. Therefore such transactions are not definitely placed in PLS category which is the basis of Islamic banking.

Ahmad Ziauddin made the following reasoning about the similarity of methods such as sale by installments and usury financing:

"This reality that replacement of interest and sale by installments, for example shows no fundamental change, is clarified when they are looked at by the approach of philosophy of interest elimination. The system of interest in Islam is banned because it is inherently a completely unfair system. The characteristic that makes this system unfair is that the capital supplier claims a fixed return while the entire risk is imposed on user of the money. Justice which is considered as the main characteristic of an Islamic system supplies the capital that is required to participate in the economic activity at risk, if he calls for gaining profit. Thus, it could be easily understood that the system of sale by installments or any other tool consists of a fixed pre-determined return on capital and is not the real replacement for interest (Ahmad Ziauddin, "concept and models of Islamic banking: An Assessment" (1984), quoted by theoretical studies in financing and Islamic banking, p 296). "

Therefore, in Islamic banking, although usury debt is forbidden, the designers and directors of these banks have found other methods to finance, relying on Islamic Jurisprudence and these methods keep them immune in practice from getting engaged with risks resulting from adverse selection and ethical risks. As another sample, the image that was presented by Timur Kuran, the critic of Islamic banking in this book about performance of Islamic banking is reported as follows:

"Murabaha has so far been the most popular financing method of Islamic banks that acts as follows: Producer or merchant presents a list of the goods that he is inclined to buy such as one ton of steel to the Islamic bank. The bank buys the steel and adds a percentage to the price to compensate the provided service and then transfers the ownership to the customer. The customer receives the steel together with a statement upon which he has to pay for the goods in a new price and at the date as mutually agreed. What makes this transaction Islamic is that the bank has held the ownership of the steel for a while and put itself at risk. In fact when the steel was owned by the bank, any damage including theft had to be undertaken by the bank and not the customer, but the risk of this transaction is minimal because there is no minimum time for the period of bank's ownership and only one thousandth of a second is sufficient to legalize the transaction religiously. Of course from economic point of view, the very small period of ownership has made Muzarabah equal to the condition of the loan with interest: Bank does not undertake any risk and the customer pays for the value of the money at the time. There will be only a difference in words and it means that the customer's payment is called in one case 'cost of service' ' or 'markup' and in another case 'interest'.

The Islamic banks keep their ownership period very short when using Murabaha. Thus these banks declared their mission to put an end to the story of interest and have used the method that is not very different from interest, but is only hidden under an Islamic cover (Timur Kuran, "Islam and mammon", 2004).

We are noticing that in Islamic banking, receiving a fixed return in theory is forbidden, but in practice is common.

The important question that is raised here is that why Islamic banking or in other words, Islamic bankers find themselves committed to put part of their properties at risk in any possible way and to keep the assets with fixed pre-determined return secure in their portfolio. This is the question that keeps the minds of the critics of Islamic banking busy." Timur Kuran raises this question as follows:

"Why does Islamic banking keep distance from its principal and infra-structural theory to this extent in practice? In more precise terms, why do banks that were supposed to develop the financial world have stuck to the same methods of common banking to this extent (Ibid, p.12)?"

3.3. Summing up the former topics together (comparison of Islamic banking, Anglo-Saxon banking and Universal banking in theory and practice)

The characteristics of the three systems of Islamic banking, Anglo-Saxon and Universal banking are summarized in theory and practice in the following table:

Use of financial method based on interest		Use of financial method based on PLS		Banking system
In practice	In theory	In practice	In theory	
High application	Authorized	Low application	Authorized	Anglo-Saxon
High application	Authorized	High application	Authorized	Universal
High application (implicitly)	Unauthorized	Low application	Authorized	Islamic

Considering this table, we will be able to imagine the threefold banking system according to their theoretical fundamentals (and inclinations) in form of spectrums where in one end of it, there is Anglo-Saxon banking and on the other end, there is Islamic banking. Naturally universal banking is placed in the middle of this spectrum because according to its theoretical fundamentals (and inclinations), it finds itself authorized to use both methods of financing. But Anglo-Saxon banking and universal banking are usually placed where their theoretical fundamentals (and inclinations) requires them to be and it is only Islamic banking that keeps distance from its theoretical fundamentals theoretically and in some instances, (such as Iran's Islamic banking experience), it becomes closer to Anglo-Saxon banking model. The reason for this issue is the radical use of tools such as leasing or lease to purchase in one hand and to enclose clauses in the Muzarabah and Musharaka contracts (according to which the receivers of the credits are obliged to pay the fixed pre-determined return) in practice on the other hand.

Conclusion

We found out that the Islamic banks are inclined to use the methods applied by Anglo-Saxon banking system despite their theoretical grounds (of course not explicitly, but by using the methods that are obviously usury-free such as leasing, or adding clauses in the 'Muzarah' contracts or joint stocks that guarantee the bank's required interest). When trying to find the reason for the external performance of the Islamic banks, three topics of 'conditions of lack of confidence in the society surrounding the banks', 'adverse selection phenomenon' and 'ethical risks' are taken into account and it was shown that under the conditions where lack of trust dominates the society and or the risks from information asymmetry are serious, Islamic banking system in comparison with the universal banking system will not necessarily be considered as an optimal system because in the afore-mentioned cases, the obligation to emphasize on PLS method could result in all or some of the following results:

- Increased costs of financing the investment projects (when the conditions of lack of trust prevails);
- Increased costs of transaction (in case of instrumental use of contracts such as leasing and Sukuk (a type of Islamic bond) and joint stock with guaranteed profit to finance the revolving capital of the production units
- Increased risk of bankruptcy of Islamic banks in comparison with Anglo-Saxon and Universal banks (in case of weak ethical indexes in the society).

The strategic policy of the current analysis could be presented in this way that in order to use all the capacities of Islamic banking and to turn it to an opportunity in the path of development of Islamic societies, it is necessary that

- Firstly, the ethical indexes should improve in a society.
- Secondly, the official institutions responsible for transparency of transactions and reduction of transaction costs should be reinforced
- And thirdly, management, expert and supervisory systems of Islamic banks should be reviewed and their efficiency should increase.

It is only in this case that we can list and count precise implementation of Islamic banking as one of the factors that paves the ground for development.

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