

Open course

IH 5 OP 1 Islamic history

Islamic economics and banking

Presentation.

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A bird's eye vision

Interest free banking system is the current focus topic on the remedial measures for the silent killing of poor investors by the modern banking system. The term “Islamic banking” refers to a system of banking or banking activity that is consistent with Islamic law (Shariah) principles and guided by Islamic economics. In particular, Islamic law prohibits usury, the collection and payment of interest, also commonly called riba in Islamic discourse. In addition, Islamic law prohibits investing in businesses that are considered unlawful, or haraam (such as businesses that sell alcohol or pork, or businesses that produce media such as gossip columns or pornography, which are contrary to Islamic values). In the late 20th century, a number of Islamic banks were created to cater to this particular banking market.

The most distinguishing feature of the Islamic economic system is the prohibition of interest. Usury, Interest and Riba are synonymous terms but they have different technical meanings. Usury refers to the consumption loans given on higher rates and thus causing exploitation of the borrower. Interest refers to the cost of using money in finance and economic theory.

The idea of Islamic banking is certainly very *interesting* and a must in the case of the three holly-book religions. An interest free system could work and provide unlimited prosperity but certainly, absolutely, and undoubtedly it will not work under the current system. Islamic economic principles have prominently been applied in financial industry especially in banking. In Egypt, first Islamic savings bank was established based on the principle of profit-sharing at Mit Ghamr in 1963. The Islamic financial system in Malaysia was first introduced in

1963. It started from a modest beginning with the establishment of the Malaysian Pilgrims Fund Board (Tabung Haji), to the setting up of the country's first Islamic bank, Bank Islam Malaysia Berhad (BIMB), which commenced business on 1 July 1983.

In 1975, the Islamic Development Bank was established to provide financing to projects in the member countries. Dubai Islamic Bank was the first modern Islamic commercial bank founded in 1975. Indonesia's first Islamic bank was Bank Muamalat, which was established in 1991. In Bahrain, first Islamic commercial bank was established in 1978.

In Pakistan, Meezan Bank was the first Islamic commercial bank established in 2002. Since then, Bank Islami, Dubai Islamic Bank, First Dawood Islamic Bank, Bank Al-Barakah and Emirates Global Islamic Bank have started their operations as full fledged Islamic banks. The branch network of 6 full-fledged Islamic banks and 12 conventional banks (with dedicated Islamic banking branches-IBBs) increased to 528 branches by June 2009. It is estimated that Islamic banking will achieve a market share of 12 percent by 2012 in Pakistan. (Source: SBP Strategic Plan for Islamic Banking 2009).

Total assets of Islamic banking in Pakistan reached Rs. 313 billion by June 2009. The financing and investment portfolio of Islamic banks reached Rs. 195.0 billion by June 2009. In terms of market share, total assets, financing & investment and deposits reached 5.1 percent and 4.2 percent and 5.2 percent, respectively, at end June 2009. The deposit base of Islamic banks reached Rs. 238 billion at end-June 2009. (Source: Business Recorder, September 09, 2009). Lately, the Vatican said banks should look at the rules of Islamic finance to restore confidence amongst their clients at a time of global economic crisis. (Source: Osservatore, March 04, 2009).

Islamic Finance industry is a nascent but growing industry. Islamic financial industry beyond banking has achieved financial deepening in Mutual Funds industry, Investment Banking, Public Finance and insurance. On the geographical level too, Islamic banking has grown from Middle East to Europe and now is well positioned in South Asian markets as well.

Islamic Finance is catering to the needs of all investors. Islamic finance apart from being Shariah Compliant also has ample potential to attract investors solely from the business point of view as well. Islamic

Finance is growing in multiple dimensions and is now spreading in finance, mutual funds, syndicated finance, investment banking etc. other financial sectors like insurance, structured finance, project

Islamic Finance is now able to provide one stop solution to its customers. Shariah compliance also ensures Corporate Social Responsibility (CSR) and ethical compliance. Islamic banks do not conduct business with companies producing tobacco, alcohol or engaged in business of gambling, casino, nightclubs, prostitution etc. This mechanism has given Islamic banking the name of 'ethical banking' in Europe.

Islamic Investments are not involved in Risk Arbitrage, Junk Bonds, Muni Bonds, Brady Bonds, Currency Options, Swaption, Swaps, Call/Put Options, Combinations or spreads of Options, Futures trading, Forward contracts, Credit Default Swaps, short selling, speculative insurance underwriting, sub prime loans, debt swaps, rollover loans, CDOs, excessive leveraging etc.

Islamic investments are more akin to equity financing. The balance sheet of Islamic banks is capable of taking financial shocks. Islamic banks are not obliged to give fixed return to their depositors and general creditors. The creditors, shareholders and depositors share and participate in the bank's business. Therefore, if incase, there is a shock on asset side (NPLs increasing), Islamic banks will be able to share this loss with their depositors and shareholders.

Islamic banks can not rollover loans. Therefore, the packaging and repackaging of loans and then issuing more and more debt securities on the back of these non performing loans can not legally happen in Islamic Banks. Islamic banks are obliged to have backing of assets in all their investments. Therefore, Islamic banks' losses even theoretically can not go beyond the value of the real asset. There are also unsolved or not understood issues for example, why does a pre-determined cost of capital prevent full employment, how would the government borrow money, and how could we solve for global financial crisis. It is a possibility that no crisis or hardships would take place in an Islamic system, but the main point, is that it is impossible to see the Islamic system work as a sub-system to the current market economy, and we can not provide Islamic economic solutions under capitalism.

Thus, study about Islamic economics and banking is a very relevant one in the present global scenario. It is an alternative to capitalism and a path to socialism. The course is to make aware about the history of Islamic economics, ancient and Islamic practices on trade and economic activities, glimpses on modern Islamic banking system,etc. The department of Islamic history also offers add on course on Islamic economics which is a job oriented one in gulf regions. Those who are interested to join please contact;

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