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Islamic banking in Southeast Asia

- Venardos, Angelo. 2005. *Islamic Banking & Finance in South-East Asia: Its Development & Future*. Singapore: World Scientific. 268 pp. ISBN 981-256-152-8 (paperback)

Muhammed Hassanali

One needs to have a firm grasp of both the current banking environment and the interpretation of Islamic commercial law to fully appreciate the challenges faced and the opportunities offered by Islamic banks today. Both aspects are riddled with intricacies and neither is uniform across national or cultural boundaries. *Islamic Banking & Finance in South-East Asia* attempts to provide an overview of the banking environment and interpretation of Islamic commercial law in Southeast Asia.

To understand contemporary Islamic banking, one must know its past. Venardos presents an overview of Islamic history, the spread of Islam in Southeast Asia and lingering colonial legacies. He provides a synopsis of Islamic law as it relates to commercial activity, explores the most common financial instruments traded by Islamic banks and outlines salient challenges confronting Islamic banks from both doctrinal and regulatory perspectives. He then describes the environment and operation of Islamic banks in various South-east Asian countries.

The Koran and *Sunna* (ways of the Prophet) form the basis of Islamic law. Both contain guiding ethical principles

from which legal doctrine must be extrapolated and developed; this process is a kind of 'discovering' of law that typically takes into account prevailing laws and customs. For example, Islamic law prohibits *riba* (usury). Most Muslim jurists take a literalist stand against usury, proclaiming that *any* interest charged is not permitted, but they allow the making of reasonable profits on goods and services. Hence, as Venardos correctly points out, contemporary Islamic banks must trade in real assets rather than charge interest. This limits the bank's ability to trade in other financial instruments (such as futures) and restricts its revenue streams.

Islamic law also prohibits *gharar* (gambling or excessive risk); thus Islamic banks avoid futures and options as they are seen as excessively risky. In this vein, Venardos narrowly portrays hedging as an instrument 'to monopolize some commodities' and calls its use 'the illegitimate objective for monopoly profiting' (p.160). He does not consider hedging from a micro-economic perspective that allows small and medium-sized businesses to effectively compete in the global marketplace while mitigating exchange rate risk.

The prohibition of charging interest forces Islamic Banks to either 'sell' tan-

gible goods or take equity positions in the businesses they finance. Hence they assume more risk than do conventional banks. Venardos emphasizes, to a fault, how Islamic banks provide conventional banking services, yet he does not delve into some of the services they provide that are similar to those provided by conventional mutual funds. A substantial part of Islamic banking involves partnerships formed in the course of financing that are more reminiscent of developing a portfolio of equity positions like those of mutual funds.

Since the 1970s, Islam has been experiencing a revival of sorts; Muslims are asserting their religious identity and are trying to lead lives as worthy Muslims. This has partially fueled the demand for Islamic banking, as Venardos alludes to in his discussion of Islamic banking in Indonesia. However, the rise of increasingly extreme interpretations of Islam threatens advances made by Islamic banking in two main ways: the first is a growing suspicion of anything Islamic in non-Muslim countries, especially in post-9/11 Western Europe and North America; another is the rise of literalist interpretations of Islamic law, which stifle the creativity necessary to interpret commercial law that could be used to conceive novel financial instruments. Venardos should have mentioned these threats.

Islamic banks face several more challenges, including assessing and regulating appropriate risk levels, establishing appropriate accounting practices and providing mechanisms that create liquidity for assets held by Islamic banks. Venardos describes regulatory hurdles in Southeast Asia and what banks have done to overcome them. He also addresses the difficulties of providing useful banking services while staying within Islamic commercial law subject to a plurality of interpretations. But he focuses neither on agency risk and its impact on regulation nor on consumer perceptions of Islamic banks.

An overview of Islamic banking should explore how an ideal Islamic bank provides its customers the services they need while dealing with today's commercial banking challenges. Venardos adequately describes the underlying basis for Islamic banks, but he does not draw on the rich historical legacy of Muslim commercial activity. For example, during medieval times, the Muslim empire circulated bimetallic coinage. One gold *dinar* was generally worth ten silver *dirhams*, but the exchange rate varied widely. What did traders do to mitigate risk? How did they achieve liquidity? More importantly, what can today's Islamic banks learn from this history?

The book's other shortcomings include footnotes that refer to sources (such as Usmani, Braddell, Harvey and Partadireja) curiously unlisted in the bibliography. Conversely, the bibliography lists works that are not referenced in the text and have little (if any) bearing on Islamic banking (such as *The Khoja Case* or *Sufism's Many Paths*). Moreover, the bibliography is difficult to search as some references are out of alphabetical order. The text is not without typographical errors and cases of poor sentence structure. In chapters eight and nine, entire paragraphs are repeated verbatim.

Venardos hints that Islamic banking has the potential to offer more, both in terms of interpreting Islamic law and providing financial services and instruments. But his book leaves the impression that Islamic banks are just like conventional banks except in the different words either uses for 'interest'. They provide similar financial instruments and operate in the same way – or so the reader is left to believe. ◀

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