Islamic Banking for the Development of the Indian Economy

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Abstract
Islamic banking is considered aloof from its conventional banking. In India Islamic banking institutions will play a significant role in the market due to its large Muslim population lest they are made aware of it. Islamic banking is growing at a faster rate in other parts of the world.
This paper will first understand the meaning of Islamic bank, basic principles of Islamic banking, what is the position of Islamic banking in other parts of the world and how it will improve the economic condition of India with some suggestions.

Keywords: Islamic banking. Conventional banking, principles, world.

1. Introduction
Islamic banking refers to a method of banking that is based on Islamic Law which prohibits interest based banking and permits only profit sharing based banking. The concept is based on a verse of the Holy Quran that says “Allah has allowed only legitimate trade and prohibits interest”. It is against the interest, as interest is believed to lead to exploitation and unproductive income.

2. Basic Principles of Islamic Banking
- Sharing of profit and loss: the borrower and the lender share the profits as well as losses arising from the venture with the finances obtained from the lender. The basic view is that the general community should benefit from such activities.
• **Prohibition of investing in unlawful business**: unlawful business involved in selling alcohol or pork; or business that produce media for instance, gossip columns or pornography, or gambling industry are prohibited in Islamic law.

• **Prohibition of Riba or interest**: Islamic law prohibits receiving and giving interest, because interest deprives someone from the blessings of ‘Allah’ as it leads totaking away of property actually belonging to someone.

3. **Islamic banking concept**

• **Mudarabah or profit sharing**: Islamic banking offer savings and time deposits in the form of investment accounts under the system of mudarabah. Here the depositors share profits and losses of the institutions under the previously done agreement. The profits share should be equal to the funds contributed to the mudarabah account and these cannot be in lump sums or in guaranteed accounts. The loss to the deposito cannot be more than the amount of deposit.

• **Non-interest bearing demand deposits (checking accounts)**: Islamic banks should not be charging any fees on checking accounts as they are free to employ the depositors’ money, subject to the reserve requirements, if there are an into earning assets.

• **Joint Venture (musharakah)**: This is a form of equity financing through joint ventures. Here the bank not only participates in the supply of capital to the venture, but also in its management thus, it plays the role of an entrepreneur as well as that of a financier.

• **Murabah (Cost Plus)**: Here islamic bank does a transactions where the institutions buys a product on a client’s behalf and then resells this with a mark-up to a client, the borrower.

• **Ijarah (leasing)**: Two types of leases are used. The lessee pays the lessor installment payments that go towards ultimate purchase of the equipment by the lesse. This type of lease/purchase agreement is known as ijaraj wa-iqtiina. The second type of lesse maintains the ownership of the lessor as per the lease contract.

4. **Trends in the development of Islamic banks**

Islamic banks are the main provider of Shariah-compliant services and are being entrusted with the majority of Islamic capital / financial assets, which likewise makes financial stability dependent on their success. Islamic banking has been the major driver of industry growth over the past decade, taking the largest share of financial assets. Assets, with Islamic banks and Islamic banking windows have grown at a compound annual growth rate CAGR of 40.3% between 2004 and 2011 to reach USD 1.1 trillion.
A sample of 50 Islamic banks across 11 countries shows that the Islamic banking industry has witnessed significant growth over recent years. The USD value of total assets with these Islamic banks reached USD 411.4 billion as at end 2011, which represents 63.9% of the estimated total banking assets in 2011 if Iran is excluded. Total assets with these Islamic banks have grown at a CAGR of 16.6 between 2007 and 2011.

**Domicile of Islamic Banking Assets (2011 E)**

Following the global financial crisis, Islamic banks in Asia have been able to increase their financing portfolios substantially and develop the retail Islamic banking sector to offer a more diverse range of products and services. Based on the sample of Islamic banks, the financing-to-deposit ratio (FDR) has since climbed steadily to 80% led by Malaysia and Bangladesh, despite sharp declines in Pakistan given slower financing growth. However, in the Middle East and North Africa (MENA), the FDR declined substantially in 2009 onwards as higher non-performing credits forced banks to be stricter in distributing financing. The declines were led by Islamic banks in Saudi Arabia, Kuwait and particularly Egypt in 2010 and 2011.
Global Islamic banking assets
Islamic banking assets with commercial banks globally reached US $1.54t in 2012. This includes both pure-play Islamic banks and windows

QISMUT: Following are the countries which forms QISMUT

QATAR: Qatar’s banking sector has grown at a CAGR of 16% over last five years. Islamic banks had US$54B in assets in 2012, and are expected to sustain a 20% plus growth trajectory over medium term

INDONESIA: Indonesia banking sector is characterized by a growing economy. Islamic banks had US$20B in assets in 2012 expected to grow to US $100B plus by 2013 at a six year CAGR of 33% Many foreign Islamic banks are keen to invest in Indonesia

SAUDI ARABIA: Islamic banking constituted 53% of the system assets in 2012, estimated at US$245B, this includes both pure-play Islamic banks and Islamic assets with conventional banks. Mainstreaming of Islamic banking in Saudi to get a further boost with expected transformation of conventional banks business.

UNITED ARAB EMIRATES: Islamic banking assets estimated at US$83B in 2012 or 17% of the system assets. This includes Islamic assets of some of the larger conventional banks. Greater regulatory clarity and new enabling infrastructure critical for sustainable growth. Dubai’s Islamic economy vision should help. Most UAE Islamic banks are well capitalized and keenly exploring regional expansion going into 2014

TURKEY: Turkey will have 11 million households with income of US %30,000 or more by 2030, the same level as Canada today. Young demographic, ongoing regulatory reforms and government’s willingness to promote financial inclusion through participation banking provides for a strong playing ground for Shariah compliant financial institutions.

- Participation banks had US$39B in assets in 2012, expected to grow to US$12b by 2013 at 6-year CAGR of 21%, SME and retail banking are the primary engines of growth
- An estimated US$1.6T in assets and with a 48% share of banking system profit pool across QISMUT

Across QISMUT, Islamic banking assets are set to cross US$662B in 2013. Expect a CAGR of 19.7% through 2013-18, with total assets reaching US$1.6t across these six important markets.

Globally, Islamic banking assets are expected to grow to US$3.4t by 2018. Main dependencies for this growth are economic stability in certain Islamic finance markets, capacity and capability building at larger Islamic banks to transition to the next phase of development, and connectivity across high-growth markets and sectors.

5. Islamic Banking in India
The population of Musiim is about 154 million that is more than 13.2% of total population. However, 80% are financially excluded owing to unavailability of interest
free banking. According to Sachar committee Indian Muslims have a share of 7.4% in saving deposits while they get only 4.7% in credit. According to RBI annual report for 2007-08, Indian Muslims annually lose around Rs. 63,700 crores i.e. 27% of their deposits. Thus large number of Muslim population needs Islamic banking services in India. Islamic banking seems an alien concept in India’s conventional banking world. Despite its impressive growth in other parts of the world such as the Middle East, South East Asia and Europe, it is yet to find favour with the Indian authorities. Many developed countries of the world, such as Germany, UK, USA, France and Singapore have embraced Islamic banking to take the tally of countries where this form of banking is already operational as an alternative system. Major multinational banks including HSBC, Amanah, standard chartered saadiq, Lloyds, TSB Bank and Citigroup offer products in accordance with Islamic Banking principles. Recently, the RBI Governor D Subbarao recommended introducing Islamic Banking in India and wrote to the government about the amending the law to facilitate the same. In 2008, a high level committee on Financial Sector Reform of the Planning Commission of India (2008) headed by Dr. Raghuram Rajan had recommended the introduction of interest-free finance and banking as part of mainstream banking in the interest of inclusive, innovative growth. Today, Islamic banking has a presence in India in the form of NBFCs and Baitul Mal (Islamic Treasury), but the business is small. These institutions mostly work at the regional level, catering to a niche segment. Many Indian institutions, including some government-owned ones, have own interest in this growing niche opportunity. For example, Kerala government–owned KSIDC has started AL-Barakah FINANCIAL Services Ltd, GIC of India runs an Islamic re-assurance scheme. And several mutual fund schemes invest explicitly in compliance with Islamic rules. TASI, an index on the Bombay Stock Exchange representing only Sharia-compliant stocks, is the first of its kind in India Islamic Banking can play a vital role towards India’s economic growth and would be a mechanism to overcome the problem of inflation and liquidity. Though India ranks fourth in the global economy because of its high growth rate but its per capita income is $1,527 in 2011. According to an Economic survey of 2012-13 Muslim avail just 4% and 0.48% credits from NABARD and SIDBI respectively. Islamic banking would encourage entrepreneurship in India through its services of financing.

**SCOPE OF ISLAMIC BANKING IN INDIA:** It has the ability to contribute in the economic growth of India, entrepreneurship in India would be encouraged, it will bring FDI in India, capable of providing capital to small poor entrepreneurs in India, capable of improving the weaker section in the society, will reduce employment, loans will be provided to rural and agricultural sector, corporate and individual zakat will lessen the gap of inequality and bring social welfare.

**Major hurdles in Islamic banking:** Cheques could not be issued, financial products are interest based, capital inadequacy cannot be maintained, procedure of tax are there.

**Benefits of Islamic banking:** Growth of FDI, availability of funds for business, inclusive economic growth, no exploitation.
6. Suggestions
In today's world Islamic banking is gaining more importance in different parts of the world. If Islamic banking is opened in India it would benefit the Indians as those money which are still lying in the banks if invested in the Islamic bank would improve the economic conditions of the Muslims. As interest free banking would help to improve the education, would help in more employment, more of the courses should be taught related to Islamic banking so that people are aware of this kind of banking and would help in the development of the economy.

7. Conclusion
It should be well kept in mind that Islamic bank is not related to Muslims only it is related to all. It is not related to any particular religion but this can help us to operate and expand their network in the country along with traditional banks as the main focus of it is on social well being and wealth generation activities in the society.

References
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