Journal of Islamic Finance (Special Issue) (2019) 076 – 089
IIUM Institute of Islamic Banking and Finance
ISSN 2289-2117 (O) / 2289-2109 (P)

Interest-Free Banking and Finance in Brunei Darussalam: Present Realities and Future Prospects

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Abstract

Brunei is vigorously pursuing interest-free banking as a governmental project. This study examines the development of this institution in the country highlighting the present experiences, future prospects, and imminent expectations. Islamic banking and finance has superintended a new economic order in Brunei. Although the system is still at its primary stages, it has been successful and holds good prospects due to political cooperation. Political-will is basic to the fruitful implementation of a new economic order and the efficient Islamization process in Brunei facilitated the establishment of sound socio-cultural and economic foundations. This has vigorously promoted the essential values of Islam. Nonetheless, the 'call' for economic diversification has some implications for this institution in the country because diversification invariably exposes an economy to international interest and, more importantly, empowers the private sector. These come with the likelihood for promoting interest-based banking and financial practices. This study, therefore, concludes that Islamic banking has been very successful in Brunei but it still remains vulnerable to non-political future challenges subject mainly to the economic fortunes of the petro-dollar.

Keywords: Brunei*, Islamic*-banking*, ribā, economics, Petro-dollar*

1. Introduction

Financial transactions in the conventional banks and the economic constraints on the poor fueled by interest have been a source of worry for ethically-minded scholars both religious and secular (Harrod, 1948; Glaeser, 1998; Lewison,1999; Tarpett, 2007). All religious groups and societies with considerate moral thought, from the ancient times to Judaism and Christianity, have discouraged usury or interest (Kuran, 2001; Wood, 2002; Rutherford, 2005). For example, Christianity officially banned usury in 325 CE at the Council of Nicea which prohibited the 'Fathers' from usury. During the reign of Prince Charles the Great (known in the French West as Charlemagne) both the Church and the state banned usury. Interest here is understood as 'any increment demanded beyond the principal of a loan' (De Roover,1955). The entire writings of Aristotle from the Nicomachean Ethics to The Politics produced a sequence of economic thought under the umbrella of justice (Wykes, 2003). In the Nicomachean Ethics, for example, Aristotle denounced usury; likewise Plato (Peters, 1886; Lee, 1955).

Thus, Islamic banking also emerged as an Islamic socio-religious reaction to the age-old economic innovation of usury (interest). It has, therefore, appeared as a new reality on the global financial scene. Its principles are, however, not new because they were detailed in the Qur'ān and the Ḥadīth. The Islamic banking or financial business seems to have begun at the time of the Prophet's business with Khadījah. However, today's Islamic Banking emerged during the Islamic 'renaissance' immediately following World War II, particularly, in the 1960s when Muslim nations bid farewell to European imperialism (Botis, 2013). This was further accelerated by the petro-dollar proliferation of the 1970s in the Muslim world which necessitated the creation of financial system that reflects Islamic values and is consistent with the Islamic economic and political philosophy (Pollard and Samer, 2007; Warde, 2000; Porter *et al.*, 2009). Thus, the institution arose as the only 'body' to champion interest-free banking and respond to the concerns of Muslims for a financial tradition that reflects the *Ummatic* ethical identity of Muslims. The first bank in the Muslim world, Mit Ghamar, was established in Egypt on 25th July1963, by the Islamic economics Professor, Ahmad El-Naggar (Chachi,2005). An outstanding feature of the Islamic banking system is the prohibition of interest (*Ribā*). Islam prohibits Muslims from taking or giving interest regardless of the purpose for which such loans are taken and regardless of the rate of interest. Allah says:

> Oh you who believe! Do not devour *ribā* (usury), doubled and multiplied; but fear Allah; that you may be successful (Qur'ān 3:130).

Qur'ān 2:188 and 4:29 also enjoin Muslims to avoid the wrongful exploitation of each other's property. *Ribā* is thus perceived as 'a tool of oppression and a means to unjustly take [the] money of other[s] by exploiting their needs and circumstances' (Botis, 2013, p.139). It is held that no controversy currently exists about whether the Qur'ānic word, *ribā*, refers to 'interest' as 'all' the jurists have concurred that it does; and therefore, the modern-day interest-soaked banking systems are considered as being inconsistent with the principles of Islam (Zamir, 2007). Nonetheless, some Muslim scholars have distinguished between 'usury' (normally called *ribā* in Arabic) and 'interest' with intriguing categorizations such as "consumption loans" and 'loans for investment' or productive or "commercial loans" (Kuran, 2011; Akram, 2013) They have, therefore, questioned the popular Islamic position on interest and have, in some cases, even permitted it. The argument is that *ribā* refers to usury charged by petty money lenders and not the interest charged by modern banks which, presumably, is intentioned to 'share' in the 'profit' assuming that all bank loans are meant for investment and, therefore, no *ribā* is explicit when interest is imposed on productive loans. Others argue that not all interests are exploitative to fulfil the description of *ribā* (Khan, 2013). It appears the latter school holds-on to the definition of *ribā* as "excessive interest." Usury is, therefore, differentiated from bank interest. These are known to belong to the "Non-Equivalence School" or "the modernists" as opposed to the traditional or conservative school of thought that argues that 'usury' and 'interest' are equivalent (Ahmad and Hassan, 2007). The modernist's argument is just equivalent to what Patinkin calls 'profit' on capital (Patinkin, 1972). The above arguments about *ribā* or interest imply that ethical business transaction in financial establishments is an important consideration in the Islamic approach to finance.

Thus, Islamic banking has been synonymous to interest-free banking (Botis, 2013). For western economics, however, an economic system is inconceivable without the reality of interest. Hence, in his Wealth of Nations, Adams Smith, a top scholar of western economics and, indeed, the founding father of modern economics, fittingly called 'the Father of economics' by western writers, legitimized interest (Smith, 1776). On the other hand, the Turkish-American economist, Timur Kuran (2011, p.147), argued that no interest-free economy has ever endured among Muslims on earth: "As far as is known, no Muslim polity has had a genuinely interest-free economy." While the latter statement is a bit general, it is understandable because the western conception of interest is not premised on same moral or ethical framework as the Islamic system and so interest does not have so unpopular connotation as it is in Islam. For this reason, Paul Samuelson, for example, defined it as '… the price of rental for the use of money' just as Joseph Persky defined it as '…the rental price of money' (Samuelson, 1976, p.50; Persky, 2007, p.227). Furthermore, Patinkin sees interest as a form of income from property and, therefore, classified it into three: namely, dividend, rent, and profit (Patinkin, 1972). Incidentally, Islam does not proscribe dividend, rent or profit in genuine transactions provided they involve physical goods and services, but proscribes them if they are made on physical money without mediating goods and services. This is because money is not deemed in Islamic economics as a capital good on the same foundation as the other factors of production. Therefore, contrary to conventional economics, in Islam, since justice (*'adl*) and equitable distribution of wealth constitute the backbone of economic values, interest and all of its forms are proscribed.

As an Islamic nation with pronounced consciousness to maintain ethical transactions in her financial institutions (both banking and 'non-Bank Financial Institutions') and gradually free the economy of *ribā* in a manner that is consistent with the Islamic economic philosophy, Brunei entered into interest-free banking transactions (Shresth,2007). This was done through *Sharī'ah* mechanisms that satisfy the moral urge of the customers. This paper examines the development of Islamic finance in Brunei shedding light on the present realities, future prospects, and imminent expectations or challenges.

2. Historical Overview of Islamic Banking/Finance

The origin of the Islamic financial system is not clearly known as it is difficult to determine exactly when, especially, banking operations in Muslim societies began. However, from its Italian origin (Chachi, 2005), conventional banking acquired shape through different stages until Muslims promoted their version of it. In early times, Islam gave financial transaction a maximum space when it placed trade on similar footing with *jihād* by offering the 'merchant a highly honoured place in society' and assuring him elevated position in the hereafter if he deals honestly (Yusuf, 2010; Mustafa *et al*., 2016). Financial transaction, including banking, whatever form it takes, is a trap for Muslims because of the phenomenon of borrowing and lending, and the temptation of *ribā*. Yet, no Muslim society has existed without financial business because many Muslims have made a living through trade. The dominance of trade in Makkah and Madinah among known companions like Khadījah, Abū Ṣufyān, Abū Bakr and the Prophet (pbuh) himself implies that banking and finance, at least, at the non-formal level, had been known to Muslims. Chachi (2005) makes reference to numerous 20th century scholars who mentioned Muslim bankers and banking facilities and argues that Islamic financial services (banks) existed during the Abbasid period. We could refer to the Perso-Arabic, *Jahbadh*, used for 'financial clerk', 'expert in matters of coins', 'government cashier', and 'a money collector', which was used for a 'licensed banker' during the Abbasid period as evidence (Chachi, 2005).

Nonetheless, the understanding of the "bank" used above is unclear although expressions like: 'financial clerk', 'government cashier', etc. which define *Jahbadh* are integral to today's banking systems. The *jahbadh* is the Arabic form of the Persian *gahbad*. It derives from the double-word *gah* (meaning 'goldsmith's vessel') and the Sanskrit *bad* (*pati*: which means "the master" or "the manager"). During the Sassanid regime, the word was used for a "money-changer." Institutions for interest-free transactions existed among Muslims in the major trade centres which performed 'almost all the banking functions' during the Abbasid 10th century. For example, during the reign of Muqtadīr (980-1032 C.E.), the *Diwān al-Jahābidhah* assumed a role similar to what banks do today including administration of deposits, remittance of funds through the issuance of checks (*Sakk*) and bill of exchange (*Suftajah*), and the granting of huge loans to the caliphs, their *Wazirs* and court officials (Metwally and Shahata, 1983).

Regarding the important roles of central banks like issuing and endorsing currencies, although the early Muslims contended themselves with foreign-minted currencies like the Roman, Persian, and Himyarite coins, according to Al-Ṭabarī, the *Umayyād* 'Abdul Mālik issued the first originally Arabic gold dinars and silver dirhams in Syria in the 7th century (Al-Ṭabarī, 1329; Hitti, 1970). In 696 CE, the governor of Iraq, al-Hajjāj followed his example in Kūfah (Hitti, 1970). Undoubtedly, these endeavours were supervised from the official outfits of financial institutions. Yet, it appears these never caught the attention of historians.

For this reason, the sources do not provide us with vivid information about the sequence in which Islamic financial institutions sprang up in the Muslim world. Nonetheless, it appears the first recorded Islamic bank began in Egypt in 1963, superintended by El-Naggar. In the 1970s, however, many Islamic banks were established across the Middle East. For example, the Islamic Development Bank appeared in 1974 followed by the Dubai Islamic Bank. In 1979, Pakistan became the first Muslim country to attempt to fully Islamize her financial system. Today, Islamic banking is a major factor for economic productivity in many Muslim countries including the OPEC economies of the Middle East and the Malay world, particularly, Malaysia, Indonesia, and Brunei. It continues to expand both in its infrastructure and financial assets. In the West, Britain had her first Islamic Bank in 2004. Pollard and Samers (2007) list many financial institutions, both bank and non-bank, that either have '*Sharīʻah*-windows' or render *Sharīʻah*-compliant services to the public.

2.1 Islamic Banking/Finance in Brunei

Islamic banking and finance appeared in Brunei in 1991 when the statutory body known as *Perbadanan Tabung Amanah Islam Brunei* (TAIB) was formed ('Ali & Lee, 2014). Since then, the industry has grown steadily. In 2010, it played a significant role in the country's banking industry with a total disposable asset of B$6.36 billion and a total deposit of B$5.167 billion. These accounted for 37% and 34.6% of the total market share, respectively. Brunei has two main Islamic financial institutions; one bank: *Bank Islam Brunei*

Darussalam (BIBD) also known as the Islamic Bank of Brunei (IBB) and one non-bank: *Perbadanan Tabung Amanah Islam Brunei* (TAIB [Brunei Islamic Trust Fund]) (Venardo, 2005). According to the Ministry of Finance, in 2009, the above two institutions formed 40% of the country's total banking assets. The *Autoriti Monetari Brunei Darussalam* or the Monitory Authority of Brunei Darussalam (AMBD) is more-or-less the 'central bank' of Brunei. There was also the Islamic Development Bank of Brunei (IDBB) which was established in 2000 and later merged with BIBD in 2005 (Borneo Bulletin Yearbook, 2013). In connection with the former, His Majesty, the *Sulṭān* of Brunei, is reported to have remarked thus:

It is a milestone for our country and will become much more significant in proportion to our status [as an Islamic nation]. We are confident that our way of doing business will be widely accepted by the world at large. This is not only because it brings profits but it also offers fairness and at the same time prevents exploitation (Venardos, 2005, p.198).

Since independence, Brunei has endorsed, supported, and vigorously promoted the growth of Islamic banking and finance as an alternative to the established conventional banking system. As an Islamic nation (*Negara Dikr*), the Bruneian economic philosophy is that the banking sphere, and for that matter, financial transactions in general, fall within the ambit of the human enterprises channeled towards the establishment of socio-economic justice (*'adl*). Thus, it operates the 'open-market economy' in which both Muslims and non-Muslims interact and are able to operate within the same operational rules in the economy in which all clients are treated proportionately according to the rules of justice without discrimination.

2.2 Favourable Foundations for Interest-Free Banking in Brunei

The only Islamic institution that renders banking services in Brunei is *Bank Islam Brunei Darussalam* (BIBD). This bank was inaugurated in 1993 to replace the International Bank of Brunei (IBB). The transactions of BIBD are *Sharī'ah*-compliant. This implies that the bank facilitates savings and issues loans in line with principles of Islam. The system is, therefore, free from the interest-based transactions of the conventional banks. The issue of interest-free banking advocated by the *Sharī'ah* often beats people's imaginations. This is because, for the conventional economist whose views dominate economic intellectual discourse, it is impossible to imagine an economic order without the existence of interest. The fact is that the conservative economist understands profit in its strictest or literal sense without much consideration of the human person who, from the Islamic perspective, is at the core of all economic interactions. Even so, one needs to understand that, the Islamic interest-free banking cannot operate smoothly without, first, the goodwill of the Muslims and; second, the full institutional provisions, legal support or the cooperation of the state actors (the government) (Khan and Bhatti, 2006). This should be born in mind in appreciating the controversial review of the bank interest case in Pakistan by the country's highest court of law, the Supreme Court (SC), in 2002, which virtually stifled the effort of the interest-free banking advocates. In the course of the proceedings of the case, a state council is reported to have fumed that the '*Ulamā* themselves were "the main hurdle in the Islamization process of the country" (Zaman, 2012, p.128).

Nonetheless, unlike Pakistan where certain socio-economic variables obstructed the implementation of interest-free financial transactions at the national level (Khan and Bhatti, 2006), in Brunei, the relevant state structures have gradually appeared to support the implementation of the system. The following have been the foundation for the growth of the interest-free finance in Brunei.

2.2.1 The Political-Will and Determination

Political-will and interest are instrumental to the success of every national or societal enterprise. For an institution to succeed in terms of its ability to engage productively with civil society to accelerate and promote sustained development, it is necessary that it acknowledges the diverse limiting factors of operational capacity, political-will and cooperation. This is important because interest-free banking, as a national policy in today's mixed society of profit-minded industrialists and business magnates who understand the control of the economy as a means for accessing and firmly controlling new business opportunities, has certain severe implications. Naturally, promoting interest-free financing demands cooperation both at the personal and institutional levels and the devising of austerity measures to cut-down national expenditure and simultaneously control budget-deficits and the after-shocks of unemployment exacerbated by the cut in state spending.

The point is that the governments of developing countries mostly rely on foreign donors and foreign budget supports to finance their budgets. Since foreign financial inflows imply sometimes relying on foreign organizations like the International Monetary Fund (IMF) and the World Bank, where not only repellent anti-interest-free policies might apply but physical interests are also charged on loans, promoting interest-free banking, in effect, implies also withdrawing from the transactions mediated by interest in all its forms. This should be borne in mind in attempting to understand why although the Pakistani President, Ziaul Haq, pledged to eradicate interest-based transactions in his country, he, at the same time, had to veto, for ten years between 1980 and 1990, any attempt by the Federal *Sharī'ah* Court (FSC) to issue any ruling that would 'interdict' government transactions that were interest-mediated. The above implies that creating an interest-free economy is a governmental or 'political' responsibility that could be discharged more efficiently not necessarily through a constitutional or statutory force alone such as it happened, for example, in the case of Pakistan's *ribā* ruling, but also the political-will, lack of which is also exemplified by the same Pakistani *ribā* issue. For due to its implications on business, employment, government budgets, etc., an interest-free economy could only operate in a country where "personal and state institutions are also restructured on Islamic lines" (Khan and Bhatti, 2006, p.147).

Thus, with its will-power to establish an Islamic economy in which *ribā*-free banking and all its components could operate smoothly, after colonialism, the Brunei government first attempted to formulate a thorough scheme for sequentially bringing-forth the Islamic institutions that naturally created the opportunity for implementing Islamic values within the economic ring. This was, perhaps, what His Majesty *Sulṭān Dan Yang Di-Pertuan Hj Hassanal Bolkiah*, had in mind when, on January 1, 1984, he pronounced that his country would, thenceforth, be *Negara Melayu Islam Beraja* (i.e. a Malay Islamic Monarchical State), currently subsumed under the acronym, MIB. Part of the speech reads: "… *Negara Brunei Darussalam* would forever remain a Malay Islamic Monarchy state, independent, sovereign and democratic" (Serudin, 2013, p.209). To ram home this urge to create an holistic Islamic state where the ideal Islamic institutions would be established to pave the way for the holistic Islamization of all the arenas of the people's life (be it social, economic, political or even cultural), His Majesty re-announced the MIB publicly, for the second time, in July 1990. This political move by the *Sulṭān*, which apparently was, so to speak, to legitimize his political authority within the fragile religious environment and to "promote loyalty to the new nation" (Talib, 2002, p.141), officially made the implementation of Islamic values in all aspects of the Bruneian life (including the economy) a governmental obligation which would facilitate the restoration of the Bruneian Islamic *Ummatic* identity that was almost lost to colonialism.

The Islamization of the Bruneian economy and the implementation of interest-free finance aimed at three objectives.

1. To practicalize the Islamic economic system and transact business according to the principles of the Qur'ān and the prophetic traditions. This drive came with it the need to stand firm against interest-based transactions and the prohibition of *Maysir* (gambling and other forms of economic exploitation) (Qur'ān 5:90).

2. To nurture a value-oriented economy in which financial institutions would develop and function the natural way and in a manner that they would take cognizance of the interest of the poor to promote the public good (*Maṣlaḥah*) and place the human person at the centre of economic transactions. This demanded a drastic reduction of the cost of money through profit-and-loss-sharing, and the promotion of social welfare through the projection of cash inflows (both internal and external revenue) over cash outflows (both external and internal expenditure). This would lead to favourable national and international trade (*Tijārah*), which are recommended for Muslims (Yusuf, 2010; Yusuf, 2017).

3. To reduce the after-shocks of excessive productivity, liquidation, and economic downturn by boosting risk-sharing through the promotion of ethical insurance (*Takāful*) and other related indemnities.

2.2.2 Strong Currency and Abundant Natural Resources for Investment

Interest-free banking economy should have a good opportunity for self-reliance. However, economic self-reliance also implies the availability of adequate natural resources for ethical exploitation by all and sundry. Lack or inadequacy of resources that would offer the opportunity for ethical investment could result in unethical livelihood. It must be noted that, in every economy, the factors of production (land, labour, and capital) are integrated to bring about ethical business and economic security. Thus, land resources, human-based resources (labour), and financial resources (capital) are interlaced and must each be available in the right proportion to bring-about the ideal economy from the Islamic perspective in which interest-based transactions are eliminated.

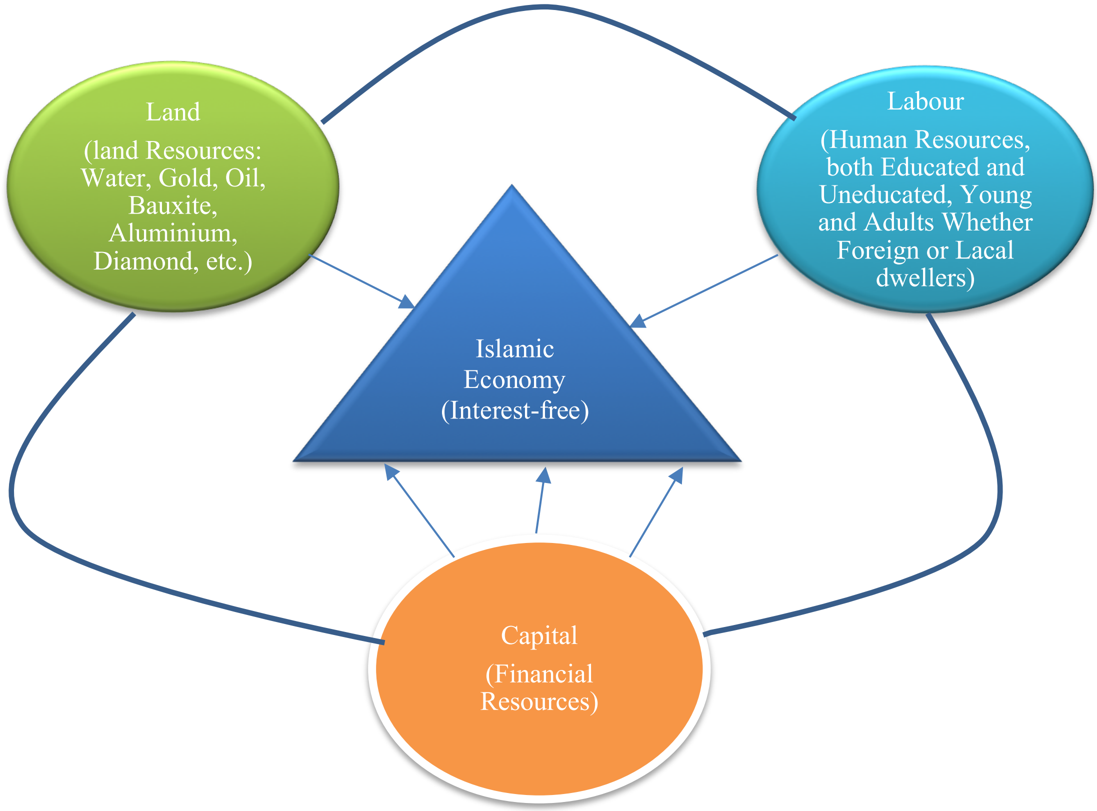

Figure 1: Diagram illustrating the Relationship between Land, Labour, and Capital in the ideal Islamic Economy (Source: Authors' Construct)

All the above factors of production provide the wheel for driving an economy. Although a nation's economic strength often depends on the weight of her financial resources, in Brunei, land resources, particularly, oil, is a crucial factor for her economic growth. Oil and gas export constitute 78% of the country's revenue and formed 96.2% of her total export in 2008, compared to 95% in 2015. Therefore, our argument is that the disproportionate availability of any of these basic factors of production mentioned above could invariably result in an imbalanced economy. Thus, lack of natural resources (land) faced by a large number of people (labour) without the corresponding amount of money (the capital) could lead to a trade in the latter and, ultimately, the promotion of interest-based transactions. Consequently, in Brunei where stringent economic management makes the above factors of production appear proportionate, interest-free banking has the opportunity for growth. Brunei has huge oil reserves and ranked 14th in the world oil deposit and 4th in natural gas according to 2008 reports (Al-Harran and Se, 2008; Welfens *et al.*, 2016). These huge oil reserves, judged against the country's small population, offer the citizens a lot of advantage in terms of standard of living.

Furthermore, tying her cloth to that of one of the 'Asian Tigers', Singapore, with which she uses equivalent currencies (Singaporean Dollar = Brunei Dollar), Brunei has a strong currency to back her young Islamic economy to compete favourably with the interest-motivated conventional financial system (Polak and Roslan, 2009). With this sound economic base (supported by her strong currency), the Bruneian government finances its budgets from the nation's huge oil and gas exports. Thus, her public debt constituted only 2.6% of the country's GDP as at 2014; although these numbers have observed sluggish rises since 2006 (see Figure 2), yet, the current rate is far lower than even the public debt of the large and established economies of the USA and the United Kingdom.

Figure 2: Brunei's public Debt increases (%) since 2006 (source: Prime Minister's Office (Department of Economic Planning and Development, Brunei) Retrieved from http://www.tradingeconomics.com/brunei/government-debt-to-gdp

The above issue of low public debt is significant because the control of the degree of interest-mediated foreign and home borrowings by a government is instrumental for transforming the economy of a country and placing it on a just economic system known in Islam as interest-free economy. According to the Department of Economic Planning and Development, Brunei's public debt began from 0.49% in 1985, a year after independence, till 2014 when it reached the relatively high of 2.6%. In 1986, Brunei recorded 0% public debt. Interestingly, to protect the over-exploitation and degradation of her natural resources, particularly, her forests, Brunei virtually imports everything she consumes with little investment in agriculture on her local lands. Nonetheless, as an oil-rich country, although her current balance of trade surplus falls below her average balance of trade of BN$ 1,115.70 million recorded in 2005, Brunei has been able to maintain a balance of trade surplus of BN$ 286.70 million as of August 2015.

Figure 3: Brunei's Balance of Trade Surplus Downturn since October 2014 (Source: Department of Economic Planning and Development, Brunei).

According to Pecotich and Shultz, Brunei recorded a balance of trade surplus of BN$ 4,826 billion when her export value was estimated at BN$ 6,734 billion with imports value of BN$ 1,908 billion (Pecotich and Shultz, 2006). This gives her favourable balance of trade as she exports more than what she imports. Even in 2009, a year of fallen world oil prices, Brunei's surplus was equivalent to 40% of her GDP. She has recorded fiscal surplus consistently since 2003 through even the global economic slump in 2009. The 2015 IMF estimates in consultation with the Bruneian government, however, reports a downturn of 2% of the country's GDP with 0% inflation. Her budget surplus formed 9.3% of her GDP in 2014 from

10.13% in 1990. Consistent with the chart below, Brunei has recorded very favourable budget surpluses and upshots (refer Figure 4).

Figure 4: Brunei Government's Budget Surplus since 2006
(Source: Department of Economic Planning and Development, Brunei)

With a stable political machinery and environment, the implication of the above budget and economic indicators is that there is likely to be very little pressure on the economy and this grants it the opportunity to resist external shocks. Thus, personal income-tax, which puts undue pressure on the middle class, is simply non-existent in Brunei. Furthermore, balance of trade surplus reflects a favourable balance of payment and these, together with the tax-free income policy, imply a high per-capita or disposable income. Brunei, therefore, has one of the highest per-capita income in the ASEAN community which stood around US$ 40,000 according to the 2012 of the Deutsche Bank. Thus, the government's firm grip on the national economy grants it the opportunity to properly regulate the injection of the financial component of the factors of production in its right proportion so that it does not trigger unethical trade in money characterized by interest-based transactions. This calm atmosphere, therefore, accords the Islamic financial system the opportunity to grow because it provides the institutional inducements and motivations to keep it running. This, however, does not mean that the interest-based banking is completely obliterated from Brunei. The Internationally controlled banks like the Standard Chartered Bank and HSBC are present to not only serve the around 30% non-Muslim population but even cross-over to the investment of the Muslim population. Nonetheless, even at the conventional level, interest rates have remained relatively stable at 5.5% since 1999. Unlike the modus operandi in many countries, the official financial regulators of Brunei, *Autoriti Monetari Brunei Darussalam* (AMBD), does not set any benchmark for determining interest rates in the various financial institutions. For this reason, the banks usually depend on the Prime Lending Rate (PLR) as their yardstick.

2.2.3 Islamic Foresight, Mentality, and Patriotism to the Economic Course of the Nation

Bruneians, and for that matter the Malays, are not only religious, ethically-minded, and dedicated to the course of Islam but are also very patriotic to their national course. Thus, although the political-will and the royal dedication to the course of interest-free financial business have been very instrumental, the cooperation of the Bruneian populace is also noteworthy. This is because the political instrument alone without the cooperation of the local aristocrats and business magnates would not have kept the system on equilibrium. The above issue of ethical consideration is of critical importance in understanding the success of the interest-free finance from the Bruneian standpoint because, as a society of classed and highly esteemed economic and socio-political nobles, interest-based lending and borrowing could have been fundamental to economic survival in their conventional senses. With a firm grip on the country's economic resources, they could have sabotaged the system through a sell-out to unethical foreign investment and control that would truncate the progress of the interest-free discourse. The latter is crucial because, in many Muslim countries, interest-free banking exists and, is indeed, sanctioned by the governments, yet, the business and wealthy aristocrats are still engulfed in interest-based dealings under the pretext of economic necessity (*Ḍarūrah*). For example, in Pakistan, it appears the government has permanently stifled interest-free banking with the view that:

… bank interest is not *ribā* and it is utterly impossible in the present day circumstances to divorce the economy of Pakistan from the international economy by abolishing interest (Khan and Bhatti, p.147).

Yet, the prevailing financial sector in Brunei is manned by dedicated business moguls, from the top echelons to the lower ebb, who are both committed and have the requisite knowledge that facilitates accurate personal and institutional record-keeping, openness, accountability, careful regulation and supervision. Beyond these, the monitoring framework demands the formation of an ethical assessment window, known as *Sharī'ah* Supervisory Board (SSB), for providing the operational direction and guidance for Islamizing their operations. These features not only confirm and deepen the Islamic economic moral belief in the system but they also enable these financial institutions to gain the trust of their customers while attracting their conventional counterparts into the business. Therefore, from the Ministry of Finance, *Autoriti Monetari Brunei*, to the general populace (the customers), everybody is committed to the sustenance of the system. Professionalism and relevant knowledge-based business is very important in Islamic finance; and lack of professional exposure has been perceived as one of the factors inhibiting Islamic finance in Pakistan.

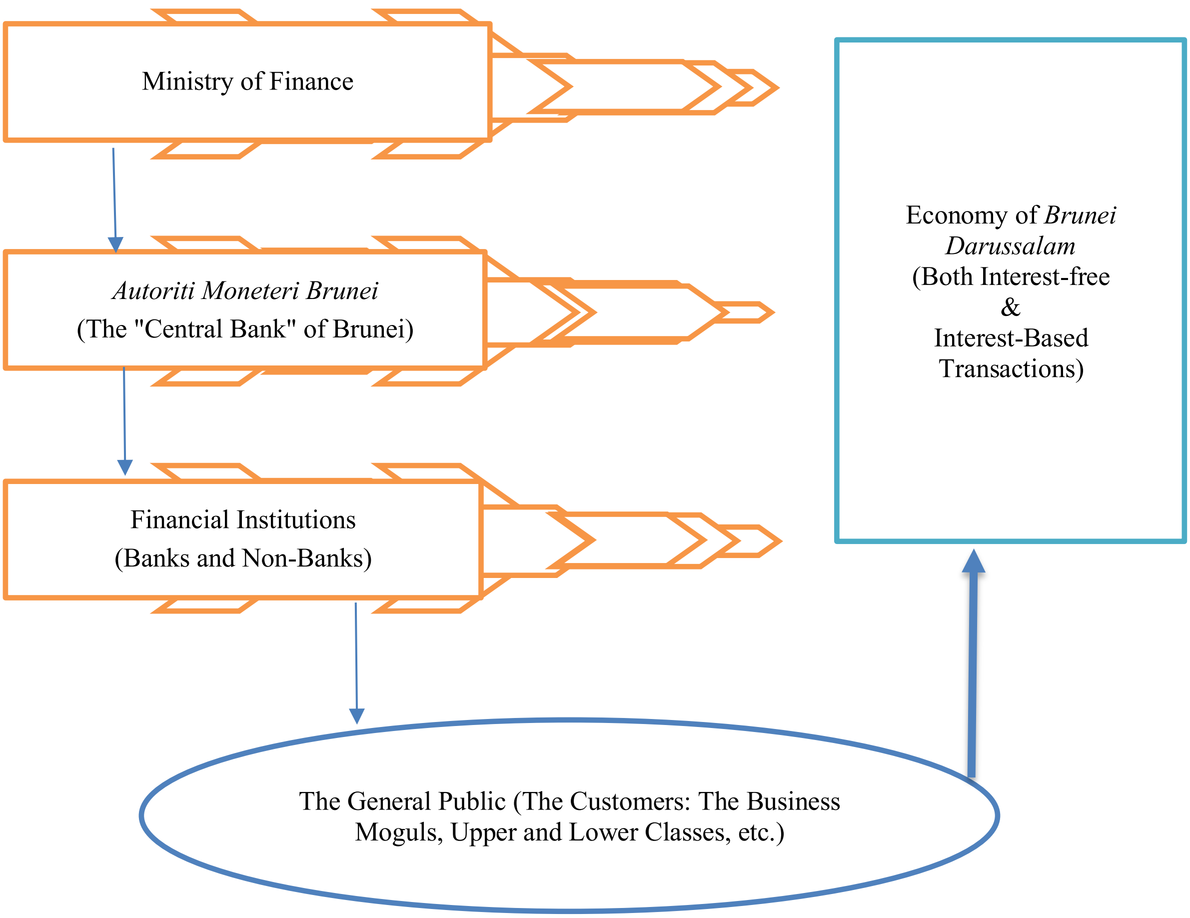

Figure 5: The Hierarchy of the Islamic Financial Authority in Brunei (source: Authors' Construct)

2.2.4 Favourable Taxation and Comprehensive Social Welfare

Taxation is one of the causes of high cost of living. Taxes place constraints that increase the cost of production which reduces profit margins even within *ḥalāl* limits. In the end, it is the customers who suffer because the producers naturally shift their cost onto the consumers through the production cable through the wholesaler and the retailer. This ultimately increases the per-head cost of living (Gillingham and Greenlees, 1987). At the banking or institutional level, taxes lower the cash flow for producers and reduce the individual's disposable income (Caragata, 1998). Therefore, higher level of taxes potentially impacts on the cost of money, incentive structures of individuals and producers. When the cost of investing money in the production of physical goods and services is high, it forces the capital owners into the ethically challenging option of trading in the physical money without the mediation of goods and services subsumed under the name 'interest-based' financial transactions. Thus, in countries where the cost of doing business is exacerbated by exorbitant taxes and huge governmental levies, money owners exploit illegitimate banking facilities like interest-mediated fixed deposits, treasury bills or bonds since these simply incur no production cost to justify a loss or reduction of profit (Wilson, 2003). In some developing countries, like Ghana, tax officials and task forces from Metropolitan, Municipal, and District Assemblies, harass business people, particularly, petty-traders in a bid to meet their tax targets. Instances of these in Accra, the capital, in the case of the Accra Metropolitan Assembly (AMA) often lead to clashes between traders and the task force. Khan and Bhatti (2006, p.156) give a similar scenario in Pakistan where taxation appears "unrealistic and oppressive after the exclusion of the social superiors from the tax bracket."

The phenomenon of unfair and high tax demands provides the breeding ground for multiple accounts by business people as a way to evade tax; and this gradually develops into other forms of transactions that are inconsistent with the essential principles of Islam. Workers in Brunei pay no personal income tax and corporate tax has remained relatively fixed. In addition, the government also gives numerous tax incentives to facilitate private sector investment. These incentives include 30% corporate tax rebate; tax exemption on the importation of plant, machinery equipment, and many others. These tax incentives are further shored-up with a wide range of social welfare system that guarantees the provision of free or cheap and available housing, education, and good medical care for all citizens (Islam, 2011). These facilities make Bruneians comfortable by all standards. Thus, as religious people, the unethical means of livelihood is typically out of the picture.

3. Prospects of Islamic Banking and Finance in Brunei

It is not worthy to evaluate the Islamic banking and financial experience in Brunei against that of the established conventional system. Even so, it must be emphasized that the Islamic system has grown at a fast pace in tune with the Sultanate's strategic plan to make it a hub for ethical investment. After being attracted to the economy, the international banks which included HSBC and the defunct Citibank, even if they are not totally *Sharīʻah*-compliant, tried to create windows that adjusted some of their operations to satisfy the demand for Islamic banking packages (Wilson, 1994; Ebrahim and Joo, 2001). This phenomenon makes the Islamic financial transaction not only a dominant option in the country but a recognized competing partner for the financial business in Brunei. According to the Oxford Business Group, Brunei's two Islamic financial institutions (*Perbadanan Tabung Amanah Islam Brunei* (TAIB) and Bank Islam Brunei Darussalam (BIBD)) had a total asset valued at $7.9 billion which represented 41% of the country's total banking asset in 2013. The above was an increase from the 2010 estimate of 37%. The 2013 financial review by the business magnates also indicates that the Islamic banks in Brunei have increased in non-performing loan ratio of 9.7% as compared to the 4.1% of the interest-motivated banks (Oxford Business Group, The Report, with IMF estimates). Nonetheless, the Islamic banks continue to gain just like their interest-based counterparts due to the former's high patronage, investments, and earnings. The Islamic banking proceeds on liabilities averaged 9.2% during the first nine months of 2013 as against the 10.9% of their interest-based counterparts within the same period.

The socio-cultural foundation of Brunei does not promote exploitative economic transactions in whatever form they might take. Furthermore, through the policy of vesting almost all productive resources of the country in the hands of the central authority of the *Sulṭān* and the continuous provision of an allinclusive social welfare, the Bruneian government has reduced the control over the country's wealth by the few, which is considered as the main obstacle to sustainable economic development in the context of social welfare (Khan and Bhatti, 2006). In terms of foreign exchange and the challenge unleashed by the slash in the 'petro-dollar' due to the fall in the price of oil, the backbone of the economy, the government has sharply responded with a pragmatic approach in order to counter its impact on foreign exchange, maintain balance of payment (BoP) surplus, reduce public debt to a reasonable level and to prevent its severe impact on the economy. This has been done through a provisional slash in government spending which will in turn guard against both its domestic and external borrowings all of which have implications for interest rates. The implication is that the Bruneian Islamic economy and its interest-free banking and finance have a good opportunity for future growth and ultimately, all things being equal, the interest-free banking has a good future.

4. Challenges of Islamic Banking and Finance in Brunei

Despite the success chalked, the young Bruneian 'Islamic' financial economy still faces some challenges.

4.1 Competition from the Interest-based Counterparts

As an Islamic country with the political-will to promote interest-free banking, the regulation of domestic interest rates for the conventional banks should be a priority. In the conventional system, this is done by setting a benchmark, a focal point around which all interest rates of the various banks shall revolve. This is the duty of a central bank which regulates interest rates by determining policy rates through the adjustment of the amount of business deposits (Høien, 2011). This regulates the flow of money in-and-out of the nation's biggest financial store (the central bank). The assumption is that the higher the demand (for money), the higher its price (the interest rate). Thus, the central bank reduces the price of money (interest rate) through the purchase of securities such as treasury bills and expansion of its deposits. On the other hand, it increases interest rates through the sale of securities and a cut in credit stock. In Brunei, however, there is no 'central bank' in its conventional connotation. Therefore, as we indicated earlier, as an Islamic state opposed to interest-based financing, Brunei, through the quasi-central monetary institution, the *Autoriti Monetari Brunei*, does not set any benchmark for regulating interest rates. This is because it does not have it on its agenda to promote interest-based transactions by setting a benchmark. Nonetheless, it does not also prohibit any bank from charging interest. This makes interest-based banking a phenomenon of indifference (*Ibāḥah*) in Brunei. The citizens are given the freedom of choice between either patronizing interest or not. Thus, the various banks use the prime rate as the guide to determine their interest rates. Prime rate refers to the lowest rate of interest at which a financial institution could lend money to its customers. It is the rate of interest imposed by banks on "loans to their most trustworthy corporate customers" (Gendreau, 1983, p.13). Other borrowers normally pay a rate marked above (not below) the prime rate. It is, therefore, fixed by the banks themselves. There is, therefore, a sort of competition between the interest-free institutions and their interest-based counterparts in the country.

4.2 Uncertain Business Practices

Despite the effort of the authorities to rid the economy of unethical business practices through the implementation of interest-free banking, even the Islamic financial scene still manifests visible features of non-*Sharīʻah*-compliant activities. The ill-perceived means of transacting business such as *gharār* (something of unknown consequence, uncertainty or of speculative risk), *maysir* or *qimār* (gambling [Qur'ān 5:90]), essentially, are all detested in Islamic finance which is based on profit-and-loss sharing. Secondly, customers are expected to receive only what they have toiled for (Yusuf, 2010). Anything short of this is fraud (*ṭafīf* in the language of the Qur'an [83:1-3]). Nonetheless, it is not uncommon for Islamic financial institutions in Brunei to give away expensive cars like Jaguar as rewards (*Barakah*) for lucky 'winners.' This ill-perceived means of promoting business remains a challenge to not just the interest-free bid but the ethical banking and finance in the country because it is inconceivable that, at one end, we suppress unethical business while we also try to promote its variants at another end.

4.3 The Continual Slash in the Petro-dollar

Another major challenge to Islamic banking in Brunei is the petro-dollar, the backbone of the Bruneian economy. So long as the oil remains in its current abundance, Brunei has enough to shore-up the shortfalls in its infant 'Islamic' economy. However, the same 'petro-dollar' not only renders the economy more vulnerable to the unpredictable international prices of the 'precious liquid' but the liquid itself keeps reducing in quantity. According to The Brunei Times, Brunei's oil and gas exports will shrink by 3.5 million metric tons by 2035. Liquefied natural gas is expected to go on reducing because its main fields have peaked. The net export of oil would drop from 7.7 metric tons in 2010 to 4.5 metric tons in 2035 while the net export of liquefied natural gas would fall from 7.6 metric tons in 2010 to 4.5 in 2035. The production of oil and gas in Brunei began to reduce since 2008. The implication is that the hold of the petro-dollar on the economy is expected to weaken. Already, the country's GDP was down by 1.5% in 2015, according to the ADB due, perhaps, to the fall in oil prices, coupled with the maintenance of the oil facilities. For the same reason, it was reported that the country was expecting a budget deficit of B$2.28 billion for the 2015/2016 fiscal year. This gradual development has necessitated the urgent call for the diversification of the economy. Diversifying an economy has been an effective tool for increasing and sustaining long term economic growth in a country. According to Hvidt (2013, p.1), "current development plans point unanimously to diversification as the means to secure the stability and the sustainability of income levels in the future." Mature economies that can support a variety of well integrated sectors have the potential of maintaining a more sustainable growth. However, initiating productivity in yet-to-be-developed areas is another hurdle that demands the collective effort of, not just the government, but the private sector and the international community, which are all beyond the boundaries of a country's economic autonomy. Apart from the structural barriers to the diversification of the Bruneian economy, the above features of economic diversification from the global perspective also pose a predictable, and indeed, the main challenge to the future prospects of interest-free banking. This is because it will expose the country to the exploitative and interest-oriented international community and the private sector. With the entrenchment of foreign and private sector investments and domination of the economy, the Islamization policy might eventually lose its hold on the economy and thus gradually pave the way for the interest-oriented economy. The implication is that privatization or diversification comes with it the gradual shifting of the control of the country's wealth to the private sector because the government "gradually withdraws from parts of the economy that are best operated by the private sector" (Crosby,2007, p.4). After ceding its control of wealth to the private sector, the government will invariably lose its exclusive power to control or direct the course of economic transactions and potentially limit its ability to fulfill its financial obligations within the current limits, etc. This will in turn make the government more vulnerable to the dictates of the private sector and even foreign governments and interest-based financial institutions which it might have to rely on financially to maintain the economy. All the above issues have implications for the interest-free finance as the government cannot afford the risk of losing: (1) its share of foreign trade; and, (2) foreign investments and the inflow of foreign financial resources through the frustration of still holding on to interest-free banking or financing.

5. Conclusion

From the discussion, it is self-evident that the Islamization of the Bruneian economic arena signaled the emergence of a new economic order in the country. The new economy was bound to succeed not necessarily on its own merit but due to the political will and cooperation. Political will is important for the fruitful implementation of interest-free finance. Next is an efficient Islamization process that facilitates the establishment of socio-cultural and economic foundations that vigorously promote the essential values of Islam in their entirety. The interest-free banking advocates in Brunei (the political leaders) never overlooked these essential prerequisites. Beyond that, the cooperation of the citizenry from the wealthy upper-class to the indigent lower-class, which, for all intends and purposes, interest-free banking tries to protect, affords Brunei everything it takes to establish an Islamic order. The young 'religious' economy offered auspicious terrain for the implementation and promotion of interest-free banking and finance. The large volume of the nation's precious export, oil, as against her imports, low public debt subsequent to the low dependence on the international community and the private sector, and consequently, favourable balance of trade (BoT) and balance of payment (BoP), coupled with budget surpluses, have facilitated the growth of interest-free banking in Brunei. The government held the view that ribā and its associates are prohibited for Muslims whether it is in the form of usury or bank interest and irrespective of whether it is transacted within a bank or a non-banking financial institution. Nonetheless, it has been impossible, given the contemporary circumstances of mixed society and particularly the interwoven nature of modern-day trade, to divorce the economy of oil-rich Brunei from the international economy by totally abolishing interest. Thus, interest-free banking operates conterminously with interest-based banking in the economy. This mixture, however, occurs at the informal level; the official national economic philosophy is channeled towards interest-free finance. Therefore, the interest-free banking and finance still maintains the opportunity for future growth. Nonetheless, the need for the diversification of the economy is expected to have imminent implications for this interest-free philosophy in the country in the course of time. This is because diversification, which implies unveiling the economy internationally, also, more importantly, demands the empowerment of the private sector. This comes with it the likely consequence of endorsing interest-based financial practices. Thus, our main conclusion is that the Islamic banking and finance has been very successful and, indeed, holds good prospects for the future in Brunei, yet, it still remains vulnerable to non-political future challenges subject mainly to the prospects of the petro-dollar. This then calls for a certain alertness so that the appropriate policies could be devised to mitigate any unexpected consequences for the national Islamic philosophy.

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