Islamic banks have had mixed success in Jordan. The Jordan Islamic Bank for Finance and Investment was created in 1978 as a member of the Saudi Arabia-based Al Baraka network of Islamic banks, but 90% of its capital was Jordanian owned. By 1986 it had become the sixth largest of Jordan’s banks in assets and had financed numerous projects. The Islamic International Arab Bank provides a full range of comprehensive and complementary banking services for individuals and corporations in accordance with Islamic Shariah rules. The existence of such banks has proven to be for the benefit of the entire economy. My studies and research in the area have led to the following findings.

“The existence of Islamic banks has proven to be for the benefit of the entire economy”

- The existence of Islamic banks in Jordan mobilized large amounts of monies previously hoarded by individuals so as to avoid engaging in usury interactions with banks.
- Statistics indicate that the establishment of Islamic banks in Jordan has not reduced the deposits of previously existing banks (reallocation of fixed money supply). Instead it has reduced the hoarded money, which can then contribute to the growth of the financial system.
- The statistical results of a two-stage ordinary least square model to capture the direct and indirect effects of Islamic banks in Jordan show that changes in total investment and net transfers from abroad have had a positive and significant impact on real per capita income.
- The total credit provided by conventional banks proved to be insignificant, even though it shows a positive coefficient. This can be explained by the fact that a large portion of such credits goes to the service sector.
- Regarding the specific impact of the change in financing and investment by Islamic banks in Jordan as a percentage of total credit by conventional commercial banks on the investment level, it was found to be positive but insignificant. This is to be expected, since most financial operations conducted by such banks are short-term or medium-term, so that the bank has to hold high levels of cash to meet any contingency in an emergency situation.

Islamic banks differ from conventional banks in that their spectrum of financing is more varied. Their investments are more diversified in terms of maturity, liquidity and risk, ranging from the relatively short-term, more liquid and less risky mode of Murabahah to the longer term, less liquid and higher risk mode of equity (or direct Musharakah) financing. Each mode differs in its effect on the capital accumulation capability and resource utilization efficiency of the banks, and thus the economic growth of the relevant country also varies. The effect of a bank’s activity on economic growth will therefore depend on which modes of finance and investment the bank undertakes most, and how much each one of these modes contributes to economic growth.

“At present, fixed return modes of financing are dominating usage by most Islamic banks – modes such as Murabahah and leasing”

Broadly speaking, Islamic financial transactions are of two kinds: one is based on a fixed charge on capital, and the other is based on profit sharing. At present, fixed return modes of financing are dominating usage by most Islamic banks – modes such as Murabahah and leasing. Even though these are clearly distinguishable from interest-based modes, as transactions are always done through real commodities, they do not yield the full benefits in terms of promoting growth with equity which is expected of an Islamic financial system. Specialists in Islamic financial theory had counted on Islamic banks to provide a significant amount of profit-sharing finance, which would
have had economic effects similar to direct investment and would have produced a strong economic development impact. However, due to practical difficulties, profit-sharing finance has remained negligible in the operations of Islamic banks.

Financing modes such as Murabahah are serving a useful purpose: they provide investors with high liquidity at low risk. Unfortunately, until a proper institutional set-up is built and the necessary products, including those for managing risk, are developed, it may not be possible for Islamic banks to increase drastically the use of riskier modes. However, Islamic banks can be encouraged to provide more profit-sharing finance if arrangements are made to reduce the costs involved by appropriate institutional arrangements, as well as financial engineering consistent with the preferences of fund users. The benefits of direct investment in terms of economic development may not always be fully reflected in the rate of return; they are felt by society as a whole. It may, therefore, pay to support the involvement of Islamic banks in profit-sharing finance, as until such arrangements are made, banks will not increase their risk exposure to any large extent. In the short run, therefore, the emphasis should move to a greater reliance by businesses on equity and a smaller reliance on credit. For this purpose attempts should be made to increase the number of equity institutions such as mutual funds, unit trusts and equities.

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References are available on request from the author.