Islamic financing formulas and their role in economic development

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Abstract

Islamic banking is currently one of the fastest growing segments of the financial market industry; this study aims to investigate the relation between Islamic banks performance and economic growth. It attempt to answer the question whether Islamic banks are a perquisite for economic development or whether their financial stability a consequence of it. Islamic modes of finance are designed to facilitate financing by the principles in Islamic Sharia, such as Murabah, Mushraka, Ijarah, Istisna and Salam. In addition financial intermediation is an important indicator of economic development as well as economic growth. The objective of this study is to determine the relationship between Islamic modes of finance and Islamic financial intermediation, and its relation to financial stability in Islamic banks. So that to choose the most successful mode that should be encouraged to apply in Islamic economy. After international financial crisis most of the works in Islamic finance field focuses on the financial risk and financial stability of the Islamic banks, therefore to avoid mistakes which was took by conventional financial system. However the main goal of Islamic bank to enhance social justice and human being of the Muslim through successful financial intermediation that can lead to economic development, poverty alleviation, wealth distribution. Participatory financing is a unique feature of Islamic banking, and can offer responsible financing to socially and economically relevant development projects. This is an additional service Islamic banks offer over and above the traditional services provided by conventional commercial banks.

Key words:

Islamic Finance, Poverty, rate of interest, Islamic mode, economic development.

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صيغ التمويل الإسلامى ودورها فى التنمية الإقتصادية

المستخلص

تهدف هذه الدراسة إلى دراسة العلاقة بين أداء المصارف الإسلامية والنمو الاقتصادي. وهي تحاول الإجابة على السؤال عما إذا كانت المصارف الإسلامية متطلبا للتنمية الاقتصادية أو ما إذا كان استقرارها المالي نتيجة لذلك. تم تصميم صيغ التمويل الإسلامية لتسهيل التمويل من خلال مبادئ الشريعة الإسلامية، مثل المرابحة والمشاركة والإجارة والإستصناع والسلم. وبالإضافة إلى ذلك، تشكل الوساطة المالية مؤشرا هاما للتنمية الاقتصادية فضلا عن النمو الاقتصادي. الهدف من هذه الدراسة هو تحديد العلاقة بين طرق ونظم التمويل الإسلامية والوساطة المالية الإسلامية، وعلاقتها بالاستقرار المالي في المصارف الإسلامية. وذلك لاختيار أنجح طريقة التي ينبغي تشجيعها لتطبيقها في الاقتصاد الإسلامي. بعد الأزمة المالية الدولية تركز معظم الأعمال في مجال التمويل الإسلامي على المخاطر المالية والاستقرار المالي للبنوك الإسلامية، وبالتالي تجنب الأخطاء التي أخذها النظام المالي التقليدي. إلا أن الهدف الرئيسي للبنك الإسلامي هو تعزيز العدالة الاجتماعية والإنسان للمسلم من خلال الوساطة المالية الناجحة التي يمكن أن تؤدي إلى التنمية الاقتصادية، والتخفيف من وطأة الفقر، وتوزيع الثروة. وتمثل صيغ التمويل الاسلامى سمة فريدة من نوعها في مجال الخدمات المصرفية الإسلامية، ويمكن أن تقدم تمويلا مسؤولا لمشاريع التنمية ذات الصلات الاجتماعية والاقتصادية. وتتميز هذه الخدماتعن الخدمات التي تقدمها البنوك التجارية التقليدية بالتنوع .

الكلمات المفتاحية:

التمويل الإسلامي، الفقر، معدل الفائدة, الصيغ الإسلامية, التنمية الإقتصادية

Research Design:

Statement of the problem:

As we knew Islamic finance have grown rapidly in recent time, also there is general conception that Islamic banks are more stable during last financial crisis than conventional counterpart; however there is no clear consensus about the relation between Islamic finance and economic development, so that this study investigates how can Islamic modes of finance effect on economic growth and bank financial stability at the same time.

Objective:

This study aims to develop new model that will interpret the relation between Islamic finance models and real economic growth, financial stability.

Methodology:

This study follows quantitative method by employing cross sectional data context analysis. The data is collected from six banks over six countries through the period 2011-2013. Pearson regression is used to measure causal relation between GDP and banks performance representing in Islamic modes of finance, Z score. Data is collected from banks annual reports and central banks annual reports.

Significant of the study:

The study develops new simple model to describe the relation between Islamic modes of finance and real economy growth. Also the study fills the gab because there are no previous studies were conducted in the relation between Islamic modes of finance and financial stability of the banks.

O**verview:**

Islamic Finance even it emerging recently but development and expanded upon all the world, we know that it is only in the past few decades lots of efforts have been made to explain Islamic financial and economic principles.

Important matters these days as the emergence of Islamic finance round the world, the paper also discuss the issue of poverty its meaning and what is the reasoning of it and what happen according to the conventional financial system, that conserving only with the rate of interest model. Therefore .understand how under developing countries suffering heavily, and the poverty rates increasing. the demonstration mainly raise the model of Islamic finance as substitution by an innovative transform model, which create development mainly and solve the problem of poverty with many more advantages and financial benefits. In short, Islamic tools crushing the poverty as by Zakah , Awgaf ,and Islamic mode of finance.(1)

This paper have four sections, firstly the poverty issue, it is meaning and types, as well as reasons and quantities. It is next section, an examine into the financial system, which affecting a continual increase on poverty rate, which originated from the rate of interest model, especially when provide it is finance for the under developing countries, as example to dominate these countries by huge amount of funds, and increasing on debt rate, unfortunately both IMF & WB contribute for these results. Thereby, leave these countries under the poor rate. Further, scenarios on internal finance will aggravation situations as well. Third section is about the Islam,–as its last religious and the whole message came from GOD by prophet Mohammed (peace be upon him) regulate the material and spiritual life– which provide a holistic view that can interpret into sort of system that affect all aspect as economic, social and political life. The last section discuss the Islamic tools for finance, include Zakah, Awgaf, and the Islamic mode of investment. (2)

Poverty:

Poverty is pronounced deprivation is well–being including –low income and the inability to acquire the basic goods and services necessary or survival with dignity (World Bank 2006). The statistical reported that billions of people live in extreme poverty about 1/2 of the population live in poverty.

Poverty linguistically is being poor, want scarcity or lack, inferiority, poorness, poverty being sick but not able to see doctor, poverty not having enough money to pay the rent. Poverty is hunger, lack of shelter, being sick and not being able to see a doctor, not having access to education, or not having a job, it is fear for the future and living one day at a time.

Poverty has many faces, changing from place to place and across time, and has been described in many ways. Most often, poverty is a situation people want to escape. So poverty is a call to action –for the poor and the wealthy alike– a call to change the world so that many more may have enough to eat, adequate shelter, access to education and health, protection from violence, and a voice in what happens in their community. I In addition to a lack of money, It is about not being able to participate in recreational activities, not able to send children on a day trip with their schoolmates or to a birthday party, and not able to pay for medications for an illness. These are all costs of being poor. Those people who are barely able to pay for food and shelter simply can't consider these other expenses.

When people are excluded within a society, they are not well educated and when they have a higher incidence of illness, there are negative consequences for society. We all paying the price for poverty. The increased cost on the health system, the justice system and other systems that provide supports to those living in poverty has an impact on our economy.

Reasons behind are varying as example the Disasters, war, dept., unfair trade, unemployment.

However, While much progress has been made in measuring and analyzing poverty, the World Bank Organization is doing more work to identify indicators for the other dimensions of poverty. This work includes identifying social indicators to track education, health, access to services, vulnerability, and social exclusion. As there is no one cause, that define poverty, and the impacts of it are different in every social case. Poverty varies considerably depending on the situation. Feeling poor in Canada is different from living in poverty in Russia or Zimbabwe. The differences between rich and poor within the borders of a country can also be great.

Economic development:

Economic development is the process by which a nation improves the economic, political, and social well-being of its people. The term has been used frequently by economists, politicians, and others in the 20th and 21st centuries. The concept, however, has been in existence in the West for centuries. Modernization, Westernization, and especially Industrialization are other terms people have used while discussing economic development. Economic development has a direct relationship with the environment and environmental issues

The Traditional Financial System:

The western economic ideology which build up the theory of scarcity of recourses that divided the factor of production as land, lab our, capital, and entrepreneur, these theory try to say the rent is price of land, the wage for lab our, the rate of interest is the price of money capital and the profit for entrepreneur. The interest rate is use for money price. It is the rate at which interest is paid by borrowers (debtors) for the use of money that they borrow from lenders (creditors). Specifically, the interest rate is

a percentage of principal paid a certain number of times per period for all periods, during the total term of the loan or credit. Interest rates are normally expressed as a percentage of the principal for a period of one year.(3)

The global financial system basically depend organizations to finance rich people by direct loans, no room for past experience that banking system is try to finance poor people along as loaning them is consider high risky and pointless. Most theories upon rate of interest are proofing this practice in the modern economy.(4)

Simply, as we can see the target the traditional financial model is subjected by borrow and lending, theses banks are aiming to absorbed the money from depositor after promise them to give the specific rate of interest and after it collect these large amount of money contact to the business men and provide that with different rate of interest. Bank just collect from group and proceed it to other group to make profit through gaining the deferent between the rates of interests.

It is a repeated routine of two similar transactions, with a narrow perspective on the money as a technical account statement, brow and lend management between two parties, supposed to be the money capital and business owners. The important notification here is that accusation against the International Monetary Fund (IMF) and the World Bank are the major cause of poverty, which for in under-development countries, despite, claims that they will reduce poverty in Africa, it is widely accepted that most of the debts are actually a cause of poverty in Africa, which are due to the policies of IMF and the World Bank. Their programs have been heavily criticized over the years, as they in most of the times result in poverty scenarios and mysterious impact about how there as loans can be returned. The IMF and the World Bank's polices are very different now from what they were originally intended for.

These two monetary institutions were first formed by 44 nations at the Bretton Woods Conference in 1944 with the goal of creating a stable framework for the post-war global economy. The IMF in particular, was originally formed to promote steady growth and full employments by offering unconditional loans to economies, in crises and establishing mechanisms to stabilize exchange rates and facilitate currency exchange.

However, much of these visions never came to reality. Pressure from the US government made IMF start offering loans based on strict conditions. Critics have said that these policies have reduced the level of social safety and worsened lab our and environmental standards in developing countries.

Most Scholars and human rights activists contend that the Bank's aggressive dealings with developing nations, which were often ruled by dictatorial regimes, exacerbated the developing world's growing debt crisis, devastated local ecologies and indigenous communities.

The World Bank, initially known as the International Bank for Reconstructions and Development, was formed to fund the rebuilding of infrastructure in nations ravaged by World War II. Its focus soon changed in the mid 1980's. The Bank turned its attention away from Europe to the third World countries, most of which are in Africa. It started funding massive industrial development projects in Africa, Asia, and Latin America.

Critics say that IMF policies have reduced the level of social safety and worsened lab our and environmental standards in developing countries. The World Bank and IMF adjustment programs differ according to the role of each institution. IMF's loan conditions focus on monetary and fiscal issues. They emphasize programs to address inflation and balance of payment problems, often requiring specific levels of cut backs in total government spending. The adjustment of the World Bank are wider in scope, with a more long-term development focus.

Thereby, they highlight market liberalizations, seen as promoting growth theory expanding exports particularly cash crops.

The IMF and World Bank are largely controlled and owned by the development nations such as USA, Germany, UK, Japan, amongst others. The US for example controls 17 to 18% of the voting right at the IMF. When an 85% majority is required for a decision, the US effectively has veto power at the IMF. In addition, the World Bank is 51% funded by the US treasury.

Under a plan devised mechanism the World Bank and the IMF loan money in return for the structural adjustment of their economies. This means that economic direction of each country would be planned, monitored, and controlled in Washington. For instance, the World Bank assistance for helping a poor country involves, country by country investigations with a meeting of begging-Finance Ministers who are handed a restructuring agreement pre-drafted for voluntary signature.

Trade liberalization can lead to dumping of cheap and substandard products from outside. This undermines local industries that produce or intend to produce the same products.

According to James Sackey, former World Bank Country Representative in Sierra Leone, these instructions include privatizations, trade liberalization, high interest rates etc. Trade liberalization for under-developed economies could have some serious attendant effects.

For one, it could lead to dumping of cheap and substandard products from outside. Such items as clothes, shoes, creams are just amongst many others that flood markets in developing economies. This undermines local industries that produce or intend produce the same products. Under- development countries infant industries fail to take off under extensive trade liberalization. This is also very critical with respect to imported food such as rice, wheat, milk, amongst others. Developed countries which have excess of these food items reduce their prices and export them to Africa as a way of getting rid of them. If such situations were not conditioned, Africa would never be able to produce its own food.

Privatization, on the other hand, and its effects on government enterprises that do not function well cannot be challenged. But wholesale privatization of everything that is government owned cannot also be justified. In any case, there are few difficulties such as the limited indigenous business to take over government enterprises. The shortages of local private capital to pay for the running cost of privatized enterprises and the greater importance of the services to the people of some enterprises as compared to being profitable.

What often happens is that it is so-called soft sectors of education, health, and housing amongst others that will suffer from the cut in government expenditure.

Furthermore, high interest rates increase the incentive to save money, but they also encourage speculative investment that brings quick papers money profits to a few people, while adding nothing to the productive capacity. High interest rates and high credit also make capital to start new business get difficult to come by. Therefore, they result in stagnation.

Again the cut in government expenditure in some cases could be necessary. Most governments do not reduce expenditure on the army or on their non-productive and unnecessary areas. The result is that cut in government expenditure ends up harming the welfare of the people.

Nonetheless, very important factor is that devaluation of currencies which is supposed to increase self-sufficiency, by making imported products more expensive and African exports cheaper. Since most African countries do not produce these products, it is not possible to replace them with locally produced ones.

On the other hand, most of the countries that buy African products have set certain amounts on how much can be imported or have fixed prices in foreign currencies to shelter their own products, even when they become cheaper in local currencies, do not necessarily gain new outside markets or earn more foreign exchange. As it always very cheap as it's a very row materials with very low lab our, and old technologies if so, other case the business is a foreign owners.

The main source of revenues of the usurious banks is the interest which the charge in return of the use of funds deposited with them as current accounts, The bank can create =paper money = which is only of book value, this value is many times greater than the actual fund deposited.

Riba bank – Usury bank – Conventional bank – Traditional bank, the bank that concentrate upon current account transactions (debit /credit). That the whole income of these bank emerge from interest.

Islam:

Islamic Shria is the principle guide, formed form Quran and Sunna −Sunna is way Profits lives and says−to present all of issues that suite these roads. The spirit essence of the religion and the general principles of the Islamic were valid yesterday, are valid today, and will valid tomorrow, as a comprehensive style of life through all life aspect and live history of people as Islam also unite many past religions such as Christianity and Judaism. Share will guide people as continually extrapolated from sources of the religion, considering a main fact that **Quran** is the last of divine message for human guidance.[5]

The Islam organize the spiritual development of individual and rectify the socio–economic structure of the society by moving towards social justice, as the economic issues were introduced in the main sources of the religion *Quran and Sunna*. And have a distinguished the character from other religions as Judaism and Christianity. It is easy to notice that it is a religious community as well as a political, social and economic community.[(6)]

It is practical bearings and contains thing that good and beneficial to the people irrespective of time and place of stage of their cultural, social and technological development.{ Today I have perfected your religion for you and completed my blessing on you and approves Islam as the way of life for you} Quran 3−3.

Money in Islam:

Most The economist gave the meaning of money as [What Money is that Money does Walker p 409] .The modern economic system by [K,K Dewelt]. The whole existing financial system in the world is built on a simple concept of money as a commodity. At the same simplicity, if money is commodity it must have a market, a price and has to be bought and sold. Thereby, the commercial banks can use an interest rate as a tool to call the depositors to keeps their money at the bank and also offer the business men to give them loans by certain rate of interest so the bank is just like a machine for using the rate of interest plus and minus [(7)].Money in Islam: it is a medium of exchange that represent the estimated value of things not as a commodity itself. It has special social importance, as it is not allowed of being kept, without using in finance, trade and moved between people wherever need of investment. and is not allowed to play a role of good, its function is just for evaluating goods and services with efforts only.(8)

How money is Different from other commodities:

1. Money had a technical or artificial property of yielding its owner real income simply by his holding it i.e without exchange it against other goods.
2. It had no carrying cost no production cost and no substitute having complete liquidity.
3. Demand for money was not genuine as it was derived from demand for goods that money could buy.
4. Money was exempt from the law of depreciation to which all goods were subject to that law.(9)
5. Money was the product of social convention having a purchasing power derived mainly from its sovereignty as against the intrinsic value of other goods.
6. Commodity has value and benefit you can eat, drink, wear or different other activities but money you cannot. Money has no intrinsic value at all.(10)
7. Money is the unified descriptive value of commodity while it is consumable, transforming and luxury, comfort or beauty as it is an actual purpose of itself.

It is clear to be stated that Money is a means of exchange as it is no more than a means of exchange, and it is not a commodity which can be bought and sold.

Based on the previous demonstration, the interest based banking concentrate the wealth in a small section of the society by confining the finance to the creditworthy, who possess collateral .This precluding the majority of the population access, which results in aggravation of poverty and social unjust facing poverty risks.(11)

Important consideration accordingly, Islamic main guides correct the rules, financial system money is primarily and exclusively a measure of value, a means of exchange and standard of deferred of payment. Money has to operate through some real economic activity or service. It is facilitator and intermediary not an active self-contained agent in itself. Capital is productive not money per se.

This is a means towards production through creative entrepreneur efforts. It is to be an instrument towards value- added through physical expansion of the economy.[12]

To be specific, real economic progress and development consist in expansion of physical and human aggregate of the economy via creation of assets, products and services, not merely in the form of fiduciary financial expansion. It is through such a generation of wealth that well-being takes place and the relationship between money-economy and physical–economy remain real equilibrium.

Islamic Finance:

Islamic finance is a part of an Islamic Economic system which is inspired by Sharia (Islamic Law), it's profoundly aimed to support the achievement of the objective of sharia, which should manifest in the economy as it enables growth and justice, and ultimately the economic system would serve the interests of all human being.

Central to Islamic finance is the fact that money itself has no intrinsic value. It is simply a medium of exchange as evinced. Each unit is 100% equal in value to another unit of the same denomination, and it is not allowed to make a profit by exchanging cash with another person. As it's in most cases not allowed to benefit from lending money or receiving money from someone.

Guidance was founded on principles derived from Islam's ethical treatment of financial dealings otherwise known as Islamic Finance. Islamic financial transaction laws are aimed at protecting the rights of all parties involved in a business transaction while also eliminating the possibility for either party to exploit the other, or change value of things at the intermediate abstraction of goods, services or real efforts and real implementation of real value.

The rules and the principles of the Islamic finance is:

1. Any predetermined payment over and above the actual amount of the principal is prohibited.
2. The lender must share in the profit or loss arising out of the enterprise for which the money was lent.
3. Making money from money is not Islamic ally acceptable.
4. Uncertainty, risk or speculation (Garar) is also prohibited.

5. Investment should only support practices or productive that are or even discourage by Islamic bank for example would not finance trade in alcohol, areal-state loan could not be made for construction of casino, and the bank could not lend money to other banks at interest.

Islamic Modes of Investment:

Investment is the action of deploying funds with the intention and expectation that they will earn a positive return for the owner (Brokington 1986, p.68). Funds may be invested in either real assets or financial assets. When resources are used for purchasing fixed and current assets in a production process or for a trading purpose, then it can be termed as real investment. The establishment of a factory or the purchase of raw materials and machinery for production purposes are examples in point. On the other hand, the purchase of a legal right to receive income in the form of capital gains or dividends would be indicative of financial investments. Specific examples of financial investments are: deposits of money in a bank account, the purchase of Mudaraba Savings Bonds or stock in a company. Ultimately, the savings of investors in financial assets are invested by the respective company into real assets in the form of the expansion of plant and equipment. Since Islam condemns hoarding savings and a 2.5 percent annual tax (Zakat) is imposed on savings, the owner of excess savings, if he is unable to invest in real assets, has no option but to invest his savings in financial assets. When money is deposited with an Islamic Bank, the bank, in turn, makes investments in different forms approved by the Islamic Shariah with the intent to earn a profit. Not only a bank, but also an individual or organization can use Islamic modes of investment to earn profits for wealth maximization. Some popular modes of Islamic Investment are discussed below. A comparison is also attempted between the Islamic Modes of Finance and these of conventional banks.

Islamic Banks:

An Islamic Bank is a financial institution that operates with the objective to implement and materialize the economic and financial principles of Islam in the banking arena. Islamic banks were presented as the vehicle of the Islamic system of economic development.

It is a financial and social institution whose objectives and operations as well as principle and practices must conform to the principle of the Islamic Sharia (Jurisprudent). And which must avoid the interest in any of its operations. Islamic banks are engaged in mobilizing saving from Muslim savers by offering sharia compliant products that has different dimension of return, risk, liquidity, maturity, safety, and a like. Its ruling of Islamic Shria in fields of finance and other dealing, and reflect Islamic Principle in real life.(13)

The Islamic bank basically implements a new banking concept, as based on the universally principle and Sharia (Partnership)-(Labour +Capital). The sprite of Islamic bank is reinvestment act .The basic characteristic of Islamic bank such are:

1. Eliminating of dealing on the basis of interest rate
2. Directing efforts towards development by means of investment

The investment through two ways:

1. Direct investment
2. Investment in participation

These happen by the following actions:

1. Directing investment into channels exclusively producing the commodities and services which meet the legitimate needs of the Muslim
2. Making sure that the product –whether a commodity or services- is lawful in Islam.
3. Making sure that all the phases of production (financing, manufacturing, selling and buying) are lawful in Islam.
4. Making sure that all the factors of production (salaries-working system) are consistent with Islamic principles and are permitted by Islam.
5. To give priority to the needs of society and the common interest over the individual's profit and his private interest.(14)

The Main Islamic Modes of investment:

Murabha (Mark-up):

It is sort of selling at cost with addition of known profit. The bank practices selling by profit to the buyer. When the client asks the bank to buy a commodity from the local market or import it from abroad, the client describes the commodity and give complete specification. Then the bank purchases the commodity, sets the price, and acquires it. Then the bank supplies it to the applicant at its cost plus a known profit. It is a trustee contract whereby the bank provides capital and the client provides labor for joint venture [15]. The profit generated by the venture is divided according to a predetermined ratio. In the Mudaraba contract is one basic juristic rule governing the transaction, which is that losses are to be borne only by the provider of funds (lender), i.e. the bank. The user of funds, i.e. the customer (the borrower) does not bear any portion of the loss unless the loss was due to misconduct or negligence on his/her part. The Murabha operation consist of a promise to buy and a promise to sell ((There is existence of some misapplication of Murabha which turned out to rather fictitious in some cases due to the difficulty of tracing its implementation)). [16]

Murabha sale consist of, a promise to by, a promise to sell and Murabha sale .It is not however selling an unknown commodity so the bank receives a purchasing application and does not offer to sell it until it has really acquired and owned the order commodity and showed it to the client (purchase order) who will then decide whether or not it conforms to his specifications.[17]

Partnership (Musharka):

This is a partnership contract whereby the bank and the client contribute jointly to finance a venture. Musharka has three forms:-

1. Continued musharka.
2. Diminishing musharka.
3. Musharka in the working capital.

It focuses on an economic and social viability. Engagement in productive activity. Co-management in productive activity. Non-financial capital. Absence of debt. It not build up on debtor/creditor relationship. Long –term perspective. High profitability.

Diminishing Musharaka:

Diminishing or Digressive Musharaka is a special form of Musharaka, which ultimately culminates in the ownership of the asset or the project by the client. It operates in the following manner.[18]

The Bank participates as a financial partner, in full or in part, in a project with a given income forecast. An agreement is signed by the partner and the bank, which stipulates each party's share of the profits. However, the agreement also provides payment of a portion of the net income of the project as repayment of the principal financed by the bank. The partner is entitled to keep the rest. In this way, the bank's share of the equity is progressively reduced and the partner eventually becomes the full owner.

When the bank enters into a Diminishing Musharaka its intention is not to stay in the partnership until the company is dissolved. In this type of partnership, the bank agrees to accept payment on an installment basis or in one lump sum, an amount necessary to buy the bank's partnership interest. In this way, as the bank receives payments over and above its share in partnership profits, it's partnership interest reduces until it is completely bought out of the partnership.

After the discharge, the bank withdraws it claims from the firm and it becomes the property of the partner. The decreasing partnership arrangement is an Islamic bank innovation. It differs from the permanent partnership only in continuity. It appears that there are four steps of the diminishing partnership. Those are mentioned below [19]

Salam Sale:

This is sale in which the price is paid immediately for goods to be delivered at a future date. Salam is,at its origin, an agricultural product. The farmer normally needs financing for purchasing agricultural inputs like seed, fertilizers, pesticides, diesel for tractor, payment of water charges, labor, etc. The rational for Salam is the need of producers of agriculture and small-scale enterprises. Price of Salam can be in installments that each period has a different price, like, for planting, for clearing, Or for harvesting. These three steps can help the farmer to get finance at the specific times he need. Also figha accept the payment of the principal to be made in kind.[20]

Istisna'a Sale:

Definition of Istisna'a Sale:

The Istisna'a sale is a contract in which the price is paid in advance at the time of the contract and the object of sale is manufactured and delivered later (IDB 1992, p.28). The majority of the jurists consider Istisna'a as one of the divisions of Salam, Therefore, it is subsumed under the definition of Salam. But the Hanafie school of Jurisprudence classifies Istisna'a as an independent and distinct contract. The jurists of the Hanafie school have given various definitions to Istisna'a some of which are: "That it is a contract with a manufacturer to make something" and "It is a contract on a commodity on liability with the provision of work". The Purchaser is called 'Mustasnia' contractor and the seller is called 'Sania' maker or manufacturer and the thing is called 'Masnooa', manufactured, built, made (ABIIB). Islamic banks can utilize Istisna'a in two ways.[21]

Ijara (Leasing):

Ijara is simply an Islamic lease agreement. It is defined by AAOIFI as: “Ownership of the right to the benefit of using an asset in return for consideration”. In this type of financing, the bank purchases a piece of equipment selected by a client, and then leases it back to him/her for a specified rental over a specific period. The duration of the lease, as well as the basis for rental, are set and agreed in advance. In some cases, the bank may lease a tangible asset from a third party and subleases it to its client. The Islamic banks are currently practicing this technique in circumstances, under which clients opt to buy the item(s) eventually. In such circumstances, Ijara is practiced either in the form of “Ijara-wa-Iktana” or “Ijara with diminishing Musharaka”. The contract of “Ijara-wa-Iktana” extends the concept of Ijara to a hire and purchase agreement. It includes a promise from the client to buy the equipment at the end of the lease period, at a pre-agreed price. Rentals paid during the period of the lease constitute part of the purchase price. In other words, the monthly payment will consist of two components, i.e., rental for the use of the equipment and instalment towards the purchase price. Often, as a result, the final sale will be for a token sum. However, the contract of “Ijara with diminishing Musharaka” is widely used for home-buying services. Diminishing Musharaka means that the bank reduces its equity in an asset with any additional capital payment the client makes, over and above his/her rental payments. The client's ownership in the asset increases and the bank's ownership decreases by a similar amount each time the client makes an additional capital payment. Ultimately, the bank transfers ownership of the asset entirely over to the client.5 The liquidity risk in both types of Ijara contract will therefore be limited as the sale price is built into the rental installments[22]

Conclusion

Islamic banking is currently one of the fastest growing segments of the financial market industry. Islam offers new perspectives for defining progress and sustainable civilization that is based on social justice and quality of life rather than unlimited individual accumulation of wealth. Hence, what becomes important in the new Islamic vision of the future is personal transformation of a balanced and harmonious human rather than a consumer who strives for material accumulation. Simply said, the Islamic model or paradigm is focused on expanding human empathy not territory.

The Islamic financial model prove that it's a suitable mechanism to solve the poverty problem directly by emergent the different variety models that not only concern at only one type of traditional financial system.

The world today waiting for the applications of most of these Islamic modes of finance so as to bridge the gap between poor and richer, on the same way the percentage of poverty can easily decrease and abolish immediately.

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