"Interest Free Islamic Banking in India for Inclusive Growth and Social Uplift: Scopes and Challenges"

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Introduction

Banking is the need of our time. It should be a continuous effort that maximum people involve themselves in the banking system. In this process, Interest Free Islamic Banking can play an important role, and recently the Kerala High Court has given an important judgment regarding this issue and now we may hope that a large number of people interested in interest free banking in India will involve themselves in the process of Islamic Banking.

Historical Aspect of Islamic Banking

The first Islamic Development Bank founded in Dubai in 1975. In 1977, in Egypt and Sudan two private Banks named the Faisal Islamic Bank were opened. During that period Iran, Sudan, Pakistan, Indonesia and Malaysia also adopted new guidelines of Islamic Banking. At present about 280 interest free banking sectors are running in approximately 50 countries. Denmark, USA, Britain, Luxemburg and Switzerland have also adopted this special kind of banking system. In present times South of London has developed as a centre of Islamic Banks. In Britain the number of Islamic Banks are 22 and the share of Islamic Banks in London Stock Exchange is approximately 10 lakh billion dollars. The business of Islamic Banks have grown by the rate of 37% and in 2007 this business had reached 729 billion dollars and their financial condition is far better than other banks.

Islamic Banking in India

About 140 million Muslims live in India. A considerable number of people from muslim population are generally reluctant in doing business with the present banking system. There are certain other people also who are also not comfortable with the present system. They will be able to do their business according to the Islamic Guidelines of Banking. In this age excluding Arab World, USA, Britain, China, Switzerland and Germany, a large number of Islamic Banks run their businesses. After Indonesia the maximum number of Muslims live in India and they maintain some distance from commercial banks. Banking experts say that the Muslim population will also benefit from the Islamic Banks and they will also be able to improve their economic conditions and this system must be helpful in eradicating poverty among Muslims and will certainly help in their overall uplift.

Concept of Interest Free Islamic Banking

Islamic banking refers to a system of banking or banking activity that is consistent with the principles of Islamic law (Sharia) and its practical application through the development of Islamic economics. Islamic banking has the same purpose as conventional banking except that it operates in accordance with the rules of Shari'ah, known as Fiqh al-Muamalat (Islamic rules on transactions). Sharia prohibits the payment or acceptance of interest fees for the lending and accepting of money respectively, (Riba, usury) for specific terms, as well as investing in businesses that provide goods or services considered contrary to its principles (Haraam, forbidden). While these principles were used as the basis for a flourishing economy in earlier times, it is only in the late 20th century that a number of Islamic banks were formed to apply these principles to private or semi-private commercial institutions within the Muslim community.

Islamic banking activities must be practiced consistent with the Shari'ah and its practical application through the development of Islamic economics[1]. Many of these principles upon which Islamic banking is based are commonly accepted all over the world, for centuries rather than decades. These principles are not new but arguably, their original state has been altered over the centuries. The principal source of the Shari'ah is The Qur'an followed by the recorded sayings and actions of Prophet Muhammad (pbuh) – the Hadith. Where solutions to problems cannot be found in these two sources, rulings are made based on the consensus of a community learned scholars, independent reasoning of an Islamic scholar and custom, so long as such rulings to not deviate from the fundamental teachings in The Qur'an. It is evident that Islamic finance was practiced predominantly in the Muslim world throughout the Middle Ages, fostering trade and business activities.

In Spain and the Mediterranean and Baltic States, Islamic merchants became indispensable middlemen for trading activities. It is claimed that many concepts, techniques, and instruments of Islamic finance were later adopted by European financiers and businessmen. The revival of Islamic banking coincided with the world-wide celebration of the advent of the 15^{th} Century of Islamic calendar (Hijra) in 1976[2]. At the same time financial resources of Muslims particularly those of the oil producing countries, received a boost due to rationalisation of the oil prices, which had hitherto been under the control of foreign oil Corporations. These events led Muslims to strive to model their lives in accordance with the ethics and principles of Islam. While a basic tenant of Islamic banking, the outlawing of riba, a term that encompasses not only the concept of usury, but also that of interest has seldom been recognised as applicable beyond the Islamic world, many of its guiding principles have. The majority of these principles are based on simple morality and common sense, which form the bases of many religions, including Islam.

The universal nature of these principles is immediately apparent even at a cursory glance of non-Muslim literature. Usury was prohibited in both the Old and New Testaments of the Bible, while Shakespeare and many other writers, particularly those writing in the 19^{th} century, have attacked the barbarity of the practice. Much of the morality championed by Victorian writers such as Dickens, ranging from the equitable distribution of wealth through to man's fundamental right to work - is clearly present in modern Islamic society. Riba best translated today as the charging of any interest, meaning money earned on the lending out of money itself. The prohibition on paying or receiving fixed interest is based on the Islamic tenet that money is only a medium of exchange, a way of defining the value of a thing; it has no value in itself, and therefore should not be allowed to give rise to more money, via fixed interest payments, simply by being put in a bank or lent to someone else. The human effort, initiative, and risk involved in a productive venture are more important than the money used to finance it. Money in Islam is not regarded as an asset from which it is ethically permissible to earn a direct return.

Money tends to be viewed purely as a medium of exchange. Interest can lead to injustice and exploitation in society; The Qur'an (2:279) characterises it as unfair, as implied by the word zulm[3] #(oppression, exploitation, opposite of adl i.e. justice) There is no real 'lending' in Islam since all 'lenders' obtain ownership interests in the assets that they finance, or earn a profit-share or purely fee-based remuneration. In order for an Islamic bank to earn a return on money lent, it is necessary to obtain an equity, or ownership, interest in a non-monetary asset. This requires the lender to also participate in the sharing of risk. Individuals and the world as a whole probably know too well the burden of interest and misery and suffering that irresponsible lenders have inflicted on individuals and societies. It has become so completely institutionalised and accepted in modern economies that it is almost impossible to conceive that there are some who completely oppose it and refuse to enter into any transactions that involve interest. Islam's prohibition of interest and usury was not unprecedented. The early Jewish and Christian traditions also forbade riba. Even the renowned Greek philosopher, Aristotle, condemned acquiring of wealth by the practice of charging interest on money.

Status of Islamic Banking

Islamic banking is no longer a novel experiment. When the concept of Islamic banking with its ethical values was propagated, financial circles the world over treated it as a utopian dream. Having lived for centuries under the 'valueless' capitalist economic system, they asked what ethics had to do with finance? Besides their range of equity, trade-financing and lending operations, Islamic banks also offer a full spectrum of fee-paid retail services that do not involve interest payments, including checking accounts, spot foreign exchange transactions, fund transfers, letters of credit, travellers checks, safe-deposit boxes, securities safekeeping investment management and advice, and other normal services of modern banking. Islamic banking because of its value-orientated ethos enables it to draw finances from both Muslims and non-Muslims alike[4]. Islamic banks are evolving financial and investment instruments that are not only profitable but are also ethically motivated.

Islamic (sharia) banking and its prospects in India

In this era where trends flourish around increasing aspirations to identify with social conscious initiatives, it comes as no surprise that Islamic Banking is booming. The concept of interest is fundamental to the business of banking. With this background it is very interesting that sharia banking is working without profits and is still flourishing. They are not only profitable but are also growing at an astonishing rate in sense of capital, assets and consumers. From Jakarta to Jeddah to Jordan, 280 Islamic banks operate in over 50 countries, with assets estimated between \$ 250 million and \$ 300 billion. Management Consultant Mckinsey and Co. says in their world Islamic Competitiveness Report, 2007 that the value of assets managed by Islamic Banks will grow by 33 % by 2010.

In India, The Raghuram Rajan Committee (2007) on Banking Sector Reforms in its report had recommended introducing Islamic banking in India, creating a flutter of excitement in the Muslim investment community. Rajan, who earlier was appointed economic advisor to the Prime Minister, prefers the term 'interest-free banking' instead of 'Islamic banking'. "Interest-free banking offers a set of new contractual possibilities that may bring hitherto excluded citizens into the formal financial system, he told DNA. Interest-free banking does not mean charity, of course. It only means that the investor/lendor does not get interest, but gets compensated through a form of profit-sharing."

Despite the Rajan Committee's endorsement of interest-free banking, India hasn't been proactive in tapping this rich vein of capital, unlike other 'secular' nations. Britain, with a population of less than 2 million Muslims, already has 6 Islamic banks, of which three were set up in 2008. According to estimates, globally, assets worth $300 billion are under the management of Islamic banks at present, and this is set to cross $1 trillion by 2013. "People are starting to see that Islamic banks are not a threat but an opportunity for economic growth," says Ali Ravalia, associate, UK Financial Services Authority (the UK's equivalent of SEBI). In India, with the world's second largest Muslim population of 154 million, the lack of Islamic banking is a barrier to the flow of substantial funds into the market. "There is at least Rs5,000 crore of unclaimed interest in Kerala alone. People prefer to put their money in gold or jewellery, which is the worst kind of investment from an economic point of view," says Shariq Nisar, CEO, Bearys Amanah Investment. "I know of at least 300 Islamic societies which accept deposits and lend money, but can't make a business of it because of the Shariah's prohibition of interest. And they are not able to convert themselves into banks because the government will not permit any form of banking without interest. Some of them have collected more than Rs200 crore in interest-free deposits, but they do not have any avenue to invest that money," he says.

Barriers in path of Islamic Banking

Politics apart, there may also be regulatory barriers to contend with. Islamic finance consultant MH Khatkhatay identifies two fundamental problems: Firstly, a bank in India cannot raise deposits without promising a specified rate of return to depositors, but under Shariah, returns can only be determined post-facto depending on profit; secondly, banks have to maintain a statutory liquidity ratio (SLR), which involves locking up a substantial portion of funds either as cash, gold or in government securities. "Cash will not get you any return; keeping it in gold is risky as it could depreciate; and government securities are interest-bearing, which is unacceptable under Shariah. These two issues make Islamic banks unviable at present," says Khatkhatay[5]. # The other hurdles involve restrictions on equity investment (the primary investment avenue in the Islamic system), and in trading

Concluding Observations

Islamic banking is already fast gaining prominence among the global financial institutions, especially in the backdrop of the banking sector woes impacting the markets like the US and Europe and the concept has a huge potential market in India as well, according to market intelligence and data analysis services provider Grail Research. The study finds that India has the potential of emerging as a significant market for Islamic banking institutions, provided there is a favourable change in regulatory environment and increased awareness among Muslims and India as a whole. As per the census, India has the second largest Muslim population in the world but a large portion of this has not been able to access the banking services because as per Islamic principles, giving or receiving interest is prohibited though money can be lent on profit sharing or fee based model."The size of the market will be very large as the Indian population is above one billion and Muslim population itself is about 15 crore and majority of them, in the name of religious faith, are looking for interest free banking and finance," University of Calicut Professor A I Rahmatullah said.

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