



YUGOSLAV SOCIETY FOR THE SCIENTIFIC STUDY OF RELIGION
FACULTY OF MECHANICAL ENGINEERING – UNIVERSITY OF NIŠ
INSTITUTE OF SOCIAL SCIENCES
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edited by
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CONTEMPORARY RELIGIOUS CHANGES: FROM DESECULARIZATION TO POSTSECTULARIZATION

RELIGION

STATE



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From Desecularization to Postsecularization**

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THE ROLE OF RELIGION IN BANKING BUSINESS IN ISLAMIC LAW

Summary

In recent decades, the world is rapidly developing Islamic banking, as well as specific types of banking, in addition to conventional banking, as the prevailing concept of operations of banks around the world. In contrast to conventional banking that is primarily focused on profiting, Islamic banking is based on the principles of justice and fairness, in order to achieve equality in society, for the benefit of society as a whole, and in the spirit of learning Islamic religion. Islamic banking is based on Islamic law and that of the Islamic faith. Referring to the basic sources of Islam - the Quran and the Sunnah, the concept of Islamic banking, which is theoretically justified Sharia prohibits certain institutes such as interest; risk; uncertainties; deception; hazard, etc. Considering that interest (riba) is forbidden by the Quran, the profit and loss sharing principle, as well as partnership relations in mutual business ventures, constitute the core operations of Islamic banks. Since the interest loan is prohibited, the Islamic banks are prohibited to avoid jobs involving excessive speculative risk (Gharar). Also, Islamic banks are forbidden to finance activities that are considered harmful, or immoral for Muslims (e.g. the production and distribution of alcohol and alcoholic beverages, drugs, weapons, pork meat, organizing games of chance, dealing with pornography). The duty of the Islamic bank, as well as every Muslim, is the separation of zakat, a kind of religious tax. The obligation of the zakat is based on the interpretation of the nature of the property in the Quran. Since Islamic banks are profitable institutions, like the conventional banks, specific ways of doing business are designed by Islamic law and morality (e.g. murabaha, mudaraba, musharaka, istisna, ijara)..

Key words: Islam, banking, Islamic banking, prohibition on interest, sharia.

INTRODUCTION

Almost all authors who write about Islam do not fail to emphasize the integral dimension of Islam. They point out that Islam does not pretend to regulate the relationship between man and the exalted creator, but also all other segments of human relations and actions. Some Muslim authors widely argued that Islam has done a system which would solve many of the social problems facing the modern, globalized society. Special attention of Islamic experts occupies the topic of the normal functioning of the financial markets, and therefore the operation of banks, as the main actors in the financial markets.

Islamic banking is based on Islamic law and that of the Islamic faith. Of course, Islamic banks have both Muslim and non-Muslim clients, whether in Islamic or Western European countries.¹ The owners of shares of Islamic banks, as clients of

¹ There are many examples that prove this view. Malaysia is a country with a long tradition of Islamic banking, where nearly 50% of customers of Islamic financial institutions are non-Muslim. This can be justified clearly on the basis that the religion of the participating parties has never been an issue for consideration in any Islamic financial transaction. (Aldohni, 2011:6).

Islamic banks, can be other denominations (e.g. Christians, Jews, atheists, etc.) (Jovanović, 2017: 230). The essence of Islamic banking is the prohibition of interest, which has forced Islamic banks to operate under the principle of dividing profits and losses with the carrier of the financing venture.

THE EMERGENCE AND GROWTH OF ISLAMIC BANKING

Islamic banking as a specific type of banking business appeared after World War II. The first banks are established in the newly formed countries of Asia and Africa, just liberated from the colonial powers of the West European countries. In addition to the political liberalization movements against the Western occupation, a call for cultural authenticity was another main theme of this period. The cultural authenticity movement found that „theories, concepts and methodologies can be derived from the culture of various non-western civilizations“. What cannot be ignored in the context is the extent to which religion has contributed to Islamic culture (Aldohni, 2011: 10).

The emergence and growth of Islamic banking in Muslim countries is a result of different elements. These elements are religious, social, economic and political. There were strong movements for the restoration of national identity, above all, the introduction of the Islamic faith in the all aspects of individual and social life. This means that regulations, principles and rules that the Quran and Sunnah contain should apply to all aspects of life. However, not everything went smoothly. In some Muslim countries such as Egypt and Syria, the religious movements are met with resistance of the ruling political regimes. With the advent of the oil crisis in the 1970s and the rapid development and enrichment of Near and Middle Eastern countries, the rapid development of Islamic banking has begun thanks to its natural resources, primarily oil fields. Due to the rapid increase in oil prices, enriched Islamic countries were required banks that would encourage further economic development. Middle Eastern countries have invested their wealth in further developing the economy. Thus, Bahrain became the main banking center of the Middle East, and Dubai is the leading shopping and tourism center (Jovanović, 2017: 232). The first Islamic banks were established in the mid-1940s in Malaysia, in Pakistan in the late 1950s, in Egypt in the 1960s, in India in 1969.

The effort invested primarily by economists Ahmad El Nedžara resulted in the opening of the first Islamic bank in Egypt in 1963. *Mit Ghamr Saving Bank* was founded as a profit-sharing deposit bank. The Bank is not charged interest in its operations. On the other hand, the bank invested in trade or industry, directly or in partnership with others, and shared the profits with their depositors. So, it functioned as a savings bank and investment institution, not as a commercial bank. In 1967, a bank abandoned the experiment of the interest-free business model and turned into a commercial bank because of the increasing pressure of the Egyptian government, which was slightly in favor of this kind of business (Dudić, 2012: 102).

Today, the *Islamic Development Bank (IDB)* is the largest Islamic bank in the world, established in Jeddah. The Islamic Development Bank was the first Islamic financial institutions to benefit from the inflow of oil-related wealth. The IDB established in 1974 with the support of the Saudi Arabian government and the Organization of Islamic Countries – OIC it is primarily an intergovernmental bank aimed at providing funds for development projects in member countries (Lewis & Algaoud,

2001: 7). Members of the Islamic Development Bank are 50 Islamic countries and, among the largest shareholders, are Saudi Arabia, UAE, Kuwait and Libya. The forward important development in Islamic banking took place in the 1980s with the formation of the two international Islamic holding companies. Primarily, *House of Islamic Funds (Dar al-Maal al-Islami Trust - DMI)* founded in 1981 in the Bahamas and headquarters in Geneva, and *Al-Baraka Group*, established in Saudi Arabia and operates 15 banks and over 2.000 companies, including insurance corporation, industry, research centers with activities in 40 countries (Lewis & Algaoud, 2001: 12).

The regulatory framework of Islamic banking differs from country to country, although in the world dominated by two systems of Islamic banking, depending on whether in a particular country allowed conventional banking in addition to Islamic banking. In a system of pure Islamic banking, states allow only the operations of Islamic banks in its territory (Jovanović, 2017: 235). This form of Islamic banking has taken involves the restructuring of the whole financial system to accord with an Islamic precept. Only three countries in the world where this transformation of the system is underway are Iran, Pakistan and Sudan.² In Iran, all banks have operated under Islamic law since 1984 when interest (*riba*) was abolished from banking operations, and profit-sharing techniques substituted (Lewis & Algaoud, 2001: 14). The second form has been an attempt to establish Islamic financial institutions side by side with traditional commercial banks. In such a mixed system, the types of institutions which have developed are Islamic banks created in Muslim countries (e.g. Egypt, Indonesia, Qatar, Malaysia, Saudi Arabia and Turkey), and Islamic investment and holding corporations operating in both Muslim and in non-Muslim countries (e.g. United Kingdom, France, Switzerland and USA) (Lewis & Algaoud, 2001: 14).

The Islamic banking movement was not limited to Islamic institutions in Muslim countries. The first Islamic bank in Europe was established in Luxembourg in 1978. It was the *Islamic Banking System*, now it is *Islamic Finance House*. Shortly after that, in Denmark was founded the *Islamic Bank International of Denmark* in Copenhagen and *Islamic Investment Company* in Melbourne in Australia. Western European banks have been active in Islamic finance from the beginning. European co-mmmercial banks took interbank deposits from the Islamic financial institutions which were collected by the Muslim populations in the countries in which they operated. Western banks which received interbank deposits from Islamic institutions, used this funds in accordance with Sharia principles. Among the most attractive Western participants were *Citibank* and *Union Bank of Switzerland*, which have their windows for interest-free business (Dudić, 2012:103).

Islamic banking law is not codified, nor in all Islamic countries introduced in the same way. For example, Islamic banking is regulated by law in Indonesia, Malaysia, Iran, Jordan, Kuwait and Sudan. Through government regulation, the Islamic banking was introduced in Kazakhstan and Qatar, while in Afghanistan, Bahrain and

² It is interesting that in these countries, in parallel with the adoption of regulations, the establishment of regulatory bodies, the formation of the capital market, Islamic banks have recorded high rates of growth in deposits and transactions. With a rapid rise of participants and assets imposed by the need to introduce the modern risk management in banks. Therefore, the Islamic banks of Iran, Pakistan and Sudan, at the initiative of the competent central banks, have adopted the European concept of risk management in banks, inaugurated in the recommendations of the Basel II and Basel III (Radovanović, 2018: 98). For more information about the financial markets in developed countries see (Sovilj, 2019: 160-170).

Ethiopia, the central bank is responsible for issuing regulations governing the operations of Islamic banks (Jovanović, 2017: 248).

THE ADVANTAGES AND DISADVANTAGES OF THE ISLAMIC BANKING CONCEPT

The comparative analysis with conventional banking reveals certain advantages and disadvantages of the concept of Islamic banking. The main advantage is that Islamic banks are less susceptible to financial crises, which was observed during the global economic crisis in 2007. The considerable resistance of Islamic banks to stress has been reported. Secondly, the introduction of Islamic banking into the country reduces the cost of such a way of doing business. The Islamic banking enhances competition in the market, which could lower the cost of finance for Shariah-compliant products. For states with small demand for Islamic banking services (states with a small Muslim population), the Islamic banking window could be the only feasible way of providing services, thus enhancing financial inclusion (Song & Oosthuizen, 2014: 12). Islamic banks base their businesses on the experience of conventional banks. Hence, they avoid the errors made by conventional banks in their development and operations (Jovanović, 2017: 236).

On the other hand, there are many disadvantages of Islamic banks. Primarily, the Islamic bank should misjudge the profitability of investing in a particular business venture and it should make a loss in its operations. In that case, the loss suffered its depositors that lead to loss of confidence in a particular bank. Secondly, it is difficult to monitor the operations of Islamic banks, due to the complexity of business operations and financial transactions. Furthermore, in Islamic banking, the business risk is more pronounced in comparison to conventional banking. The reason for this is the responsibility of the compliance of each banking business with Shariah. If the business is estimated to be contrary to Islamic law, the bank is obliged to abandon its undertaking (Jovanović, 2017: 236). If the Islamic bank has taken a risky business, it must be terminated, and it may cause a serious loss in its assets. The issue of how distressed Islamic banks should be resolved in accordance with Shariah principles is still under deliberation. This issue is further complicated for Islamic banking operating within a conventional bank. If the authorities are faced with a distressed conventional bank, they may not be able to carry out an orderly resolution satisfying financial stability objectives and Shariah principles that could potentially modify the treatment of the Islamic banking (Song & Oosthuizen, 2014: 12).

THE BASIC PRINCIPLES OF OPERATION OF ISLAMIC BANKS

The business of Islamic bank is based on the following principles: prohibition of interest charges; allocating funds to a charity fund; prohibition of immoral activities; prohibition of precarious business and prohibition of the premium insurance contract.

Interest prohibition (riba) - Islamic banks are prohibited to pay interest to depositors (passive interest) but also to collect interest from their debtors, borrowers (active interest). There are different interpretations of whether any interest is prohibited or only one that represents usury. The prevailing view was that any interest

was forbidden.³ The prohibition of interest in all financial affairs, especially banking was introduced in Islamic law since it prohibited people from exploiting one another due to the Islam was allowed people to earn money solely through their work.⁴

As a key element of modern operations in the financial markets, interest has a very long history, dating back to ancient civilizations, from the Babylonian Empire and ancient Greece to the Roman Empire and the Persian Empire. In support of this, there are numerous controversies about the justification of the use of interest, ie its prohibition, led by the most eminent philosophers of the ancient world - Plato in the *Laws*, Aristotel in *Politics* (Lekpek, 2013:301).

The other monotheistic confessions such as Judaism and Christianity applied the prohibition of interest advocated by Islam. The unambiguous prohibition of interest in Christianity is based on a numerous texts from the Old and New Bible, which strongly condemn the payment of interest. In this way, they emphasize its social harmfulness and immorality (in the Bible book of Exodus 22: 25-26; Leviticus 25: 35-37; Solumon's stories 28: 8; Psalm of David, 15: 5; the New Bible: the Gospel of Luke 6:35). Judaism rejects interest as an undesirable and immoral category. However, it makes a distinction between members of Judaism and those who are not, and allows interest to be paid to members of other denominations (Lekpek, 2015: 364).

The question of the prohibition of interest was also interested in Christian thinkers during the Middle Ages, among which are an especially prominent theologian and philosopher Thomas Aquinas. In his work "Sum of Theology" (*Summa Theologiae* or *Summa Theologica*), starting from the basic Christian postulates, Aquinas criticizes the use of interest, considering the socially unacceptable and immoral. As social circumstances changed over time and the influence of the Church permanently diminished, so began to reconsider attitudes about the moral and social unacceptability of interest. During the 16th century, in the Christian church appeared factions reviewed the prohibition of interest payments, emphasizing that the prohibition of interest should only refer to excessive interest (usury or greenery). Finally, under the influence of social change, the Catholic Church also relented and, in 1839 lifted the prohibition on interest payments (Lekpek, 2015: 364-365). The conclusion is that the power of the prohibition of interest in Christianity weakened in parallel with the decline of the social influence of the church. On the other hand, the prohibition of interest in Islam has maintained its existence until now. However, there are different views about interest in Islam. Some religious schools believe that prohibition of interest in Islam refers only to the too high interest, as well as the interest on consumer loans.

How important is the issue of prohibition of interest in Islam, is the fact that the 12 verses in the Quran refers to *riba*, and that is the word *riba* is mentioned eight times. Muhammad adhered to the literal prohibition of interest. In his discussions with his followers, he emphasized the prohibition of interest and its perniciousness

³ Islamic lawyers distinguish two types of interest: *riba al-nasi'ah*, which refers to the interest the borrower charges on the debtor, given the time it takes the borrower to repay the loan, and *riba al-fadl* concerning the exchange of goods, with the same commodity exchanges in unequal amounts. According to Islam, goods of the same kind can only be exchanged promptly, in the same quantities and qualities (Marinković & Lekpek, 2013: 54).

⁴ In addition to the usual ways of acquiring property such as inheritance, legal transactions of exchange (barter), gifts, leases, partnerships, other ways of acquiring private property are permitted, except for labor: booty and the Caliph's assignment, etc. (Stanimirović, 2015:111-113).

to man and society. The aforementioned Muhammad's proclamations on the prohibition of interest were recorded in the form of hadith. The importance of the hadith for the followers of Islam is invaluable, due to the fact that it explains in detail how Islamic teachings should be applied (Lekpek, 2015: 366-367). The Islamic thinkers find justification for the interest prohibition in its unfairness.

Charity (Zakat) – The Quran states that people will have various incomes and financial positions and that they have the right to possess their wealth. Those who are awarded the wealth will, however, have duties towards the society, and their wealth should be used to benefit the whole community and not to exploit others' needs. This is simply the balance that Islamic economic theory aims to achieve (Chapra, 2006: 98). Every Muslim who achieve earnings above that needed for a decent life to him and his family is obliged to set aside a certain amount (usually 2.5% of income) to help those Muslims who are in need. Also, every bank is obliged to establish a merciful (charity) fund, in order to collect contributions from wealthier clients and to redistribute them to poor citizens. The obligation of the Zakat is based on the interpretation of the nature of property in the Quran, according to all assets belong to God, and he only temporarily entrusted to a man who acquires it for life. The assets have a social role in Islam and must be used in the public interest. In addition to the zakat, which is a compulsory giving of charity to the poor, there is a sadaka in Islam, which is voluntarily given by the Muslims to the poor citizens (Jovanović, 2017: 252).

However, the obligation of the Zakat is one of the crucial obstacles to the establishment of Islamic banks in non-Muslim countries. The problem gets more complicated in Western European countries where there are some Muslim minorities who, for religious reasons, are reluctant to deal with conventional banks. The absence of formal Islamic banks, in this case, would create opportunities that underground financial authorities purporting to be Islamic can exploit. Investing or transferring any money through these organizations, over which the authorities have no supervisory powers, may be a real threat to any government. In practice, this money has been misused to finance terrorism against Western countries, despite that banks which collect money are not involved in such actions (Aldohni, 2011: 23-24).

Prohibited transactions (haram) - The Islamic banks are prohibited to avoid businesses involving excessive speculative risk (Garar). Islamic banks cannot finance activities or items forbidden in Islam because those activities are considered harmful or immoral for Muslims (e.g. the production and distribution of alcohol and alcoholic beverages, drugs, weapons, pork meat, organizing games of chance, dealing with pornography). The participation in the production and marketing of luxury commodities is considered as unacceptable from a religious point of view when Muslim societies suffer from a lack of essential goods and services such as food, clothing, health and education (Lewis & Algaoud, 2001:30).

Prohibition of precarious businesses (maysir and gharar) - Islamic law forbids all activities to Muslims which the result depends on some uncertain facts. There are two types of such activities. The first are gambling (maysir) - gambling, betting, lottery. Also, Islamic law forbids any business activities which contain any element of gambling. The reason for that prohibition is that Islam does not accept the acquisition of assets without effort. Another type of precarious business is one in which the emergence of rights or obligations for participants or their amount depends on the fact that is uncertain at the time of their undertaking (gharar). This type of operations is forbidden by Sunnah. This prohibition applies in a number of

circumstances like as when the seller is not in a position to hand over the goods to the buyer or when the subject matter of the sale is incapable of acquisitions (Lewis & Algaoud, 2001:31). The other prohibited activities are speculative transactions in the stock exchange; trading with derivative financial instruments in the stock exchange (e.g. futures and options) and premium insurance contracts. On the other hand, the transactions are allowed where the uncertainty is caused by objective price movements in the market, given that is a necessary fact to be reckoned with in the trade (Jovanović, 2017: 254).

Cooperative Insurance (Takaful) - Premium insurance business is prohibited under Islamic law due to the uncertainty that it contains.

DETERMINATION OF MONEY IN ISLAMIC BANKING

The exaggerated role of money in today's world has led to the situation that the modern man can all determine the price, but nothing value. Money in the context of Islamic banking represents only a means of exchange, that is, a way of defining the value of things. Money has no value in itself. On the other hand, money is a medium of exchange in an asset oriented economy, and a store of value (Sarker, 2012: 1).

As opposed to conventional banking, Islamic banking is variously defined money. The money in the conventional banking is a good that is sold or leased, while in the Islamic banking money cannot be sold (Budimir, 2016:66). Islam forbids money to make money. In order to the money be useful, it is necessary to turn it into a commodity, which is for sale, and that can make a profit. So, for money to be useful, it must turn into something that is inherently beneficial. Only then the Islamic bank can make a profit in business. For example, financing a home or some project requires from Islamic bank to invest funds and take a proportionate share of the ownership and risk to justify the profit (Budimir, 2016: 66).⁵

According to the Quran, trade and usury are not the same. The trade is the basis of economic growth, while usury is a phantom profit without an asset base. The question is not whether it is possible to have an economic system without interest, but how something that has nothing to do with real economic activity, such as interest, is generally able to sustain itself in the face of all the systemic crises and instability it causes. The conclusion is that the interest-free banking does not mean non-profit banking, but something more stable and secure ethical alternative.

CONCLUSION

Islamic banking is one of the fastest growing global financial sectors for which investor interest was evident even before the global financial crisis. Only with the spread of economic crisis, investor interest in Islamic banking has increased due to the efforts to find alternative ways of investment. According to some estimates, the value of the "global Islamic market" is about a billion dollars. Today, Islamic banks operate in more than 100 countries. This is a sufficient argument that the financial world has recognized this way of business attractive, prosperous and safety (Sovilj, 2019: 522).

⁵ Available at: <http://poslovnisvijet.ba/islamsko-bankarstvo-fenomen-modernog-drustva/>, 1, 20. 03. 2019.

Islamic Bank achieved a dizzying revenue in 2011, have a thousand billion dollars, which is 18% more than the previous year. According to the available data, at present there are 350 banks operating under the Islamic Law. Although most of them are located in Muslim countries, some of them present in other countries, including USA and Europe (Marinković. 2013: 108). In Australia, there are two Islamic bank, six in the Bahamas, in the United States 38, in Denmark, France and Ireland one, in Germany and Switzerland operates five Islamic banks, 23 in the United Kingdom, four in Luxembourg. In the region, there are two Islamic banks whose business is in line with the Sharia. These are *United Bank of Albania (UBA)* founded in 1992, and *Bosna Bank International* established in 2000 in Sarajevo (Dudić, 2012: 106).

In Europe, Islamic banking is the most developed in the United Kingdom. Following the establishment of the *Islamic Bank of Britain, Lloyds TSB' Group* has become a leader in Islamic law services. In the United Kingdom, the number of clients increased by 120% in the period between 2005 and 2006, the number of open accounts for 200%, while the number of savings deposits increased by 76% in the same year, reaching the amount of £ 83.9 million. In that way, London aims to become the financial center of Islamic Banking in Europe (Radić, 2016: 11). The UK has announced that it intends to be the first Western country to issue Islamic bonds - sukuk. Since Islam prohibits interest, sukuk carry a profit or rent on the base asset, where the bond is a part of the ownership of these assets. The sukuk market is increasingly liquid, with a current value of £ 40 billion. It is estimated that its value at the global level could reach 250 billion pounds. The number of Islamic banks in Europe is growing due to the increasing number of migrants from the Arab world. Furthermore, the European customers are attracted to business transparency of Islamic banking, because the Islamic banks are required to specify in what they invest their money (Dudić, 2012: 109). Given the current social situation in Europe after the numerous migrations from the Arab world, we are concluded that there will be a rapid development of Islamic banking in the forthcoming period. It is interesting that in response to the predicted growth of Islamic banking, the Belgian bank KBC, created a "Catholic Fund", which follows Catholic principles in its investment policy (Dudić, 2012: 109).

Taking into consideration the aforesaid, we conclude that the concept of Islamic banking is based on the principles of justice and fairness. The Islamic banking seems fairer to traditional conventional banking, as it seeks to facilitate social equality, with a fairer redistribution of wealth and providing equal opportunities to all society

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