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**Islamic banking in practice:
problems in Jordan and Saudi Arabia**

by

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This paper is dedicated to Professors
Salman Al-Ani, Alan Douglas,
Nazif Shahrani, and George Wilson,
my mentors on this project

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Islamic banking in practice: problems in Jordan and Saudi Arabia

The dialogue over the adaptability of Islamic economic precepts to commercial business practices is relatively new.¹ It is only in the last fifty years, for example, that Islamic banks, or banks operating without 'the interest rate mechanism' have been formed.²

Today, members of the International Association of Islamic Banks represent institutions in more than a dozen countries. All these banks share one common practice or goal: to conduct financing activities in a manner consistent with Islamic economic principles.

Therefore Islamic banks must operate under guidelines which forbid usury (*riba*) and the contracting of guaranteed or risk-free positions (*gharar*).³ Borrowers must use lending contracts that contain profit-sharing agreements, and depositors must also accept equity-based risk in uncollateralized capital venture investments if they want to receive a return on their investments. These propositions make Islamic banking most suitable for people who are willing to pursue risk-oriented investment strategies and who are not risk-averse with their savings.

In theory, Islamic economics finds its roots in the early Muslim community's efforts to mobilize capital to the benefit of the entire tribe. (Religious arguments are presented later in this paper.) However, while the theoretical concepts of Islamic banking have been vigorously debated, there have been very few, if any, instances where Islamic banks have achieved their goals of satisfying consumer and depositor demands while simultaneously operating profitably.⁴ In countries where Islamic banks have survived, mainly in the oil-rich Arab states, they have provided more money to large industrial projects than to community-based small- and medium-sized firms (SMEs).

For example, in Saudi Arabia 93 per cent of Islamic bank loans have been distributed to industrial projects, leaving the Kingdom with an SME finance gap. This distribution deficiency derives from the idea that large projects are less risky than smaller ones. Even so, Saudi bank loan portfolios have seen exceptionally high default rates in the last decade, which threatens the premise on which their interest-free Islamic banking system is based.⁵ Jordan's banks have repeatedly found themselves in similar positions.⁶

But is the failure of Islamic banks in Muslim countries due to flaws in the Islamic economic ideology? Or are there external variables that prevent Islamic banks from meeting their goals? These questions have become the major focus of recent debates on Islamic finance.⁷ This article looks at two major problems Islamic banks face in both Jordan and Saudi Arabia that make efficient operations difficult.

First, significant structural problems exist in these countries that make banking a risky proposition. Indeed, both Saudi and Jordanian capital distribution systems are heavily biased against lenders and, by default, banks must bear most of the risks of financing.⁸ It is only the foreign banks, which do not usually re-invest in host country businesses, that have operated profitably over the long term.

The second set of problems facing Jordanian and Saudi Arabian Islamic banks are attitudinal biases that exist in the business-owning community against using equity-based financial contracts for business expansion. It is found here that business owners' objections toward Islamic banks are much broader in scope than expected. Their negative attitudes include a lack of understanding of Islamic finance, biases against formal lending institutions, mistrust of government programs, and the absence of managerial sophistication in terms of financial reporting. In addition, the socio-economic (and cultural) appeal of family-run businesses limits peoples' willingness to use partnership-based Islamic financing.

The effects of these structural and attitudinal problems are pervasive in the Jordanian and Saudi banking systems. It is argued here that the relative failure of Islamic banks in these two countries does not provide arguments for the unfeasibility of Islamic economic mandates. Rather, the contention is made that structural and attitudinal problems make it difficult for any bank, Islamic or other, to sustain commercially viable operations.

Section one reviews the basic concepts of Islamic banking; section two looks at structural problems that impede the efficient operations of banks in these Kingdoms, and section three introduces information about the business communities' negative attitudes toward equity or profit-and-loss contracts. The conclusion discusses the prospects and opportunities for Islamic banks in Jordan and Saudi Arabia.

Section One

An overview of Islamic banking

The practices of Islamic financial institutions and instruments are based on the Islamic aim to protect against inimical self-interests and undue profiteering.⁹ The *Qur'an* supports a free-market system in which all resources, human and natural, are employed to full capacity, making it the duty of every Muslim to pursue productive and fair business activities.¹⁰ Merchants are told, on the one hand: 'let there be amongst you traffic and trade, by mutual goodwill' (Sura 4:29). On the other hand they are told that

miserly and selfish behavior, hoarding, usury, monopolies, hedonism, exploitation, and foreclosure in bankruptcy are banned. Three key scriptures that outline these mandates include the following Sura:

Those that live on usury shall rise up before Allah like men whom Satan has demented by his touch; for they claim that usury is like trading. But Allah has permitted trading and forbidden usury. (2: 275-276).

Give up what remains [due to you] from *riba*, if ye are [in truth] believers. And if ye do not, then be warned of war [against you] by Allah and his messenger. And if ye repent then ye have your principle [without *riba*]. (2:278-279)

No profit without toil and no money without labor. Man hath only that for which he has put forth effort. (Sura 53:39-40)

Although these scriptures ban *riba* (usury) as an exploitative business practice, they do not prevent the operations of a commercial financial system.¹¹ For example, Mohammad and his companions accepted money from fellow tribesmen for safekeeping and for recirculating capital among the tribe's entrepreneurs. However, rather than accept the money as deposits, they promised to reinvest funds with an entrepreneur who in return promised to share his profits with the intermediary, who would then divide his part of these revenues with the original owner of the capital. The intermediary's charge was to find the best investments available for his clients, but he could make no

guarantees as to the safety of the loans or about the amount or timing of the expected returns.¹²

First modern attempts

The first modern attempt to establish an Islamic savings' plan was in the 1940s when Malaysian Muslims decided to pool and collectively reinvest savings earmarked for the pilgrimage to Mecca. These pooled savings were used to finance plantation operations with the goal of returning principle plus a value-added return to depositors after the harvest season. Unfortunately, because the plan's portfolio became over-extended in real estate loans (and because the *Hajj* season did not always match the harvest season), plan administrators could not meet the depositors' liquidity requirements and the plan failed within a few years.¹³

The first attempt to integrate interest-free banking into a national capital and credit distribution system took place in Pakistan. Legislation to this effect failed to pass in 1956, but following the parliamentary debate over the potential banning of interest rates on bank loans a group of rural landowners formed the first Islamic bank. This attempt also failed because of the bank's inability to collect profit-and-loss sharing revenues quickly enough to meet the liquidity needs of its customers. In both Malaysia and Pakistan no fixed-rate interest was charged on loans or paid on deposits held at the banks. Instead, borrowers and depositors were charged an application fee to cover the bank's short-term operating costs. Payments were only collected from borrowers after their businesses had become

profitable. Depositors were paid dividends only after the banks received payments from the people or firms that had borrowed money.¹¹

The first Arab Islamic bank was Egypt's Mitr Ghams Savings Bank, chartered in 1963 by another group of rural landowners. This bank also charged only application fees to its customers and required no fixed-rate interest payments from borrowers. There was also no provision for foreclosure on collateralized property in the case of bankruptcy. The bank seemed to do well in its early years, and in 1967 it was credited by a Ford Foundation report for reducing rural poverty. But by the turn of the decade, Mitr Ghams had begun to fail because of its inability to collect principle payments on outstanding loans. By 1972 the bank faced possible liquidation, but was absorbed into Egypt's government-sponsored Nasser Savings Bank rather than declared bankrupt.¹²

New Islamic banks in the 1970s

The track record of Islamic banks notwithstanding, several Islamic banks have since been established in Arab countries: in Saudi Arabia (Islamic Development Bank in 1974); Dubai (Dubai Islamic Bank in 1975); Sudan (Faisal Islamic Bank in 1977); Egypt (Faisal Bank of Egypt in 1977); Kuwait (Kuwait Finance House in 1977); Jordan (Jordanian Islamic Bank in 1978); Bahrain (Bahrain Islamic Bank in 1979). In addition, interest-based lending is now illegal in Iran (1983) and Pakistan (1985).¹³

Today, the dialogue over the roles of charges, fees and interest rates in Islamic banking has become more complicated, and the debate over what practices are allowable has intensified. However, deposit and lending contracts that are acceptable for use in most Islamic banks have been established by the International Association of Islamic Banks. These include deposit accounts that function in more or less the same way as the more commonly-known checking accounts, savings' or demand deposit accounts, investment accounts, and trust accounts.

The main differences between these accounts and those offered by Western-styled banks is that in the former fixed interest is not paid on deposits, and credit insurance is not offered to depositors. Rather, deposits are treated as equity investments in the Islamic bank, allowing depositors to participate in the earnings of banks through dividend distributions or profit-sharing. Islamic banks can also offer night deposit accounts for covering central bank requirements and foreign exchange accounts (if legal in the country of operation); they can also issue charge cards (on a non-interest basis), and provide safety deposit and vault services.¹⁷ In addition, proposals about ways in which credit instruments from aid agencies can be used by Islamic banks are also being published.¹⁸

Partnership contracts

Clearly, the operations of Islamic banks are not completely at odds with those of commercial banks - money is deposited into both types of

institutions and then reinvested for profit. However, just as deposits into the bank are considered equity investments, loans from Islamic banks are written as partnership contracts rather than as debt arrangements. And, just as Islamic banks do not guarantee interest payments to depositors, they cannot require a stated rate of interest from borrowers. This places Islamic banks in the position of being capital venture lenders whereby they can become active partners in the firm.

Partnership contracts fall into two categories. In *sharikah* partnerships capital and labor are jointly provided and profits are distributed according to a fixed ratio agreed upon before moneys are transferred. In *mudaraba* partnerships a silent partner provides capital and a managing partner provides expertise. In this latter form, profits are shared according to a predetermined ratio but losses are assumed by the silent partner.¹⁹ In order for a *sharikah* partnership to be established for financing from an Islamic bank, some level of joint capital or labor expenditure must take place, either by a voluntary and planned agreement initiated by the partners, (such as the joint purchase of property), or through an involuntary event like an inheritance.

Commercial partnerships

Commercial partnerships (*sharikah al-aqd*) are usually more specific in the way they organize liabilities and responsibilities.²⁰ The financing of *sharikah al-aqd* can be divided into three types of contracts: *musharaka* or unlimited investment partnerships, the *inan* or limited investment partnerships, and the *mudaraba* contract

which is a hybrid of *musharaka* and *inan* contracts. In order for the *musharaka* form to be used, the partners must share equally in their monetary investment, their right of disposal for jointly held capital, their right to profit distributions, and in their responsibility toward debt reduction.

In a *musharaka* contract both partners stand to share in profits and losses, and one partner can contract debts for the business for which both partners may be held liable. In an *inan* partnership the investor can limit his assumable liability to the amount of the initial contribution. In addition, with a *musharaka* contract the bank can intercede in the management process when anticipated results are not achieved. The primary difference between *mudaraba* and *musharaka* contracts is the level of agency given to the partners - a *mudaraba* investor is not liable for losses beyond the amount invested.²¹

The major factor in Islamic banking is the equity-basis or risk-sharing provision that must be included in both depositing and borrowing contracts. Furthermore, under prevailing interpretations of Islam's economic intentions, money is not capital (or an asset) but only a device facilitating an entrepreneur's ability to transform unproductive resources into productive resources, and lenders of money are not entitled to a return unless they participate in the project's risk on a level commensurate with the risks taken by the borrower/entrepreneur.²²

Section Two

Structural impediments to Islamic banking in Jordan and Saudi Arabia

To understand the problems faced by Islamic banks in Jordan and Saudi Arabia, one must consider whether or not equity-based lending can be effectively managed under the structural constraints present in these developing economies. Many economists call for greater use of equity investments to facilitate SME growth in poorer countries.²³ However, these economists also recognize how the inconsistent regulatory environments that often prevail in many developing countries force equity-based lending institutions to assume high levels of portfolio risk.²⁴ This section describes the economic structures in Jordan and Saudi Arabia that impose risks on these countries' banking systems. Another key point for consideration is the structure of attitudes toward formal sector banks and the way in which negative attitudes raise the risk of using equity-based lending contracts. These factors are discussed in section three.

Liquidity risk in Saudi Arabia

During the 1970s, when the majority of Islamic banks were being formed, Arab countries could be divided into two development categories: the rentier states and the rentier-by-proxy states.²⁵ The oil-rich states financed unprecedented amounts of capital investment but they needed labor to implement their development plans.²⁶ The oil-poor states needed financial

resources, some of which could be provided by the remittances of guest workers employed in the Gulf states. It was in this period that Jordan and Saudi Arabia formed a particularly strong labor/remittances' interdependence. Saudi Arabia issued more work visas to Jordanians and Palestinians than to any other national group in the 1970s and 1980s.²⁷

Islamic banks in both countries hoped to be among the beneficiaries of this economic tie. However, the relationship that has developed between Saudi Arabia and Jordan forced them and other banks to sustain high default-rate risk in their portfolios. This caused the private sectors in both countries to be over reliant on the Saudi agencies for cash flow, which also made risk and return profiles almost impossible to write.²⁸ What one finds, then, is that the economic structures in both countries made it difficult for banks to distribute capital effectively.

Dependence on foreign human capital

In order to understand this economic interdependency and its effect on regional banks, one must understand that businesses in each country have pursued profit strategies aimed at exploiting oil revenues collected by the Saudi government. Saudi Arabia, unlike most developing economies in the last two decades, has had great financial resources and only modest human resources. This created great pressure on the Kingdom to import labor and services, which made it highly dependent on foreign human capital. For example, during the early 1980s

81 per cent of personnel in the financial sector were foreign. Other estimates show that 70 per cent of participants in the Saudi labor force were foreign.²⁹

Although characterized by extremes, this strategy worked while cash flows from oil revenues could sustain financing of industrial production. In the 1975-85 period the number of operational factories rose by 154 per cent and the number of industrial permits issued increased by 330 per cent.³⁰ By 1987, 2,016 factories had been constructed,³¹ with enough production capacity to meet at least 70 per cent of the Kingdom's consumer market demand.³² The average real output rate grew by 16.6 per cent a year in the producing sectors, by 14.1 per cent a year in the service sector, and by 4.8 per cent a year in the oil sector.³³ However, there is a negative side to the Saudi development success story because the lucrative incentives that supported urban industrial growth also undermined government attempts to facilitate private sector productivity.³⁴ In fact, an inordinate number of private sector producers only operate with a profit if they receive government aid. Even today, this situation ultimately forces the country's banks to assume high levels of financial and portfolio risk. The problem is worse for Islamic banks because they cannot recoup losses on loans through the charging of interest or through foreclosure in bankruptcy.

It should also be noted that foreign bank operations tend to drain liquidity from the Saudi economy. No bank operating in the Kingdom is allowed officially to charge interest on loans or pay interest on deposits.

Foreign banks, however, simply write investment contracts whereby interest payments are made via accounts simultaneously set up outside the country at the time a deposit is made. This mode of operation causes confusion in the Saudi competitive climate and facilitates the transfer of financial deposits into foreign banks that reinvest outside the Kingdom. Moreover, these transfers of cash cause illiquidity in the financial system.

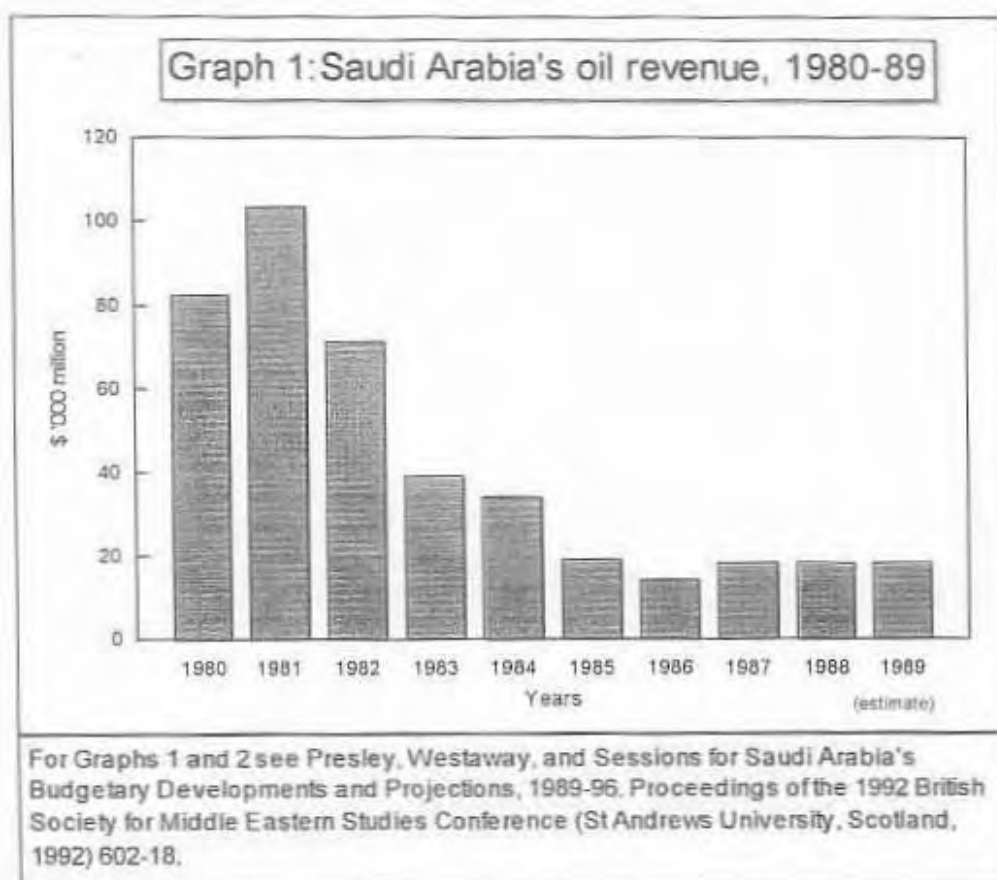
Venture capital model

Nevertheless, economic planners in Saudi Arabia have always thought it important to develop economic structures using purely Islamic models, free from the secular regulations often imposed by Western models of development. This is particularly true in the financial sector, which has been careful to honor Prophetic mandates against *riba* and other forms of exploitation.³⁵ Instead, Saudi banks lend money on a straight interest-free basis, but at the same time they rarely require an equity position in the borrower's firm. This procedure actually makes Saudi Islamic banks operate on a venture capital model for distributing capital.

In truth, Saudi banks may have been overly generous during the 1970s and 1980s in interpreting their moral responsibilities. For example, at the Saudi Arabian Agricultural Bank loans were (and still are) not based on business plans or on written risk and return profiles; funds were distributed according to a project's priority in the Kingdom's Five-Year Development Plans.³⁶ Aid, grant, and loan policies such as these made the

private earnings' process completely dependent on the government's revenue cycle. As can be seen in Graph 2, when the direction of government revenues and expenditures declined markedly in the 1980s, the profitability of most Saudi businesses reacted accordingly. In response, the highest number of bank loan defaults happened in 1987, which was only months after oil revenues hit their low and a year after the government had begun delaying payments on grants and subsidies.

distinguish between cash flow from government programs and revenues and operating profits.³⁷ And, as subsidies declined, a staggering number of businesses found that they were almost completely dependent on government disbursements for survival, and began to default on their loans. The problem became so serious in 1988 that the Real Estate Development Fund, for example, offered 20 per cent discounts for the timely repayment of loans, with additional 10 per cent discounts if lump sum repayments were made.³⁸



Dependence on government disbursements

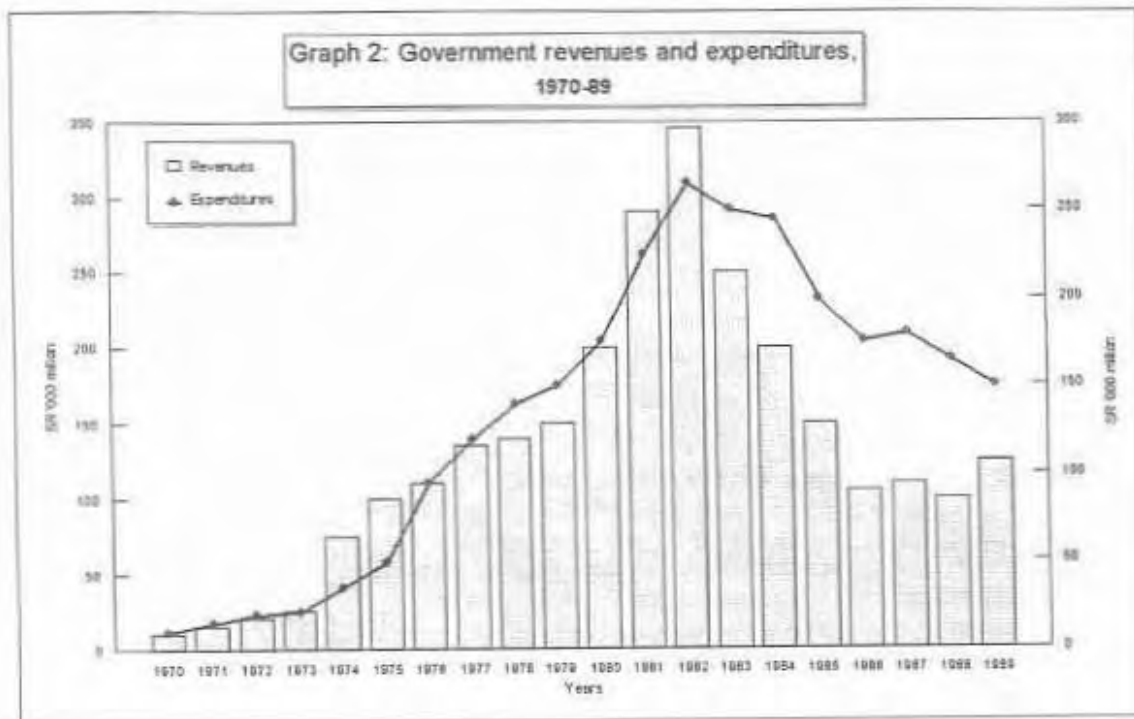
When declining oil prices forced government spending into retrenchment many businesses could not

In addition, the government's crucial role in the acquisition and distribution of production resources and the fact that the government is the country's largest consumer, mean that there is a real bias toward distributing funds to real estate projects. Fifty-four

per cent of consumption is achieved through direct government spending, and up to 75 per cent of private sector spending is supported by government-financed assistance and by grant, loan, or subsidy programs.³⁹ In 1982, 56 countries had joint venture projects in Saudi Arabia; 41 of these were contracts with the government.⁴⁰ The service sector accounts for 66 per cent of the country's gross domestic product, 38 per cent of which comes from services provided to the government. In 1985, in addition, some 80 per cent of industrial labor in the Saudi economy may have been foreign.⁴¹ When oil revenues declined the response was to increase the percentage of state disbursements to real-estate-intensive industries from 64 per cent to 84 per cent.⁴² This placed further biases into credit markets.

These factors notwithstanding, the Fifth Five-Year Development Plan

encourages banks to issue more medium- and long-term financing to the private sector in general and to SMEs in particular. In addition, semi-government financing agencies are expected to issue an additional SR 36,900 million between 1990 and 1995 to real estate or equipment-intensive businesses. Over half of these loans are to be made through the Real Estate Development Fund, whose cumulative loan portfolio in 1990 was SR 92,000 million. Planned investments in private sector development in the fifth plan amount to SR 144,000 million, about 37 per cent of total planned investments. While planned spending fell short in funding these goals, the consequence remains the same because the private sector and its financiers still depend on state funds for liquidity. These policies make asset values more closely linked to government funding programs than to corporate efficiency. The situation



has worsened since the Gulf War in 1991, when the Saudi government was forced to borrow money in order to support its security obligations.⁴³

The net effect of these factors is that banks cannot write adequate risk and return profiles for prospective borrowers. This makes it impossible for them to determine portfolio risk. Indeed, how can lending institutions create risk and return profiles if cash flows from subsidies are meant to keep inefficient businesses from failing? How can they distribute capital venture funds if businesses cannot prove the generation of non-government-linked profits? Likewise, without the threat of foreclosure, Saudi banks become responsible for assuming most, if not all, of the Kingdom's private sector risk. This would not cause a problem if the government guaranteed support throughout the life of the loan, but widely fluctuating oil markets make such guarantees impossible.

Liquidity risk in Jordan

Another clearly defined objective of Saudi Arabia's fourth and fifth five-year development plans was the replacement of expatriate workers.⁴⁴ Because the largest population of imported labor in Saudi Arabia came from Jordan (and Palestine), this change in policy intensified the level of business risk in the Hashemite Kingdom of Jordan. Although Jordan is not an oil-exporting country, economic expansion and contraction have tended to follow oil price hikes and declines. Like a number of labor-exporting countries in the region, Jordan must attribute much of its

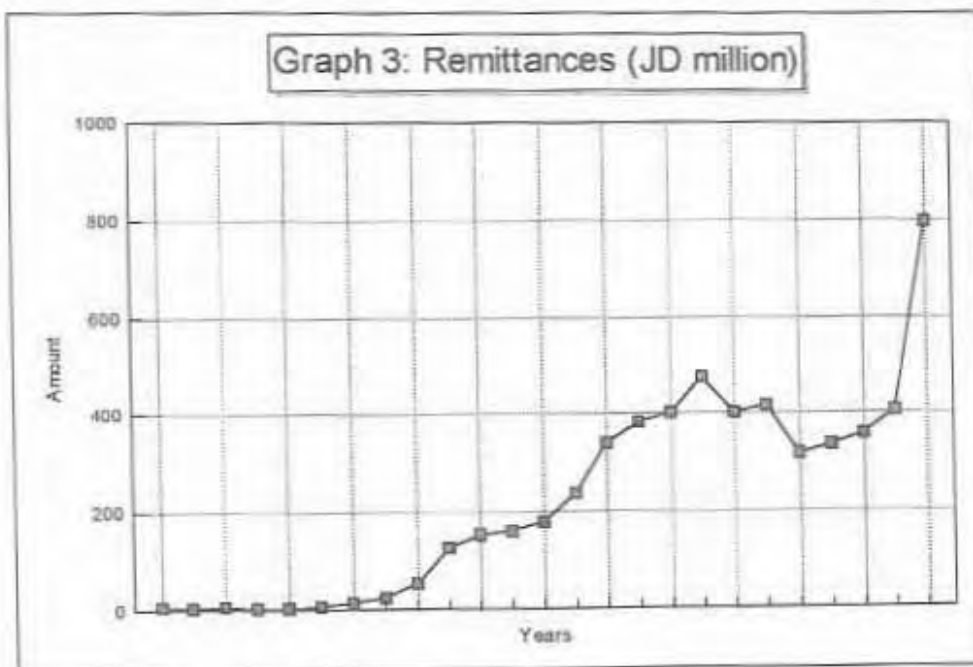
prosperity in the 1970s and 1980s to the remittances from emigrant workers. Through such a strategy Jordan became the region's premier rentier-by-proxy state, that is a state whose liquidity is indirectly dependent on the sale of natural resources, in this case, Saudi Arabia's oil. The labor/remittance dynamic between the two kingdoms cannot be over-stated in a discussion of Jordanian bank risk.

In fact, Jordan has since the 1950s turned labor exportation into its most profitable strategic resource, placing the highest premium on the placement of skilled (managerial) labor in the Gulf states.⁴⁵ Labor exportation plays an especially significant role in Jordan's economic development plans as a strategy for obtaining workers' remittances and financial assistance, and for facilitating the export of Jordanian products and services.⁴⁶ More specifically, Jordan views labor exportation as part of a broader marketing strategy to expand export earnings, increase national liquidity, raise the level of employment and decrease the country's persistent balance of payments' deficits.⁴⁷

Jordanian guest workers abroad have shown a very high propensity for remitting currency to home-country banks, making remittances 'the dominant source of reported 'export' earnings.'⁴⁸ In the 1970s, remittances doubled the value of Jordanian exports, and in the 1980s remittances exceeded export revenues and became the primary income source of one million people.⁴⁹ In addition, remittances produced one-third of Jordan's foreign exchange in the early 1980s and by 1989 migrant workers accounted for 56.6 per cent of the country's

exports.⁵⁰ Seventy per cent of Jordan's commercial activities in the 1980s were funded through income from workers employed abroad.⁵¹ Twenty per cent of tuition payments are paid through remittances, a crucial point since Jordanian guest workers in Saudi Arabia filled mainly professional posts.⁵²

received by the Gulf states, allowing for a twelve-to-eighteen-month time lag. These are shown on a period-specific basis in the graphs that follow. The first of these (Graph 3) provides striking illustrations about the level of economic interdependence during the period 1967-87.

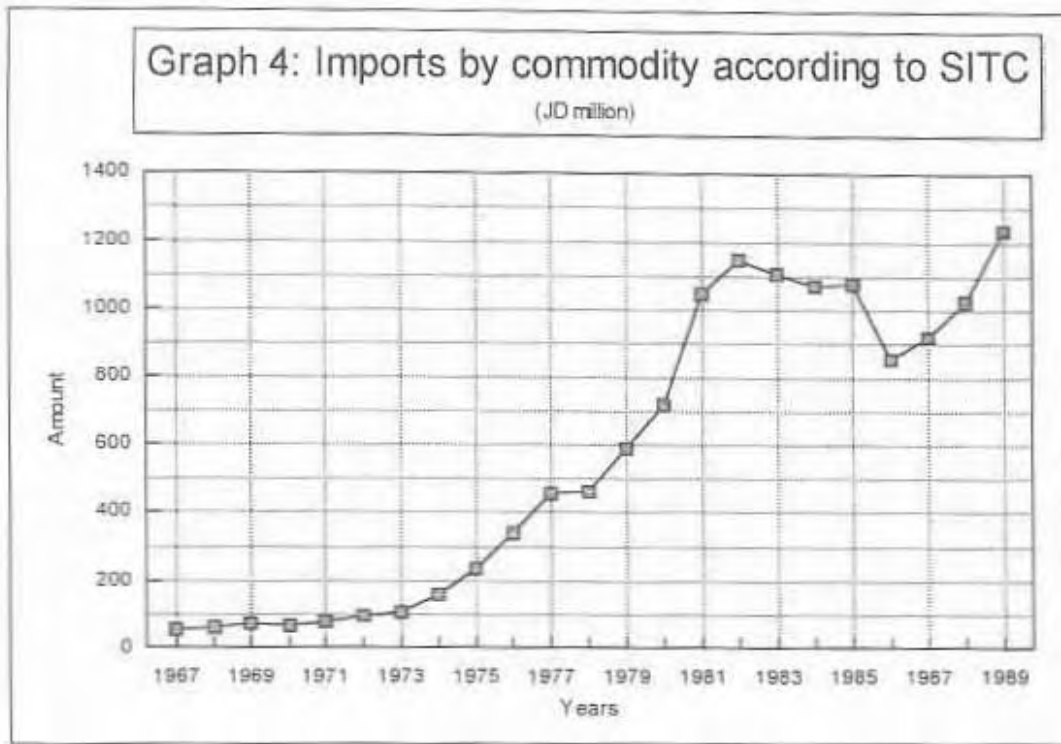


Source: Central Bank of Jordan Yearly Statistical Series, 1964-89, 26-9 and Monthly Statistical Bulletin, vol. 28, no. 3 (December 1992) p. 60.

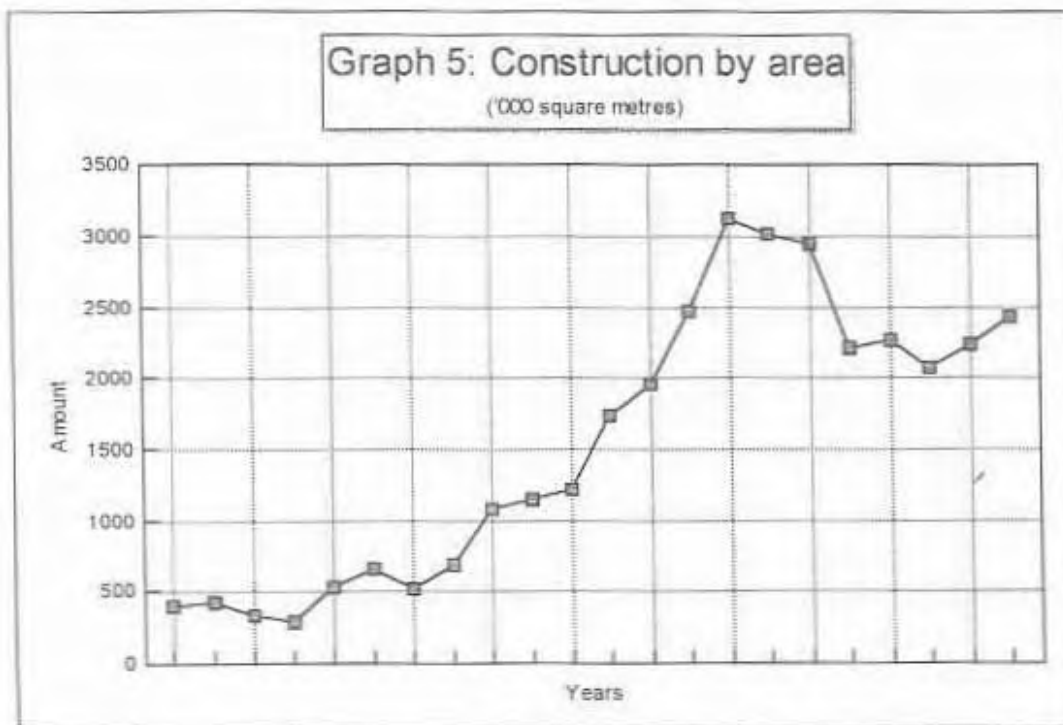
While these effects seem positive, Jordan's rentier-by-proxy strategy has become so entrenched in its economic structure that its financial stability is almost completely dependent upon Saudi Arabia's willingness to share oil revenues through the employment of Jordanian and Palestinian nationals. Over the last 20 years trends in Jordan's consumption, the money supply, and industrial output, mirror the level of oil revenues

Impact of oil price declines

These graphs illustrate how remittances, and the consumption they finance, reflect Jordan's dependency on the Gulf states' ability to collect and distribute oil revenues. Just as the oil price declines adversely affected economic activity in the Gulf states, Jordan's 'economic boom of the 1970s has in the 1980s given way to declining national revenues, governmental retrenchment, and growing unemployment.⁵³ Construction expenditures



Source: Central Bank of Jordan, Yearly Statistical Series (1964-89) 35.



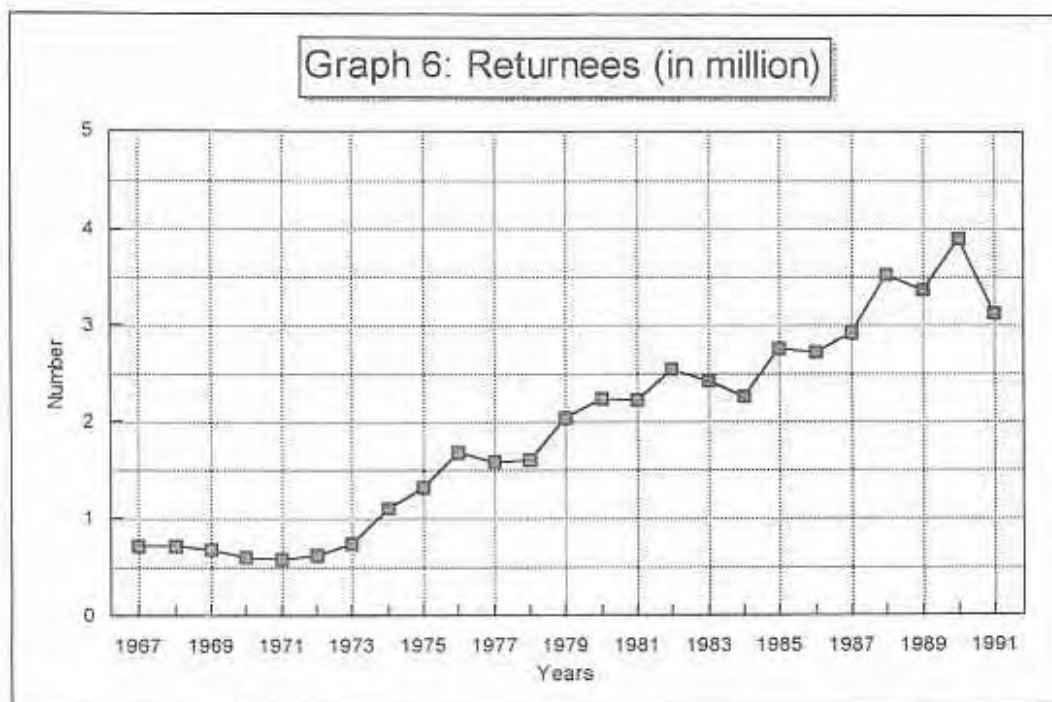
Source: Central Bank of Jordan Yearly Statistical Series, 1964-89, 25.

and the consumption of imported goods followed nearly the same patterns as oil revenues. In addition, an inverse relationship between remittances from the Gulf and domestic employment is evident. In 1979-81 when oil prices were relatively high, unemployment in Jordan was less than 4 per cent. Following the oil price collapses in 1982 and 1983, unemployment rose to 5.4 per cent in 1984 and 8.0 per cent in 1986.⁵⁴

However, this inverse labor exchange dynamic did not continue as the condition of oil markets improved. Rather, as oil revenues rose in the late 1980s, and unemployment in Jordan might have been expected to fall as people returned to the Gulf, unemployment rose to 8.3 per cent in 1987, 8.9 per cent in 1988 and 15 per

cent in 1989.⁵⁵ What in fact had begun to happen as early as 1987 was the implementation of Saudi Arabia's fourth plan goals for repatriating guest workers to Jordan. In response, the number of Jordanians returning from the Gulf increased and annual remittances continued to decline. The following graphs show the effect that Saudi Arabia's decision to employ more indigenous labor had on Jordan's money supply in the 1980s.

A direct link can be seen in these graphs between the amount of Gulf labor importation, the level of remittance income and overall money supply. Moreover, these figures on the economic impact of Jordan's changing political relationships with Saudi Arabia combine to make two points clear. First, the oil-revenue

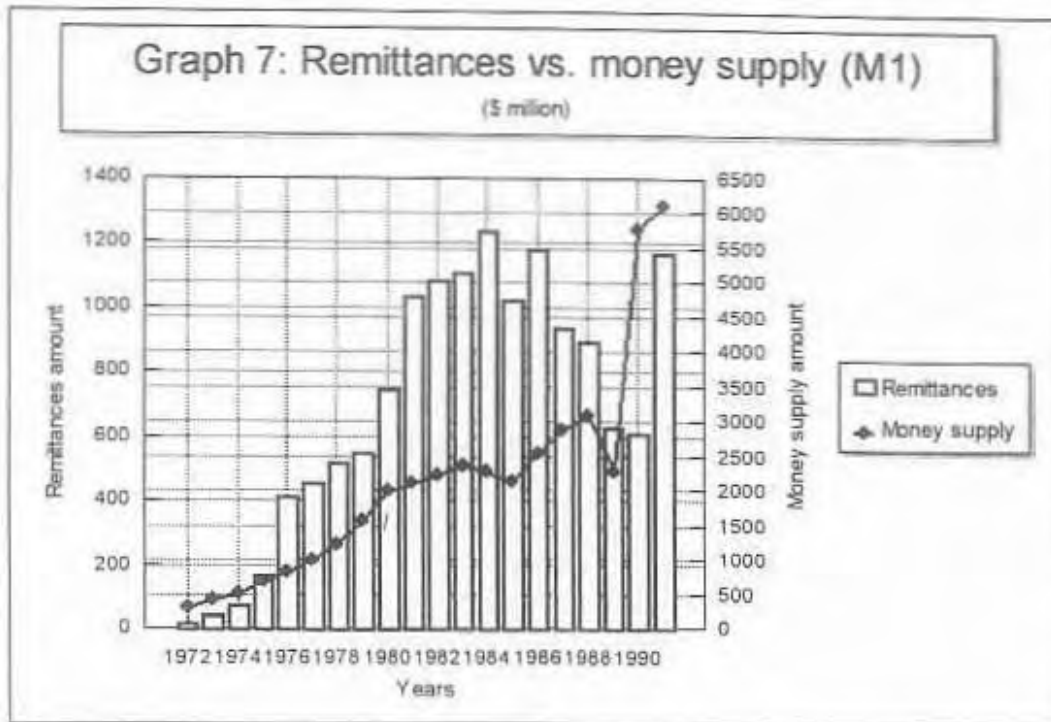


This graph shows the number of Jordanian and Palestinian people relocating in Jordan following employment as guest workers or as dependents of guest workers in the Gulf Arab states.

Source: Central Bank of Jordan Yearly Statistical Series, 1964-89 and Monthly Statistical Bulletin, vol.28, no.3, December 1992.

risks inherent in the Saudi Arabian system are also inherent in the Jordanian system, with a remittance-stream time-lag. Secondly, the possibility of

essence, Jordan's private sector had become so biased toward foreign sources of cash flow, and toward foreign government purchasing agents as



continued abrogation in the Jordanian-Gulf states' political relationship will magnify Jordan's level of economic and financial risk. In addition, the situation in the late 1980s revealed a fundamental change in Jordan's economic structure as a result of Saudi Arabia's employment of more native and Asian workers instead of re-hiring Arab workers after 1987-89.³⁶

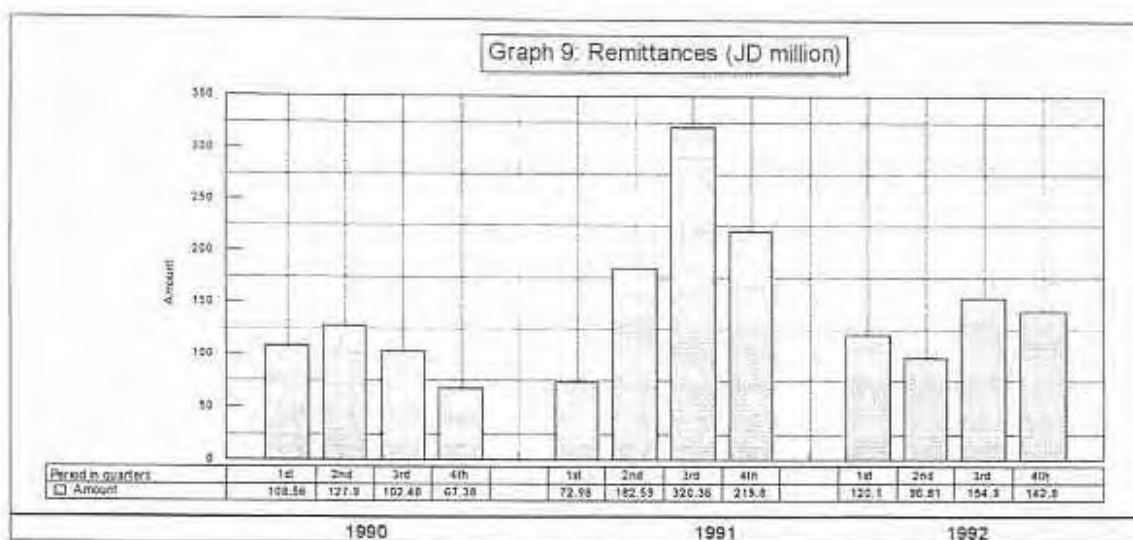
The future of the Jordanian banking structure's liquidity in 1990 was in serious jeopardy if remittances continued to decline. Alongside this dynamic stood the older confusion with regard to measurement of profit-generated cash flow seen in Saudi Arabia, except that in Jordan this valuation problem was based on emigrant-financed remittances.³⁷ In

a source of sales, that asset values were too often determined by a firm's ability to gain aid, contracts, or financing from clients or agents in the Gulf states. Jordanian banks, therefore, found themselves in the unfortunate position of having to assume not only the risks taken by their own clients (the risks intrinsic to their own economy), but also a new level of labor risk based on political dynamics over which they had no control.

In fact, both the position of Jordanian workers in the Gulf and the health of the Jordanian economy continued to decline in the 1990s. However, since the Gulf War another dynamic has been added to Jordan's financial dependency on Saudi Arabia and the Gulf states: liquidity rose

unexpectedly after the war, as did the overall level of consumption and production, at the point when alien employment in the Gulf fell dramatically and when under-employment in Jordan reached its highest level. At this point it was even more difficult to determine what part of Jordan's liquidity was earned, and what part was transferred, from the Gulf states by returnees (which also hurt Saudi liquidity). The following graphs (9, 10 and 11)

continued after the war. Because of this, a declining national economy might be expected because, as the number of returnees rose by approximately 26 per cent in 1991, it could also be expected that revenues from remittances and their related purchases would subside. Rather, consumption in almost all sectors of the economy grew substantially; money supply grew by nearly 16 per cent in 1991; bank deposits grew by approxi-



Source: Central Bank of Jordan Monthly Statistical Bulletin, vol. 28, no. 3, December 1992, p. 60 and vol. 20, no. 1, January 1993.

show the impact of returnees on Jordan's money supply.

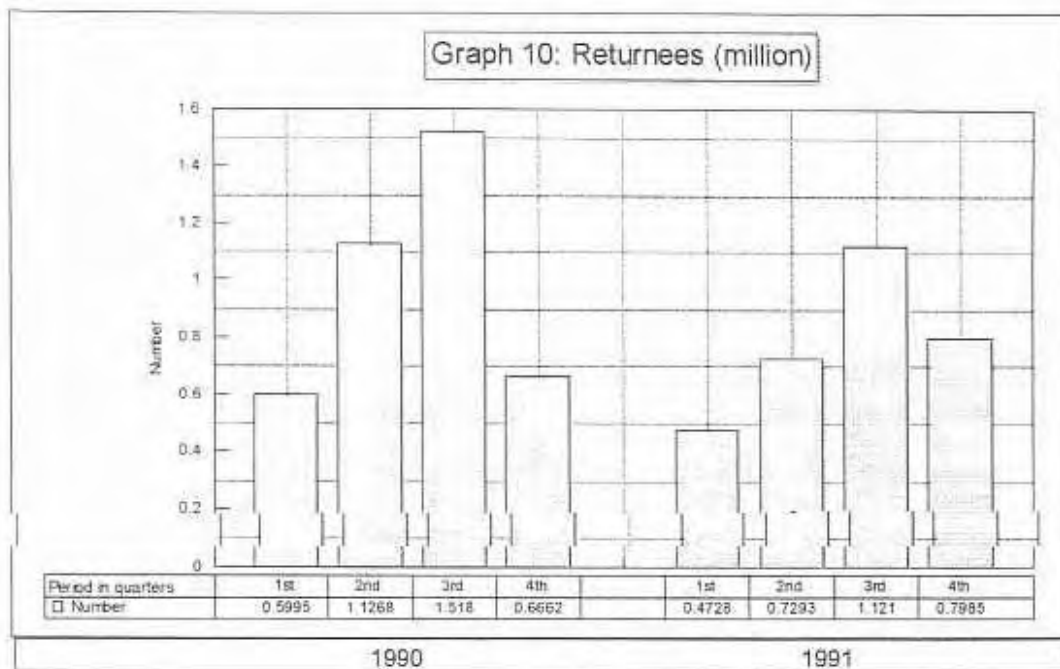
Relationship between growth and returnees

These figures show a more dramatic version of Jordan's structural dichotomy between sectoral growth and the number of returnees after the Gulf War. The bulk of returnees came in 1990 following the Iraqi invasion of Kuwait, but the flow of Jordanians and Palestinians out of Saudi Arabia and the other Gulf states has

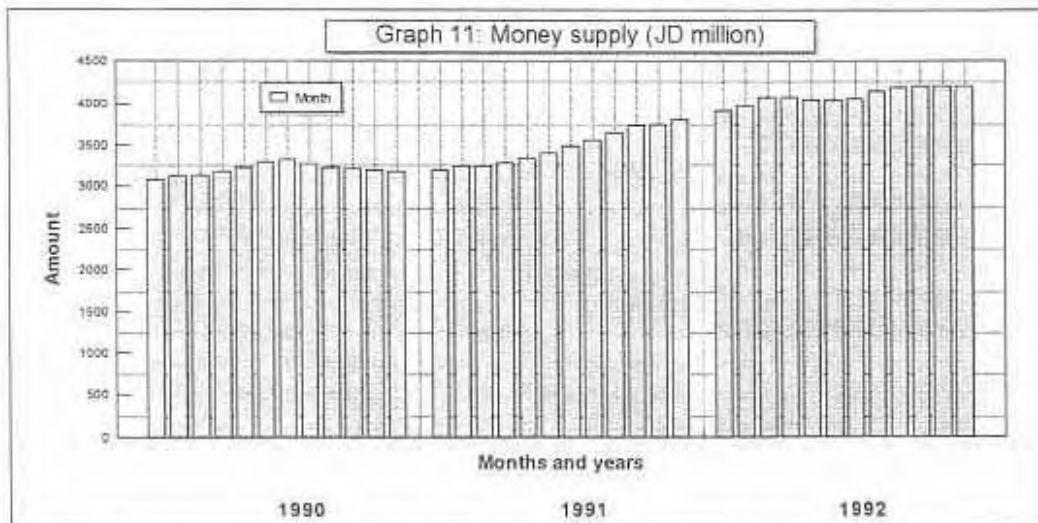
continued after the war. Because of this, a declining national economy might be expected because, as the number of returnees rose by approximately 26 per cent in 1991, it could also be expected that revenues from remittances and their related purchases would subside. Rather, consumption in almost all sectors of the economy grew substantially; money supply grew by nearly 16 per cent in 1991; bank deposits grew by approxi-

mately 51 per cent; and insurance premium receipts rose by 30 per cent.⁵⁸ In 1992 the level of money supply continued to increase, levelling off by the end of the year.

The between-the-lines' effects of these structural adjustments are critical to understand. Many economists presumed that this meant that the Jordanian economy had more liquidity than before, and that therefore the level of financial risk in the Kingdom had decreased. This was not the case. The real questions were: what do these increases in remittances



Source: Central Bank of Jordan Monthly Statistical Bulletin, vol. 28, no. 3, December 1992, p. 76.



Source: Central Bank of Jordan Monthly Statistical Bulletin vol. 28, no. 3, December 1992, p. 22.

reflect in the economic potential (or dependency) of the Jordanian economy? How can revenues rise during a period when increasing numbers of Jordanian laborers have been forced to return from jobs they had held in the

Gulf? And, does this increase in money supply really increase national liquidity?

The answers to these questions are not simple but in fact the situation

was at this point much grimmer than it appeared from the figures shown here. The growth in bank deposits was not at all related to remittances, but was instead the transfer of savings from the Gulf back to Jordan. The incline in consumption was not representative of economic growth. Rather it was the use of savings required to support returnees, who, for the most part, were either under-employed or unemployed. In addition, the increase in money supply did not represent more liquidity in the country. It is true that the transfer of deposits from the Gulf to Jordan added money to the system. But to which system and for how long?

The first point to consider is that the rate of increase in money supply had begun to level off in 1992 even though more people were returning from the Gulf. This levelling effect was caused by the relative increase in subsistence spending compared with declining remittance revenues and the continued inability of returnees to find full, meaningful, or professional employment in Jordan.

This spending, again, does not indicate growth. However, the more serious implication comes when the placement, redistribution, and reinvestment of deposits is considered. For example, most returnees' deposits were held at the Central Bank of Jordan, which means they were used to finance government or ministry-approved projects. Such transactions do not raise the level of liquidity available for use in the private sector. Indeed, a rapid decline in available capital can be seen by looking at private sector deposits held by local banks. An example is that in

December 1990 the level of deposits available in locally-licensed banks was JD 274.7 million. By the end of 1993 that number had declined to JD 183.7 million. A monthly record follows for 1991 and 1992:⁵⁹

Bank deposits with licensed banks (local) (JD '000)		
	1991	1992
January	245,038	239,451
February	231,776	218,642
March	255,794	217,685
April	270,435	212,326
May	266,833	211,178
June	250,209	206,820
July	264,139	199,333
August	261,234	214,333
September	252,619	190,421
October	246,952	203,834
November	250,063	206,512
December	259,963	220,053

The amount of deposits in local banks peaked in April 1991 and has not reached that level since. There has been a general decline in the amount of deposits available for local lending since that time. The upward trend toward the end of 1992 was reversed in 1993, and by the end of the year the level of deposits in local banks had fallen to JD 166 million, a 32.26 per cent decrease. The situation looked even worse when the amount of Central Bank deposits in local banks was omitted. The level of deposits peaked in this case in 1989 at JD 172.5 million, and fell to JD 169.6 million in 1990, to JD 149.9 million in 1991, and to JD 110.0 million in 1992. Therefore, in a period of less than three years, private sector deposits in local

indigenous banks fell by 36.23 per cent (44.07 per cent in November 1992). Monthly figures on the level of private sector deposits in banks are shown below:

Non-Central Bank deposits in Jordanian banks and finance companies (JD '000)		
	1991	1992
January	139,664	129,239
February	126,357	108,465
March	150,328	107,525
April	164,938	102,159
May	161,324	101,003
June	144,649	96,636
July	158,501	89,453
August	151,123	102,546
September	142,512	80,379
October	136,827	93,792
November	140,748	96,468
December	149,846	110,025

The presentation of trends in this area cannot be continued into 1993 because of lack of comparative information.⁶⁰ But it is clear that available liquidity had not, and probably could not, return to its prior levels. In addition, there were inter-bank investment activities that negatively affected the liquidity situation. For example, Jordanian bank investments in other local banks decreased from JD 227.2 million in 1990 to JD 166.4 million in 1991 and JD 137.8 million in 1992 - a 39.35 per cent decline. However, over that same two-year period, Jordanian bank investment in foreign banks rose 2.24 times, moving from JD 628 million in 1990 to JD 1,254 million in 1991, and JD 1,407 million in 1992. Investments by licensed banks

in foreign currencies rose from JD 357.7 million in 1990 to JD 459.8 million in 1992, JD 488.5 million in 1992 and JD 504.5 million in 1993. Therefore, less money was held or reinvested in dinars. This indicates further that even less of the available capital in Jordan is being reinvested in the indigenous private sector. By extension, this means that the level of business risk is increased due to lack of finance.

Messages for the future

The messages are clear for Jordan: despite their positive effects, remittances cannot be counted upon as the source of cash flow in the 1990s; failing political and economic relations with Saudi and the other Gulf states make Jordan's businesses less stable; and among the financial groups there is little intention to recycle money into the local economy. This in effect makes the Jordanian economy more dependent than ever on the ability to renew its labor/remittance contract with Saudi Arabia's (and the other Gulf states') agencies and businesses.

Moreover, these figures show that there are at least two structural problems in Jordan that make the risk of private sector finance extremely high. The first of these is that the banking problems that are present in the Arab rentier states are compounded in the rentier-by-proxy states, which puts lending officers at Islamic banks in exceedingly difficult positions. In order for financiers to fill finance gaps through equity finance, they must write risk and return profiles on a capital venture model. And in still too many cases

Jordanian firms cannot distinguish cash flow from profits or from remittances, or from the reduction of savings deposits transferred from Gulf banks. This places Islamic banks in a much riskier competitive situation when pursuing the distribution and reinvestment of new capital.

The second of the Jordanian economy's structural problems may be more serious because it is reflected in the internal attitudes of bank managers. It is clear that they do not feel that reinvesting money in Jordan's economy and in its currency is wise.

If this were not executives' shared opinions then their banks would not be investing so heavily outside of the indigenous capital structure. Therefore, Jordanian banks cannot be providing liquidity to their customers in the private sector. Or, at the very least, they are reserving their capital for transactions with only the largest corporations in the Kingdom. This leaves small- and medium-sized enterprises (SMEs) without capital or liquidity. It could be argued that Islamic banks may have a further edge, then, in the SME market where they are supposed to operate best. In practical terms, however, it means that they are left to lend money in the riskiest markets.

Section Three

Attitudinal impediments facing Islamic banks

The structural problems in both Jordan and Saudi Arabia are real impediments to the development of efficient Islamic bank operations. However,

another set of negative factors revolves around attitudinal biases among Jordanian and Saudi Arabian business owners. The problems presented by these managers are particularly important because 'employment generation, poverty eradication, improving the distribution of incomes, fulfilling basic needs' are most often related to the health of SMEs.⁶¹ Anderson and Khambata argue that substantial increases in equity financing for SMEs yield the most overall benefits.⁶² Therefore, if Islamic banks want to distribute capital where it can mobilize the most employment, SMEs should be their preferred target market for lending.

Credit risk of SMEs

The problem here is that SMEs usually carry the worst credit risk, which makes it logical for financiers to avoid lending to them.⁶³ For example, Berzeg found that Saudi Arabia's SME manufacturers yield the lowest rate of return at the highest level of risk.⁶⁴ Erol and El-Bdour found that Jordan's SME manufacturers have the highest level of earnings' variability.⁶⁵ Therefore, Islamic banks reaching into the SME market must have access to evidence of a firm's earnings' stability and its ability to meet principle payments and distribute earnings.

They must also be able to assess the level of sophistication of a company's management.⁶⁶ As was discussed in section two, this is often difficult because of structural impediments. While these are considerable, other equally strong impediments arise because SME managers do not understand the value of financial

records or because they distrust formal sector distributors of capital. In either case, negative (or naive) attitudes often mean that financial control systems have not been developed to the extent required for proper evaluation and control.¹⁶⁷

Attitudes towards financial information

Recent studies have shown that lenders in several predominantly Muslim countries find it difficult to obtain accurate information about firms, especially when considering investment in small manufacturing groups. However, the problem seems just as important when government reports are analyzed.¹⁶⁸ It is certainly true that the financial information process is flawed in both Jordan and Saudi Arabia and that the attitudes of most business owners toward changing this situation are less than positive.

Al-Hajjar and Presley present the most definitive studies on this subject in Saudi Arabia. They conducted a random survey of 431 SME business owners in order to test the managerial sophistication of managers in the Kingdom. They found a general unwillingness by SME owners to maintain financial records; less than 30 per cent kept financial records; only 20 per cent wrote business plans or developed *pro forma* accounting statements when considering the starting of a business; only one-fifth prepared annual budgets; and almost one-third of the businesses surveyed did not keep a bank account exclusively in the name of the business.

Follow-up interviews confirmed that the reason for poor record-keeping lay in management's misunderstanding of the role that accounting should play in decision-making. Managers also said that they wanted mainly to share management with family members and that family reputation and not financial data should be the basis for obtaining bank financing.¹⁶⁹

Improvement of managerial skills - a key requirement

These responses indicate a general neglect on the part of small business owners of provision of the financial records needed for banks to identify and pursue lending opportunities. Clearly one of the key requirements for Islamic banks' penetration into the Saudi Arabian market will be the improvement of managerial skills in the SME sector. While regulated accounting systems may not have been necessary for financing businesses through informal arrangements, accurate and consistent records are key factors for banks wanting to assess risk effectively. Therefore, it can be logically assumed that much of the lack of funds directed toward SMEs in Saudi Arabia is due not to banks' negligence, but rather to the low level of managerial sophistication among private sector managers. If so, the sooner the Kingdom enforces its accounting and auditing regulations, the sooner SME development and employment plans can be implemented.

Other research shows that attitudes about the production and use of financial information in Jordan are similar to those in Saudi Arabia. A

series of studies produced at the Arab Institute for Bank Studies in Amman illustrates the problems caused by lack of accounting standards and enforcement in Jordan.⁷⁰ In 'The information needs of investors in unregulated capital markets,' Solas and Bakay present data collected by randomly distributing questionnaires to stockbrokers and their clients in order to determine the information needs of investors and their attitudes towards the reliability of available financial and corporate data.

Both brokers and investors felt that there was a void of available and valid information on which people could base investment decisions. In the cases where accounting information was available, most respondents considered that the statements they received were of no use; 54 per cent of the respondents said the information was not relevant; 65 per cent said it was not reliable; 90 per cent said it was not prepared consistently; 65 per cent said it was not comparable; 78 per cent said it was inadequate; and 89 per cent said the information they received was not delivered in a timely fashion. Follow-up interviews revealed that business owners lacked the 'education and experience to realize the importance of financial information.'⁷¹

This also raises other questions over the ability of the Amman market to operate under a system of free competition. Respondents indicated that the lack of standardized accounting data encourages people to take advantage of personal contacts when seeking information about investments or sources of financing. This system forces firms to find financing

through informal capital markets, i.e. relatives and friends. In a related survey about Jordanian investors, El-Bdour found that peer group attitudes played the most important role when considering investment options and that respondents tended to use mainly 'services being utilized by their relatives and neighbors.'⁷² He believes that these attitudes force people to place the highest value on information from informal sources, which makes it difficult for market operations to be regulated.

Moreover, these responses indicate that there is a high level of competition between banks and informal financiers in Jordan's SME market, which is also the case in Saudi Arabia. Therefore, competition based on the perceived benefits or disincentives of the formal financing sector clearly inhibits capital distribution in these countries. This is caused by the fact that entrepreneurs feel that they may lose control over their businesses if they work with government-regulated institutions. They prefer instead the secrecy that goes with informal financial contracts.⁷³ One can only speculate at this point that the persistent disregard of formal sector financing opportunities is partially due to institutional distrust.⁷⁴ However, whatever the reasons may be, SME owners' negative attitudes toward reporting on business activities puts banks at a competitive disadvantage.

Attitudes toward Islamic banks

The opinions about formal sector accounting and financial systems are real and they put all banks in the region in a precarious position *vis-à-vis*

the level of portfolio risk they are willing to assume. However, in this regard these market disadvantages are shared by both commercial and Islamic banks. What must be explored next are the attitudinal factors that specifically affect the competitive advantage of Islamic banks. In other words: how do the attitudes of business owners toward the idea of equity participation and deposit security affect these banks' competitive position?

Several authors note that developing country SME owners often have negative attitudes toward equity or participatory financing contracts.⁷⁵ Unfortunately, little comparative work has been done on the competitive reasons why people choose Islamic over Western-styled banks. Two such surveys are presented by Al-Hajjar and Presley on the concerns of SME borrowers about *musharaka* and *mudaraba* contracts and surveys by a team led by El-Bdour on patronage behavior among Jordanian investors.⁷⁶

The competitive problems faced by Islamic banks are clearer in Jordan, where the banking structure allows relatively open competition between interest-paying banks and Islamic banks. A series of articles by El-Bdour (and co-authors) illustrates the reasons why Jordanian financial-service consumers prefer Western-styled banks to Islamic banks. After analyzing responses to 431 questionnaires, it was determined that profit and security motives determined patronage behavior. In responses to questions about deposit accounts, most people intended to invest money in whichever bank offered the highest rate of return at the lowest level of risk. Ninety-four per cent of the

respondents rejected the idea that religious concern over interest-based investing was a reason for choosing one bank over another. Seventy per cent of the people who held accounts at Islamic banks said they would remove their money if returns fell below competitive levels. When asked about investing windfall income, the lowest preference was for depositing the money in an Islamic bank.

For questions about loan contracts, respondents generally claimed to pursue cost-minimizing behavior. Borrowers from Jordanian banks listed the availability of credit with favorable terms, lower interest rates, and fewer service charges as their primary motivation for bank selection. Over 70 per cent of the respondents held the view that banks issuing fixed-interest loan contracts were more effective at meeting their credit needs. Most people did not believe that Islamic banks offered favorable financing to SMEs, and said that they geared too many of their products toward short-term lending, which in turn made cash-flow management difficult.⁷⁷ They also preferred to take loans from 'commercial banking services' rather than receive financing on a 'profit-loss sharing basis.'⁷⁸ In this regard, Jordanians wished to avoid the possible pitfalls of shared-management contracts, and they felt shared-equity financial instruments were more expensive in the long-term than interest-bearing credit instruments.

Marketing priorities for Islamic banks

These responses tend to confirm the idea that Jordanian investors prefer

Western-styled banks to Islamic banks. In order to draw more customers, Islamic banks will need to increase the number of services they offer to depositors, as well as to be more creative and flexible in developing lending contracts. More importantly, they will have to develop a more positive image for efficiency and reliability in the market-place, especially if they hope to become a bigger presence in the SME market.

A different approach was taken in studying the problem of negative attitudes toward participatory finance in Saudi Arabia. In an extension of their earlier study, Al-Hajjar and Presley sought to determine why the Kingdom's SME owners were not taking advantage of the financing opportunities offered by Islamic banks; only 31 per cent of government-backed financing went to SMEs during the 1980s, even though census reports for this period indicate that over 91 per cent of firms in the Kingdom employed less than 10 people.⁷⁹ Two main reasons surfaced: managerial inefficiency and a distrust of agency-led financing. These have been discussed. However, another reason why SMEs are not taking part in commercial lending opportunities may revolve around negative attitudes toward *mudaraba* and *musharaka* financing programs.

In this study Al-Hajjar and Presley collected data from 222 small firms within Saudi Arabia's manufacturing sector. Follow-up interviews were made to verify the empirical findings, which led to the conclusion that the majority of SME owners in Saudi Arabia were not willing to accept participative financing. Eighty-

three per cent of the survey respondents rejected the possibility of a shared financing arrangement. Among this group, nearly 90 per cent rejected *musharaka* financing because they wanted to remain sole proprietors or because they wanted to hand over the business to a family member at a later date. In contrast, 'only thirteen per cent would prefer to share ownership with a commercial bank.'⁸⁰

In the six manufacturing sectors considered, rejection of *musharaka* never fell below 80 per cent in any sector, nor rose above 87.5 per cent, [reflecting] little sectoral variation in attitudes.⁸¹ Once again, family considerations were the largest concern. Others held the view that a potential new partner might assume too much control. The *mudaraba* form of finance was only slightly more popular; with 78 per cent of respondents being unwilling to borrow in this fashion. Approximately two-thirds expressed 'fear that the financier would eventually take over the business... [and, another] 30% of respondents also indicated that their reluctance to accept *mudaraba* was due in large part to the possibility of management interference.'⁸²

These responses are additional evidence that the Saudi SME owner would rather use informal financing arrangements. However, the high level of concern over the financier's potential ability to take over the business makes it seem just as likely that SME owners participate in informal market financing because they distrust the government-backed Islamic banks. A substantial number of respondents feared their *kafil* contracts, or contracts where a Saudi has improperly

registered himself as a partner in a foreign-owned joint venture, would be exposed, indicating further that SME owners hide information from formal sector agencies, mainly the Ministries of Commerce, Finance, and Interior. Unless these attitudinal barriers are regulated, banks will remain at a disadvantage.

Conclusions

The attitudinal factors listed in section three identify crucial impediments to Islamic bank development in Jordan and Saudi Arabia. A finance gap exists for SMEs in both countries, which is an odd state of affairs given that their development plans make SMEs' enhancement a stated priority. Does the fault for this finance gap lie with the banks? Maybe, since in Jordan Islamic banks must compete in an open market. But the real questions remain: can Islamic banks devise more appealing investment accounts to offer to potential depositors, and can they offer borrowers attractive lines of financing contracts and still be able to hold risk efficient portfolios? Surely the answer is 'yes', but can these contracts be developed in Jordan and Saudi Arabia's current economic structures?

To the latter question, the answer is less clear. The biggest problems facing Islamic banks in Jordan and Saudi Arabia are beyond their management's control. Islamic banks cannot be held accountable for government policies that allow businesses to operate without presenting audited financial and accounting records. They also cannot immediately change peoples' mistrust of government

ministries or agency-regulated firms. Western economists have tended to blame Islamic banks when finance gaps occur in predominantly Muslim countries, but in so doing researchers have neglected to consider the influence of attitudinal barriers on banking systems. Whether one believes that banks are the cause or the product of financial problems in Arab countries, it is obvious that both Western-styled banks and Islamic banks fail for many of the same practical reasons.

It is important to keep in mind that the economies of Jordan and Saudi Arabia have been in a constant state of flux since World War I, predominantly because of external economic, military, or political intervention. We should also remember that oil revenues did not reach price and production levels high enough to enhance the development process significantly until the 1970s. We can hardly expect the Hashimi and Saudi governments to have created sustainable legal structures responsible for regulating bank management in less than twenty years. And, since the concept of Islamic banking is relatively new in practice, we cannot expect to find refined managers in these institutions.

Two central problems

However, no matter how well defined the theoretical principles of Islamic banking may be, Jordanian and Saudi investors want higher-than-average returns for taking lower-than-average risks. This fact forces Islamic banks to face two central problems. The first is that they must provide services that are attractive enough to

draw clients away from the informal financial sector. Therefore, Islamic banks must begin to take a pragmatic approach based on customer-oriented marketing; they must pay consistent and predictable return on deposits; and they must redefine their position on the issue of deposit guarantees. In addition, they must implement safeguards against corruption, and they must spend more time and money on training programs for both employees and customers. Faith in religion cannot be seen as the major draw for encouraging patronage to an Islamic bank. As Laliwala puts it, even in an Islamic society, the laws of demand, supply, diminishing returns, diminishing utility, still hold.⁵³

Structural weaknesses

The second problem, or set of problems, arises from economic inefficiencies or structural weaknesses imposed by governments and politics. The corpus of Revelation that has led to the concept of Islamic banking can hardly guarantee the efficient management of a nation's economy. On this level, the immediate prospects for Islamic banking in Jordan and Saudi Arabia are bleak. In both countries there are structural and attitudinal problems that leave Islamic banks in a catch-22 situation. On the one hand, they operate in economies where the less *risky industrial projects* receive financing from government agencies. On the other hand, in the preferred market for Islamic banks, profitable and managerially sophisticated SME owners would rather seek investment capital from informal sector sources. In the remaining market, firms capable of creating the documentation

necessary for obtaining loans are few in number and far between. And, clearly, people will not participate in a banking system that is perceived to be corrupted by executives who are allowed to behave as if they are above the laws that govern clients.

The crux of the problem is the lack of SME, government, and industry personnel who can write risk and return profiles. The consequence of this is that institutions like Islamic banks that are committed to promoting fairer capital distribution systems are forced to bear unfair levels of portfolio risk. Therefore, barriers to efficient Islamic capital distribution become highly practical problems very quickly. Islam does provide protection against political dynamics that raise structural risks. This is as much true in a capital-rich Muslim economy, like that of Saudi Arabia, as in a capital-poor Muslim country, like Jordan. It is also as true for Arab-owned Western-styled banks as it is for Arab-owned Islamic banks.

In fact, from the information presented here it is clear that there are far fewer problems than expected that are specific to Islamic banks *vis-à-vis* other banks. In both Jordan and Saudi Arabia Islamic banks can be expected to mature as these countries' economies develop their own brand of structural stabilization. The two processes are not unrelated. The specific problem for Islamic banks is that people prefer informal sector financing, which encourages competition from family-owned moneychangers.

Still, one can surmise that, in financial systems like those in Jordan and Saudi Arabia, where enforcement

systems are so heavily biased against lenders, capital is virtually costless to the borrowers. This paper would not be the first to make that claim about the banking system in Saudi Arabia.⁸¹ The conclusions drawn here are not meant to be so strong, but it is fair to conclude that there are reasons why foreign-owned banks are the only financial institutions that operate profitably in the Jordanian and Saudi Kingdoms, i.e. they show more managerial sophistication and, more importantly, they reinvest deposits in countries where the economic structures protect capital. Foreign banks also provide an alternative for people who fear risk, government intervention and legal corruption. These barriers cannot be overcome by Islamic banks alone.

Prospects for Islamic banks

Given this state of affairs, what are the portents for Islamic banks in Jordan or Saudi Arabia? Their futures rest most heavily with the growth of professional training in finance and risk management in both the private and public sectors. The attitudes of business leaders and government officials toward accounting, auditing, and financial reporting must be changed because the success of any bank depends on its ability to distribute resources on a risk-efficient basis. The patent for establishing this basis for operations relies on several factors: the availability of an economic structure where earnings and managerial

efficiency are the determining factors in the increasing (or decreasing) value of the company; the requirement that businesses provide a consistent set of records; the provision of judicial and enforcement systems that protect asset values.

With these facts in mind, it is difficult to blame low profitability and failure among Islamic banks entirely on their management. Rather, it is a mix of problems that also includes the inability or unwillingness of business and government leaders to reform state-led financial systems. It will only be when financial regulations become more defined, and when the attitudes of SME owners are changed, that Islamic banks in the Arab region will share equitably in the private sector's development risks. The tide of opinion does seem to be moving in this direction. For example, in the current Saudi development plan the largest share of the budget, over half, will be spent on human resource training. The training programs that will eventually be funded by this mandate will be the saving feature of Islamic banking in both Jordan and Saudi Arabia. But for Jordan an equally important factor will be its ability to create employment. For the time being, Islamic banks in these Kingdoms face significant problems in the areas of management, portfolio risk, and regulation, which are problems that are also faced by many of their competitors at Western-styled banks.

Appendix I

The following describe generally acceptable accounts for Islamic banks.⁸⁵

Deposit Accounts:

A. Amanah (Current or Checking Accounts):

The general principle for checking accounts is the same under both banking systems: money is deposited that can be drawn against by assigning a money transfer to a third party by check. Service fees are charged against a depositor's accounts to cover transaction expenses. Unused deposit balances, however, do not earn interest and cannot be reinvested in the bank's investment portfolio.

B. On-call Accounts:

These accounts are similar to savings accounts in that the depositor must be present at the bank in order to withdraw money, i.e. withdrawals cannot be made by check. Depositors can demand payment in full at any time. Money deposited can be reinvested, but the bank has no profit-sharing obligation.⁸⁶

C. Investment Accounts:

Three types of 'joint investment accounts' are offered. Each of these accounts may share distribution of the bank's general investment account's annual profits.

D. Savings Accounts:

Geared to small investors, depositors' funds are partially held in a non-participating reserve account and partially invested in an investment fund. The per centage of active vs dormant money varies between banks. The per centage in the Jordanian Islamic Bank is fifty per cent. 'Subject to Note' accounts operate on the same basis at the Jordanian Islamic bank, but seventy per cent of funds are reinvested in the bank's general investment account.

E. Time Accounts:

Deposits into these accounts carry time-based withdrawal restrictions. Money receives a higher proportion of the profits earned from the bank's general investment account. Only ten per cent of funds deposited are kept in reserve, and ninety per cent is reinvested at

the Islamic Bank of Jordan and qualifies for distribution should profits be earned.

F. Specific Investment Accounts:

Deposits are accepted for reinvestment in a specific type of investment project. The bank acts as an agent for the depositor finding projects meeting agreed upon risk and return profiles. In this case, the bank, the borrower, and the depositor participate in profit-sharing arrangements, but only the depositor's funds are at risk in the case of loss. Banks are held liable for poorly placed investments only if negligence can be proven. These accounts closely match fiduciary trust and/or limited partnership arrangements in the United States. A Social Account is a Specific Investment Account where depositors order investment in municipal or public projects.

Credit Accounts:

A. *Mudaraba* contract (profit and loss sharing):

The initial purchase of equipment, goods, and/or raw materials is made by the bank and resold to the user. On the basis of cost plus a profit margin, the loan is paid back to the bank in installments. These contracts are usually short term and are often used to finance import or retail trade. The goods are to be bought according to order specifications written into the contract by the managing partner. However, the Shariah Supervisory Board has ruled that formal repurchase contracts constitute guaranteed profits. The managing partner may decline the goods and nullify the contract even if the equipment, etc. is delivered according to the specifications issued.

B. *Al-Ijarah* (lease):

A lease-to-hire contract is created where the bank acquires equipment or property and rents it to the user. An advanced form of this type of contract is the *Al-Ijarah wa Iqtina*, where a basic *Al-Ijarah* is signed, but the entrepreneur makes payments based on a profit-sharing ratio into a *mudaraba* account. The proceeds of the account are used to retire the liability or to fund additional equipment financing at the end of the contract.

C. *Bay' al-Muajjal* (accounts receivable):

The purchase of an asset is set against the promise of deferred payment, by lump-sum or through installments.

D. *Musaqat* (harvest contract):

A contract is made between the financier and an orchard owner where the harvested commodity is shared. Each party may then sell its share of the crop for profit. The contract is written specifically for the production on a certain orchard's harvest, regardless of whether the farmer owns or rents the land.

E. *Muzara'ah* (harvest contract):

A more general contract form than the *musaqat*, *muzara'ah* is used to finance farm production. The farmer plants and harvests crops and promises to split the profits from selling the crop with the investor. These contracts are tied to crops grown on plots of land.

F. *Qard Hasan* (beneficial loans):

Used for financing consumption goods, this is a straight interest-free loan. Repayment of the principle is made over an agreed upon period of time. Processing fees may be charged to cover costs.

G. *Salaf or Bai Salam* (post-production contract):

In this contract the bank agrees to buy a commodity or a producer's goods on a post-production basis, but money is distributed on a pre-production basis. The producer buys the needed materials, produces, and delivers the product. The bank is then free to sell the commodity for profit.

Notes

¹ There is a proliferation of new articles that add to the debate over the feasibility of using Islamic finance to facilitate community and economic development. See the selected bibliography for a list of the new articles. For well written and standard reviews on the potential uses of Islamic banking and finance, see first the work on this subject by Rodney Wilson. Three of his pieces on which I base my work are: 'Islamic Financial Instruments,' *Arab Law Quarterly*, 6.2 (1991): 205-15; 'Islamic Banking in Jordan,' *Arab Law Quarterly*, 2.3 (1987): 207-29; and *Banking and Finance in the Arab Middle East*, (New York: St Martin's Press, 1983).

² Zubair Iqbal and Abbas Mirakor, 'Islamic Banking,' *International Monetary Fund Occasional Paper 49*, (Washington, 1987) 1.

³ Nabil Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law: Riba, Gharar and Islamic Banking*, (Cambridge, UK: Cambridge, 1986) 49-50.

⁴ The most comprehensive catalogue on the debate over Islamic economics concepts is found in M. Umar Chapra, *Toward a Just Monetary System*, (Leicester UK: The Islamic Foundation, 1985). Also see Nabil Saleh's book, which is cited above and the articles listed in the selected bibliography. I have raised a number of these issues and some new points of discussion at a lecture presented at the 1994 National Islamic Conference which was held in Washington D.C. A summary of the lecture is found in the Winter 1995 issue of the *American Journal of Islamic Finance* in an article written by Steven Abulkader.

⁵ Bandar Al-Hajjar, John R. Presley, and J.W. Wright, Jr., 'Structural and Attitudinal Impediments to the Effective Capital Distribution in Saudi Arabia's Islamicizing Economy: Implications for Financial Sector Training,' *Economic Growth and Human Resource Development in Islamic Perspective*, (Herndon, Virginia: The International Institute for Islamic Thought, 1993).

⁶ J.W. Wright, Jr., 'Is Jordan's Economic Recovery Real?' *Arab-American Business and Consumer Magazine*, 8-9; Marwan AbuJaber and Christopher M. Vaughn, 'Jordan's Rentier-by-Proxy Economic Agenda: Recent Changes, Observations, and Opportunities,' *Proceedings of the 1992 British Society of Middle Eastern Studies Conference*, (St Andrews, Scotland: St Andrews University, 1992); and Marwan AbuJaber, 'The Economic History of Jordanian Workers Abroad and The Effects of Their Remittances on the Jordanian Economy,' B.A. Thesis, Washington College, 1989.

⁷ A.H.M. Sadaq, 'Islamic Perspectives on Monetary and Fiscal Policies and Their Implications for Development,' *International Journal of Islamic and Arabic Studies*, 5.1 (1988): 1-16.

⁸ This distinction is made because capital distribution does not necessarily mean lending. To make this point *Thoughts on Economics* ran a series on Islamic financial instruments in 1988. The two articles of note here are A. S. M. Kahn, 'Islam and Modern Banking,' 9.1 (1988): 63-66 and Volker Nienhaus, 'Islamic Banking: Microeconomic Instruments and Macroeconomic Implications,' 9.12 (1988): 66-86.

⁹ A. Pervez Imtiaz, 'Islamic Finance,' *Arab Law Quarterly*, 5.4 (1990): 259-81.

¹⁰ Radi El-Bdour, 'Problems of Research in Islamic Economics, (with emphasis on priorities and application),' *The Proceedings of the 1986 Symposium of the Islamic Research and Training Institute and the Islamic Development Bank on Problems of Research in Islamic Economics*, (Jeddah, Saudi Arabia: 1986) 110-44.

¹¹ These verses are all cited by Wilson in *Arab Law Quarterly* and come from N. J. Dawood's translation of the *Qur'an*, (London: Penguin Books, 1956) 70-3.

¹² Ma'en Mardi Al-Qatamin, 'Islamic and Conventional Banks: A Comparative Study,' M.B.A. thesis, University of Nottingham, 1990, 23-25. Mardi cites three sources for this information: S. Al-Sarkhasi, *Kitab Al-Mabsout*, (Cairo: Al-Sa'ada Press, 1903), A.Q. Al-Maqdesi, *Al-Muganni*, (Cairo: Dar Al-Manor, 1946), and Ben Abdullah Yaqut, *Mu'jam Al-Udabha*, (Cairo: Issa Al-Babi El-Halabi Library, no date). Dahman Ben Abderrahman, 'A Contribution to the Study of the Koranic Sources of Saudi Arabian Law,' *Arab Law Quarterly*, (1988): 132-50.

- ¹² S.R. Khan, 'Profit and Loss Sharing: An Economic Analysis of an Islamic Financial System,' diss. University of Michigan, 1983, 205.
- ¹³ Muhammad A. Khan, 'Islamic Banking in Pakistan,' *International Journal of Islamic and Arabic Studies*, 2.2 (1985): 21-34.
- ¹⁴ Wilson, 75-9.
- ¹⁵ David Cobham, 'Finance for Development and Islamic Banking,' British Society of Middle Eastern Studies Conference, (St Andrews, Scotland, 1992) 619-37. In addition, a number of writers about Islamic economics study the systems in Iran and Pakistan and the general failure of financial institutions in these countries. However, I will dwell only on articles about experiences in Jordan and Saudi Arabia.
- ¹⁶ See Appendix I for more detailed descriptions of Islamic bank deposit accounts.
- ¹⁷ J.W. Wright, Jr., 'American Trade and Islamic Economics in the Israeli Occupied Territories,' *International Journal of Commerce and Management*, (forthcoming, 1995); Wright, 'The Peace Dividend of Islamic Economics,' *Proceedings of the 1994 conference on Managing Development in Muslim Countries*, (Kuala Lumpur: University of Malaysia, forthcoming). For ideas on how Islamic finance might be applied in the United States see 'The Attitudes of Wealthy American-Arab-Muslims Toward Islamic Finance,' *The Role of the Public and Private Sectors in Economic Development in Islamic Perspective*, (Herndon, Virginia: The International Institute for Islamic Thought, forthcoming, 1995).
- ¹⁸ Most articles about Islamic lending/capital distribution contain some discussion of '*musharaka*' and '*mudaraba*' contracts. I find Radi El-Bdour's discussion of the types of Islamic instruments among the most complete, and much of the discussion here comes from his article 'Economic of Profit Sharing Contracts: Conceptual and Theoretic,' *Proceedings of the 1987 Workshop of the Islamic Research and Training Institute and the Islamic Development on Investment Strategy in Islamic Banking: Applications, Issues, and Problems*, 1987, 57-88. Unless otherwise endnoted, the discussion here comes closest to his, with his permission. The econometric models he presents in this article and others are not, however, germane to the discussion at hand. Other articles I read that confirm El-Bdour's definitions include Pervez, 270-8 and Rodney Wilson 'Islamic Financial Instruments.'
- ¹⁹ Forms of *sharikah al-aqd* include: *sharikah al-amwal*, based on monetary investments; *sharikah al-amal*, based on labor, and *sharikah al-wajuh*, based on the expertise and reputations of the managing partner.
- ²⁰ A.M. El Gousi, '*Riba*, Islamic Law, and Interest,' diss. Temple University 1982, 215-16. The spectrum of lending contracts does go beyond the straight *mudaraba* contracts. They include the effective equivalents of leases, accounts receivables, agricultural loans, consumer loans, and investment leverage accounts. Other types of participation contacts used by Islamic banks are outlined in Appendix II.
- ²¹ There is a growing debate over the precision of statements such as these, although Iqbair and Mirakhor's statements are supported by the majority of Islamic economic literature I have read. However, movements have been made toward developing insurance companies for Moslems based on cooperative or mutual share company concepts. Insurance companies in Saudi Arabia operate this way. Malaysia probably has the most advanced form of Islamic insurance company. For a discussion of experiments in Malaysia see Ramlah Mahmoud Nik, 'Takful: The Islamic System of Insurance Companies - The Malaysian Experience,' *Arab Law Quarterly*, 6.3 (1991): 280-96.
- ²² For example, *Savings and Development* published a series on this topic in 1989. Notable articles from this series include: Bernard Fischer, 'Savings Mobilization in Developing Countries: Bottlenecks and Reform Proposals,' 2, 117-31; Richard Kitchen, 'Venture Capital: A New Approach to Financing Small and Medium Enterprises in Developing Countries,' 3, 287-313; J. D. Von Pischke, 'Risk: The Neglected Dimension in Rural Credit Projects,' 2, 133-148; John Samuels and Michael Theobald, 'Equity Finance in Developing Countries,' 4, 337-49.
- ²³ While he does not look at the portfolio risks of banks *per se*, the best work on lacking regulations and their effects on banking and capital distribution come from recent writings by Edgardo Buscaglia on Latin America. See his recent paper 'Judicial Reform in Latin America: Economic Efficiency vs Institutional Inertia,' *Proceedings of the 1995 Latin American, Inter-American Association Conference*, 119-61, and his paper 'Law, Technological Progress, and Economic Development,' Policy Study 93-1, School of Law at the University of California at Los Angeles, (1991).

⁷¹ These terms are used as they are applied in Thomas R. Stauffer, *The Journal of Energy and Development*, 11.1 (1985) 69-93. The term rentier finds its basis in Ricardo's work on depletable resources and by extension the term 'rentier by proxy' refers to economies that are dependent on natural resource exploitation via secondary transactions, such as through remittances gained because of labor exports.

⁷² On the levels of capital investment see Muhktar Ballool's article 'Social Change and Business Policy in an Era of New Prosperity: Strategic Investment Planning From 1970 to 1985,' and Abdullah Albatel's article 'Private Sector Finance: Problems Faced by the Fourth and the Fifth Five Year Plans,' which are both in J. W. Wright, Jr., ed., *Business Development in Saudi Arabia: Essays with Saudi Scholars*, (London: The Macmillan Press, Ltd.: 1995). On labor needs during this period see in this text Khashoggi and Vaughn's article 'Labor Constraints on Saudi Business Development' and Schmidt and Garawi's 'The Saudi Managerial Environment.'

⁷³ The possible exception is Yemen, but there are no official records of migrants from Yemen to Saudi Arabia in the 1970s. Saudi Arabia's labor rentier strategy also affects other economies like those of India, Pakistan, the Philippines, Egypt, etc., but the largest number of official immigrants came from Jordan in the pre-Gulf War period. Reports to this effect are contained in various reports from the United Nations ESCWA office in Amman. Three dissertations cited in this report also note this fact. These reports are cited when specific information from them is used. There is other debate over which national groups comprised the largest groups of guest workers in Saudi Arabia during the 1970s and 1980s. It is likely that the most basic labor came from Yemen, although there are no records on early migration from Yemen and Serengeldin claims that it was from Egypt. It is more feasible that most guest workers in Saudi Arabia came via Jordan, although many were actually Palestinian. This is certainly true in the other Gulf states and some records indicate that this is also true in Saudi Arabia. Antipathy between Palestinians and Saudis led both groups to lower estimates of their mutual dependence. My opinion is that people who had lived in Jordan were the majority of the guest workers in Saudi Arabia. This is at least true for professional-level guest workers, who are of concern in this paper.

⁷⁴ J. W. Wright, 'Accounting in Saudi Arabia: Imperative Questions for the 1990s,' *Proceedings of the 1992 British Society for Middle Eastern Studies Conference* (St Andrews University: Scotland, 1992) 636-43.

⁷⁵ Saleh Ahmed Tawi, 'The Impact of Expatriate Workers on the Economy in Saudi Arabia: Compatible General Equilibrium Results,' diss. Oklahoma State University, 1984, 24.

⁷⁶ These statistics come from various Saudi government reports and are discussed in John R. Presley, and Tony Westaway, *A Guide to the Saudi Arabian Economy*, (London: Macmillan Press, 1989) 9-48.

⁷⁷ Bandar Al-Hajjar and John R. Presley, 'Managerial Inefficiency in Small, Manufacturing Businesses in Saudi Arabia: A Constraint to Development,' *Proceedings of the 1991 British Society of Middle Eastern Studies Conference*, (London University: England, 1991) personal copy.

⁷⁸ The Saudi Consulting House Annual Report, 1986, as quoted by Al-Hajjar and Presley, 'Managerial Inefficiency.' See also 'Gulf Consumer Markets in the 1990s,' *Gulf Economic and Financial Report*, 5.6 (1990).

⁷⁹ Presley and Westaway, 11. For more general information on the service sector, see 'The Significance of Gulf Services Sectors,' *Gulf Economic and Financial Report*, 5.5 (1990).

⁸⁰ On urban growth in the Kingdom see, 'Cultural Continuity and Saudi Urban Planning: National, Regional, and Municipal,' in *Business Development in Saudi Arabia*. On private sector dependency see Al-Hajjar, Presley, and Wright, and see Wright, 'More Than Petroleum: A Diversified Economy,' in Abdulaziz Al-Sweel and J.W. Wright, Jr., *Saudi Arabia: Tradition and Transition*, (Westland, Michigan: Hayden-McNiel Publishers, 1993), 27-66.

⁸¹ Bandar Al-Hajjar and John R. Presley, 'Financing Economic Development in Islamic Economies: Attitudes Toward Islamic Finance in Small Manufacturing Businesses in Saudi Arabia,' forthcoming. Also see Al-Hajjar and Presley, 'Islamic Finance: Attitudes in Small Manufacturing Businesses in Saudi Arabia,' International Conference on Islamic Economics, (Kuala Lumpur, 1992) personal copy.

⁸² Interview with J. Wayne Wright, Sr., former Chief Consultant to the General Manager of the Saudi Arabian Agricultural Bank, Riyadh, Saudi Arabia. These lending policies are articulated in various manuals and reports held by Mr Wright. Another version of this situation can be found in Garawi and Schmidt.

⁸³ Al-Hajjar and Presley, 'Managerial Inefficiency,' Wright, Brismes.

³⁸ Presley and Westaway, 48.

³⁹ John A. Shaw and David E. Long, *Saudi Arabian Modernization: The Impact of Change on Stability*, (New York: Praeger Publishing, 1989) 35.

⁴⁰ Mohammed Farid Y. Kurashi, 'The Social Responsibility of the Multinational Corporations Operating in Saudi Arabia,' as summarized by Constance B. Joy in Ahmed Hassan Dahlan, *Politics, Administration and Development in Saudi Arabia*, (Brentwood, Maryland: Amana Corporation, 1990) 259-77.

⁴¹ Shaw and Long, 38. Population estimates vary widely, especially with respect to imported labor. Shaw and Long estimate that eighty-percent of the labor is imported. Presley claims seventy percent, while some agency statistics put estimates as low as forty percent. I find Presley and Westaway's position the most defensible.

⁴² Estimates taken from The Third Five-Year Development Plan are discussed by Presley and Westaway, *A Guide to the Saudi Arabian Economy*, 100-1, 138.

⁴³ A definite progression has been made in the goals stated in the Kingdom's Five-Year Development Plans. The First Plan focused on the construction of human support services such as health care facilities, roads and schools. The Second and Third Plans concentrated on infrastructure development, with the Third Plan calling for the completion of construction of two industrial cities at Yanbu and Jubail. The Fourth Plan saw the completion of most plans for government-sponsored infrastructure projects and placed more attention on human resource development. Human resource development is the primary focus of the Fifth Plan. This progression from expenditure on construction to expenditure on intangible items such as training and small business development would normally indicate a move toward support for private sector businesses, especially as the economy becomes increasingly service-based. But, while the progression is made in the Plans, it has not happened at the practical level. Small firms are still not participating in financial incentive programs for business development. See Presley, Westaway, and Sessions.

⁴⁴ The Fourth Plan target provided for the number of non-national employees to drop by 600,000 from 1985 to 1990, and the Fifth Plan calls for the replacement of 220,400 foreign workers. The actual number replaced was about three-fourths of the target.

⁴⁵ Examples include The Economic Adjustment Program (EAP) of 1989-1993, the Encouragement of Investment Law No. 53, the Post Office Fund Act, the Development Bonds Plan. The Central Bank also encourages the opening of foreign accounts to facilitate the remittances' process. This point is discussed in A. J. Munzer, 'A Rate of Return Analysis of the Education of Jordanian Workers,' diss. University of Wales, 1980, 115.

⁴⁶ 'The Impact of The Gulf Crisis On The Jordanian Economy,' Economic and Social Commission for Western Asia (ESCWA), December, 1990, 10. This report studies ESCWA member countries: Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Oman, Palestine, Qatar, Saudi Arabia, Syria, United Arab Emirates, and Yemen.

⁴⁷ See both Mohammad S. Amerah, 'Major Employment Issues in Some Arab Countries,' (Amman: Economic Research Centre for the Royal Scientific Society, 1990) 2; and Nazli Choucri, 'Migration in the Middle East: Old Economics or New Politics,' *Journal of Arab Affairs*, 7.1 (1988): 10-18.

⁴⁸ Share, 36.

⁴⁹ Hussein A. Yahya, 'Human Capital Migration From Labor-Rich Arab States to Oil-Rich Arab States and the Consequences for the Jordanian Economy,' diss. Oklahoma State University, 1980, 34; ESCWA (1991) 13; and Nazem Abdalla, 'The Impact of The Gulf Crisis,' Economic and Social Commission for Western Asia, (1991) 10.

⁵⁰ Abdalla, 10; Hussein, 28; Abdalla, 14.

⁵¹ Dr A. Y. Abu-Ayyash, 'Absorption of Returnees in Small Industrial Enterprises: The Case of the Development and Employment Fund,' Economic and Social Commission for Western Asia, (1991) 14; also see Vaughn and Abu Jaber.

⁵² Abu-Ayyash, 14, and are confirmed in graphs presented by Amerah, 26-31. However, there is some debate over the success of labor export plans. Choucri describes the danger of investing remittances into 'squanderables' in 'Migration in the Middle East: Old Economics or New Politics.' Ismail Serageldin states:

inversely related to occupational level' in *Manpower and International Labor Migration in the Middle East and North Africa*. (London: Oxford University Press, 1983) 91. His study tends to draw conclusions based on Egyptian experience. The inverse relationship he finds is not applicable to the Jordanian experience. I tend to agree with Richard H. Adams' argument that the positive or negative effects of remittances must be measured relative to domestic employment and investment alternatives. See 'The Economic Uses and Impact of International Remittances in Rural Egypt,' *Economic Development and Cultural Change*, 39.4 (1991). See also Adam's *The Effects of International Remittances on Poverty, Inequality, and Rural Development in Egypt*. (Washington: International Food Policy Research Institute, 1991). His position is more moderate, but still discusses poor reinvestment. I too have argued that while this strategy may have worked in the early 1890s it no longer does so. Indeed, as I explain later, the remittance strategy began to fail in 1987. However, I argue that this failure is due to the region's changing political dynamics and not because of poorly invested remittances. These positions each have merit in the context of this occasional paper.

³³ James Jankowski, 'Review of *Troubles on the East Bank: Challenges to the Domestic Stability*,' by Robert B. Sutloff, *Middle East Studies Association Bulletin*, 21.2 (1987) 219.

³⁴ Amerah, 13.

³⁵ 1987-1988 figures were taken from Amerah, 13, and were verified and extended to 1989, Abdalla 8-9.

³⁶ Serageldin, Socknat, Birks, Li, and Sinclair discuss the influence of Asian labor in the Gulf from the 1975-85 period, speculating that Arab workers would be replaced in the future. M. Ali, M. Amerah, and I. Ibrahim discuss this in *The Unemployment Problem in Jordan: Characteristics and Prospects*, (Amman: Royal Scientific Society, 1987) as does I. Ibrahim in *Status and Prospects of the Jordanian Labour Market*, (Amman: Royal Scientific Society, 1989). Choucri shows this has been the case since the Gulf war and his claim remains justified today.

³⁷ It is true that purchases of goods consumed by families receiving remittances would become parts of a firm's cash flow like any other sale. However, several studies cited in this paper discuss the fact that people re-invest remittance money into real estate or into the operations of family-run businesses. I agree with the argument that families in labor-exporting countries pursue income-portfolio strategies. This assertion is certainly supported by Abujaber and Vaughn, Amerah and Ibrahim, Cantori (in his articles on corporate conservatism), and Serageldin. See also Karen Aziz Choudhry, 'The Price of Wealth: Business and State in Remittance and Oil Economies,' *International Organization*, 43.1 (1989): 123, who indirectly implies this is the case while talking about the real costs' remittances on liquidity. Schmidt discusses the extent to which the notion of family-unit businesses transfers with families who emigrate to the US in 'The Family-Run Business: A Remnant of the Old Country for Today's Arab American,' *ABC Magazine*, 12 (1993): 11-12. The implications are much more severe, however, in an economy where 60-80 per cent of private sector profits come from sales to the government.

³⁸ The money supply and deposits figures reflect comparison in six-month blocks beginning on 1 July, 1991. The percentage increase in insurance premiums collected reflect an index created from the annual reports of the top three Jordanian insurers.

³⁹ Central Bank of Jordan, *Monthly Statistical Reports*, vol. 28, no. 12, (December 1992), p. 14.

⁴⁰ Several factors make it difficult to continue this analysis in 1993. Among these is a reclassification of reporting categories for some economic indicators. Remittances, for example, are not presented for 1992. This is probably in response to the International Monetary Fund's recognition that what had been counted as remittances should have been reported as transfers of capital. In 1993 the Central Bank of Jordan does not list deposits in licensed banks and does not list deposits in financial companies at all. These omissions make trend analysis difficult.

⁴¹ United Nations Industrial Development Organization, 'The Role of Small and Medium Scale Industries in OIC Member States,' *Journal of Economic Cooperation Among Islamic Countries*, 8 (1987): 1-54. Also Donald C. Mead, 'Small Enterprises and Development,' *Economic Development and Cultural Change*, 39.2 (1991): 409-20.

⁴² D. Anderson and F. Khambata, 'Financing Small Scale Industry and Agriculture in Developing Countries: The Merits and Limitations of Commercial Policies,' *Economic Development and Cultural Change*, 10.2 (1985): 349-72.

⁴³ Richard Kitchen, 'Venture Capital: A New Approach to Financing Small and Medium Enterprises in Developing Countries,' *Savings and Development*, 3 (1989): 287-313.

⁶⁰ Korhan Berzeg, 'Comparative Measures of Average Risk and Return For Major Sectors of the Saudi Arabian Economy,' Address to the International Academy of Business Disciplines, (Arlington, Virginia, 1992).

⁶¹ Cengiz Erol and Radi El-Bdour, 'An Empirical Investigation of Risk of Stocks Traded on the Less Developed Capital Market: Jordan as a Case Study,' *Abath Al-Yarmouk*, 6.3 (1990): 25-44.

⁶² Moustafa Abdel-Magid, 'The Theory of Islamic Banking: Accounting Implications,' *The International Journal of Accounting*, 17.1 (1982-1983): 79-102.

⁶³ Helen G. Morsicato and Michael A. Diamond, 'An Approach to 'Environmentalizing' Multinational Enterprise Performance Evaluation Systems,' *The International Journal of Accounting*, 16.1 (1981): 247-65.

⁶⁴ Naim H. Dahmash, 'Public Auditing Developments in the Arab States: A Comparative Study,' *International Journal of Accounting Education and Research*, 18.1 (1986): 89-114. In Tunisia, for example, 'sloppy budgeting techniques' have significantly impeded implementation of the government's privatization plans. See John R. Nellis, 'Decentralization and local public finance in Tunisia,' *Public Administration and Development*, 5.3 (1985): 187-204. Pakistan's Auditor-General recently reported that 'up-to-date expenditure flows are often delayed for years because of complex and inefficient information flow.' See Muhammad Aram Khan, 'Implementing Performance Auditing in Pakistan,' *International Journal of Auditing*, (October, 1986): 15-17. The lack of a private enterprise accounting often inhibits Turkey's ability to draw in foreign investment capital. On Turkey see Pekin Ogan, 'Turkish Accountancy: An Assessment of its Effectiveness and Recommendations for Improvements,' *International Journal of Accounting*, (1979): 133-154; and Turgat Vare, 'The Current Accounting and Education Practice in Turkey,' *International Accountant*, no. 4, (1976): 11-12. On Syria see Adnan Abdeen, and Trevor D. Wise 'The Impact of Accounting on Tax Revenue in Syria,' *International Journal of Accounting*, 20.1 (Fall 86): 121-139.

⁶⁵ This study by Bandar Al-Hajjar and John R. Presley generated a series of articles and lectures that have been presented or published from this research. The most recent is a reprint of an earlier article in *Middle Eastern Studies* entitled 'Small Business in Saudi Arabia,' in *Business Development in Saudi Arabia: Essays with Saudi Scholars*. Also see Al-Hajjar and Presley 'Managerial Inefficiency in Small Manufacturing Businesses in Saudi Arabia: A Constraint to Development,' *Proceedings of the 1991 British Society of Middle Eastern Studies Conference* (London: School of Oriental and African Studies, 1991); and Al-Hajjar, Presley and Wright, 'Structural and Attitudinal Impediments to Capital Distribution in Saudi Arabia's Islamicizing Economy,' in *Economic Growth and Human Resource Development in Islamic Perspective*, (Herndon, Virginia: The International Institute for Islamic Thought, 1993), which is also be reprinted in *Business Development in Saudi Arabia*.

⁶⁶ See Cigdem Solas and Virginia Bakay, *The Information Needs of Investors in Unregulated Capital Markets: The Middle East Capital Markets as a Case Study*; Yasim Sarayrah and Mahmoud Qarish, *The Role and Performance of the Bureau of Audit of Jordan*; and Ahmed Belkaoui, *Linguistic Relativism in Accounting*, each of these published as part of a series at (The Arab Institute for Bank Studies, Amman, Jordan, 1990). T. R. Cairnie and M. M. Lufti, *The User-Oriented Accounting Framework and Economic Development: The Case of Jordan*, (The Arab Institute for Bank Studies, Amman, Jordan, 1990).

⁶⁷ Solas, 10.

⁶⁸ Cengiz Erol, and Radi El-Bdour, 'Conventional and Islamic Banks: Patronage Behavior of Jordanian Customers,' *The International Journal of Bank Marketing*, 8.4 (1990): 25-35.

⁶⁹ Kitchen, 296; Samuels and Theobald, 341.

⁷⁰ The Larive Corporation, an international marketing research firm in Amsterdam, conducted a survey of over 6,000 clients in Saudi Arabia to study depositor attitudes which verifies the opinions presented here. The project, however, was privately studied, and the information can not be directly cited at this time. In general, the survey shows that bank clients do intend to hide financial information from banks and from the government. Their sample was not limited to SME owners.

⁷¹ See W.H. Anderson Jr., E.P. Cox III, and G.L. Fulcher, 'Bank Selection Decisions and Marketing Segmentation,' *Journal of Marketing*, 40 (1976): 40-45; R.H. Evans, 'Bank Selection: It all Depends on the Situation,' *Journal of Bank Research*, 1979: 240-246; Erol Kaynak and U. Yavas, 'Segmenting the Banking Market by Account Usage: An Empirical Investigation,' *Journal of Professional Services Marketing*, 1 (1985): 177-188; and Al-Hajjar and Presley, among others.

⁷⁵ The Al-Hajjar and Presley surveys have been cited. The Jordan studies have been published in two articles: Erol Cengiz, Erdener Kaynak, and Radi El-Bdour, 'Conventional and Islamic Banks: Patronage Behavior of Jordanian Customers,' *The International Journal of Bank Marketing* 1.4 (1984): 25-35; and Cengiz Erol and Radi El-Bdour, 'Attitudes, Behavior, and Patronage Factors of Bank Customers Towards Islamic Finance,' *The International Journal of Bank Marketing*, 7.6 (1989): 31-38. Unless noted separately, the statistics have been taken from these articles. Additional work on this subject can be found in Radi El Bdour, 'The Profit Maximizing Behavior of Islamic Banks and Conventional Banks: A Comparative Study,' *The Kashmir Review*, 3.2 (1986): 21-40. See his related articles in the bibliography.

⁷⁶ Similar suggestions can be found in the essays in *Money and Banking in Islam*, Ahmed Ziauddin ed. (Islamabad, Pakistan: Institute for Policy Studies, 1983).

⁷⁷ This preference was confirmed in an earlier survey by A. Ahmed, *Development and Problems of Islamic Banks*. (Jeddah, Saudi Arabia: Islamic Research and Training Institute, Islamic Development Bank, 1987) 75.

⁷⁸ Al-Hajjar and Presley, 'Managerial Inefficiency.'

⁷⁹ Al-Hajjar and Presley, 'Islamic Finance: Attitudes of Small Manufacturers in Saudi Arabia,' Proceedings of the 1992 International Conference on Islamic Economics, (Kuala Lumpur: International Institute for Islamic Thought, 1992).

⁸⁰ Al-Hajjar and Presley, 'Islamic Finance.'

⁸¹ Ibid.

⁸² Jafarhusein I. Laliwala, 'Comments: Islamic Economics: Some Issues in Definition and Methodology,' *Journal of King Abdulaziz University: Islamic Economics*, 1 (1989): 129-31.

⁸³ J.W. Wright, Jr., 'Review: *A Question of Interest: The Paralysis of Saudi Banking*,' *Middle East Studies Association Bulletin*, (Winter 1993).

⁸⁴ These definitions come mainly from El-Bdour, Iqbair and Mirakhor, 1987 although the basic concept of partnership or profit-sharing contracts are common. Also Wilson, Pervez, and Saleh.

⁸⁵ There are differences of opinion on whether the bank can or cannot reinvest these funds. Abdel-Magid, for example, says that they cannot, 84. Most writers I have read, however, agree that, because there is no risk to the investor, depositors should not participate in earnings distributed from the bank's general investment account(s).

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