



Islamic Banking-The Stance of India on a Global level

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Abstract: *This paper aims to review the different facets of Islamic banking at global level and the stance of India with regard to Islamic banking services on a global level. India, being a third largest Muslim populated country has a strong potential market for the development of Islamic financial services and can become the regional hub for Islamic banking. But this can be achieved only through the development of consciousness in people of India that Islamic banking is not only useful for the Muslim communities but as a whole to the welfare of the society. This can be fully attained by reconsidering the launch of Islamic banking services in India by adopting the models followed in the banking industry of non-Islamic countries like Thailand, United Kingdom, and United States of America etc.*

Key words: *Islamic banks, Islamic finance, Prohibition of interest, Present status of India towards Islamic banking services.*

Introduction

Islam, being the second popular and prominent religion which is having nearly 2 billion followers across the world occupies around 25% of the world total population. On the basis of population, the second largest country in the world is India. By May 2018, the population of India is estimated around 1.35 billion. In India, the percentage of Muslim population is roughly 14.2%. Islamic banking is a viable option for all religions, but in particular for Muslims, interest is prohibited resulting in Islam creating its own economic system based on social fairness. The principles put forth by the Sharia law form the basis for the operating framework of the Islamic banking system.

The Sharia law prohibits the payment and/or acceptance of interest (*riba*/usury) for the welfare of the society. It is based on the belief that interest can result in a divide between the rich and poor and inflation which can give rise to financial and economic instability. With a significant percentage of its total population consisting of Muslims, banking in India is wholly based on interest. India is home to 27 public sector banks, 31 private sector banks, and 88 scheduled commercial banks (SCBs).

Islamic banking has evolved into a worldwide phenomenon to a stage where it has been adopted by countries from the western world as well. Though it is based on Sharia law and strictly adheres to Islamic principles, the concept of not charging interest is something that proves to be beneficial to everyone



irrespective of their religion. This paper aims to review the presence of Islamic banking in the international environment and the stance of India with regard to Islamic banking services on a global level.

Objectives of this research paper:

The paper is intended to study the position of Islamic banking and finance at Global level and also in particular the stance of India with regard to Islamic banking in the international scenario.

The following objectives are framed for this paper.

- 1) To explore the status of Islamic banking and finance at international level
- 2) To find out the stance of India in relation to Islamic banking and finance at global level.

Islamic banking at Global level:

According to different authors like Ahmed (1994), Naqi (1981), Zarqa 1983), Islamic banking as an ethical system focuses not only for the well-being of an individual but also for the welfare of the society as a whole. The banks which are based on the principles of Sharia were not there few decades ago. In 1963, the first financial institution 'Mit Ghamr Co-operative society' which was based on the principles of Islamic finance was started in Egypt as an experimental project by linking the ideas of rural banks and German savings bank principles within the framework of Islamic principles and sharia. In this project, this bank offered savings accounts, zakah accounts and investment accounts on the condition that there is no payment of interest for the depositors but they are allowed to withdraw their money on demand. The people in this area are allowed to borrow from this institution for any productive

and fruitful purposes without making any interest payment. This project was a huge success from 1963 to 1966 and also attracted the people to make deposits which will be used in investment projects on a profit sharing basis. The same was incorporated as 'Nasser Social Bank' in 1971.

According to Warde, 2000, there is a substantial development in Islamic banking industry by establishing huge number of banks across the nations which started with very few banks in 1970s. The annual growth rate of Islamic banks was recorded in between to 10-15% since 1990s and no more Islamic financial services are limited to a small niche market. It has become a worldwide inclination and many conventional banks were also attracted and helped for the development of Islamic banks by offering a special window to provide the banking services on the basis of Sharia principles. (Schoon, 2008).

Apart from the countries of Middle East, the Asia Pacific countries are also having banks which are non-conventional and following the Sharia law.

The 'Phillipine Amanah Bank' is an example of such bank which is established by a decree from the president of the Philippines in order to provide banking services in accordance with Sharia principles to the Muslim communities in Philippines.

Singapore, one of world leading economies has given priority for the development of Islamic finance by modifying some of its tax policies in order to align them with the principles of Islamic banking system. To attract the funds of Islamic investments, even the 2nd largest economy of the world, China has also adopted the Islamic banking.



The entry of Islamic banking in Malaysia happened in 1963 in the form of a non-banking financial institution to provide support to the people who are travelling to Mecca and Medina. 'Bank Islam Malaysia Berhad' is a first bank in Malaysia which started their banking operations completely adhering to Islamic principles. Now with the presence of five international Islamic banks and sixteen Islamic banks, the southeast nation, Malaysia has been playing a pioneering role in the Islamic banking Industry at global level. A fair share of customers of Islamic banks in Malaysia is non-Muslims. Therefore, it can be inferred that Islamic banking system is not an 'only Muslim' affair but addresses the financial needs of other communities as well without the concept of interest.

Due to the valued principles of Islamic Banking which are helpful to the society, even many non-Muslim countries also started establishing banks under Islamic finance principles.

From the western world, Luxembourg would stand first by taking the initiative to set up 'Islamic Finance House', the first financial institution under Islamic principles in 1978. In 1982, Denmark also started "Islamic Bank International of Denmark", an Islamic bank to provide the financial services under the Islamic principles.

Australia also established many banks which follow Islamic principles. In 1989 itself, to cater the financial needs of Muslims in Australia, MCCA was started as co-operative by providing finances and investments under Islamic values.

To encounter the increasing demand for the investment instruments based on Islamic law, the Citigroup and Dow Jones created a bond index based on Islamic law

for the first time in the world. These types of bonds are regarded as hot cakes due to their nature of investment like an asset that could be rented or sold easily.

Even the other developed countries like Germany, United Kingdom and United States of America have also taken initiatives and established Islamic banks by considering the countries like Bahrain, United Arab Emirates etc where the Islamic banks have showed a success path as an alternative to conventional banking system.

Among the GCC countries, Kingdom of Bahrain is one of the pioneers in providing the financial services through Islamic banks. In 1990, a non-profit international autonomous corporate entity was established in Bahrain to formulate and monitor the standards of Accounting and Auditing practices under the Sharia law for the needs of the Islamic financial industry. (AAOIFI- The Accounting and Auditing Organization for Islamic Financial Institution)

When compared to other GCC nations, Bahrain and United Arab Emirates are leading in Islamic finance by having more number of banks which are operating under Islamic Sharia law. There are more than 500 financial institutions around the world which are operating on the basis of sharia law. The expansion of Islamic financial institutions is increasing tremendously across the globe as projected by the Asian Development bank. According to Khan et.al., 2012, the huge population of Muslims over two billions in the global market is the reason to get attention for the players towards Islamic banking system.

Developments in India during the recent past with regard to Islamic banking:



In order to improve the productivity and efficiency of banks as a whole, a huge number of major changes have taken place in the field of Indian banking sector over the last 10 to 15 years.

Committee headed by Anand Sinha:

A committee was established in June 2005 by Reserve Bank of India (RBI) headed by Mr. Anand Sinha with an aim to make the banking services to more number of people in India. The committee also studied the financial products of Islamic banking system under the guidance of the committee head, Anand Sinha, who is also the deputy director of RBI.

The committee proposed to make changes in the banking regulation act 1949, in order to accommodate the Islamic banking into Indian economy with a separate rules and regulations. They also highlighted that the existing taxation system is also needed some kind of modification for facilitating IB in India. Based on the report from this committee, RBI opined that it is not practical to introduce the Islamic banking system in India or to permit the Indian banks abroad to operate under Sharia law without carrying out the necessary amendments in the current banking regulations act.

Committee headed by Raghuram Rajan:

With an aim to make advancement in the reforms of the Indian financial sector, the PCI (Planning Commission of India) in June 2008, had appointed a committee led by Mr. Raghuram Rajan, who was the ex-chief economist at International Monetary fund (IMF). The two key recommendations made by this committee have made a path and boosted

to the demand for Islamic banking services in India.

As per the first recommendation of this committee, it is needed to launch appropriate measures which will allow starting the concept of 'interest free finance' at large scale through the prevailing banking system with a motive of growth and development of the society by inclusion and innovation. They also confirmed that the same concept is already in progress which is offered by a few Non-banking financial companies and co-operatives but in a limited manner.

Secondly, the committee strongly felt that a well-defined framework which has the financial products based on interest free concept is needed in order to implement Islamic banking in India. So needed measures are to be initiated to develop such a framework without this the implementation of IB would be a day dream for ever.

Committee established by parliament:

There was one more committee apart from the above, which is established by our prime minister named Parliamentary committee guided by Mr. Rahman Khan former deputy chairman in Rajya Sabha. This establishment of this committee has led to strengthen the need and demand for starting Islamic finance and banking activities in India.

This committee made a suggestion to form a fund which will be based on Sharia principles for supporting the Haj pilgrimages. Due to the non-availability of investment opportunities in compliance with the principles under Shariah law discouraged the majority of Muslim population in India from making



investments not only in the stock markets but also through banks.

Though at the beginning SEBI had some hesitation to issue permission when the application has been filed by 'The Taurus Mutual Funds' for the introduction of fully compliant mutual fund scheme as per Sharia in 2007, but the approval was given and the fund was launched in 2009 as 'Taurus Ethical Fund'. (Islamic Finance News, 2009)

A special initiative by the government of Kerala:

An agreement was made by KSIDC (Kerala State Industrial Development Corporation) and Al Barakah group in 2010, to provide financial services to the Muslim communities in India with compliance as per Sharia law. As per the agreement, KSIDC holds 11% stake in the newly established financial institution. But the same was challenged by Mr. Subramanian Swamy, in the high court of Kerala by stating that government agencies involvement in establishing such Islamic investment company is against the secular principles of maintained in the constitution of India. But Kerala High court in 2011, has allowed the establishment of an Islamic investment company by dismissing the case which is filed by Subramanian Swamy.

When RBI rejected the proposal of starting Islamic banking services in India, the Chairman of national commission for minorities has made a special request to ministry of finance in June 2012 to reconsider the same. Subsequently, RBI was asked by ministry of finance to look into the feasibility of developing an Islamic banking model as a part of Indian banking system. In October 2012, the governor of RBI

announced their discussion with MoF and agreed to look into the possibility of making adjustments in existing laws which will open doors to introduce Islamic banking system in India. (Unnikrishan, 2012). This move of RBI has paved a positive path for the future possibility of Islamic banking services in India.

Launching of Sharia share index in India:

Sharia Index is used in order to construct certain products that are socially responsible to attract and channelize the investments from those people who prefer to make investments in companies that strictly abide and do not foster any activities as prohibited by their beliefs according to their religion. Sharia index constructs SRIs which are the products that are socially responsible. SRIs as constructed by Sharia Index are predominantly meant for Islamic investors by allowing them to make investments that are not in violation of principles of their religion.

In 2010, the Bombay Stock Exchange (BSE), with a great idea to increase more participation of Muslim communities in the financial market, launched a special share index called 'Sharia Share Index' which is firmly adhering with Sharia law comprising of Sharia based funds. The Taqwa Advisory and Sharia Investment Solutions (TASIS), is an Islamic finance company in Mumbai will screen the stocks of Sharia 50 Index. Most of the Muslim communities around world including those from the middle east region, though interested to make investments in the rapid growing financial market of India, but restricted due to the reason that these financial markets are operating on the basis of



interest which is forbidden as per their Sharia principles. This Sharia share index is created in India to fill this gap and attracting investments of these communities also.

TASIS is a prestigious institute in India which advises on screening of stocks based on Sharia law. It screens the stocks and filters them based on sharia norms. TASIS played an efficient role in starting up of first Sharia Index at BSE, and also at NSE by screening the NIFTY Sharia 25 Index, NIFTY Sharia 50 Index and NIFTY Sharia 500 Index which are part of the parent indices NIFTY 50 and NIFTY 500.

At the moment, though there are some equity funds which are in operation as per the principles of sharia, but there is not even a single bank completely providing Islamic banking services in India. This is due to the challenge of amendments not being made to the Banking regulations act. Unless the act is amended, it will remain a potentially untapped financial benefit for the full-fledged economic development by considering the all sections of the population.

Conclusion:

India, being a third largest Muslim populated country has a strong potential market for the development of Islamic financial services and can become the regional hub for Islamic banking. But this can be achieved only through the development of consciousness in people of India that Islamic banking is not only useful for the Muslim communities but as a whole to the welfare of the society. In order to launch Islamic banking services in India, a major supportive measure is required from the Government of India by making the amendments to the

Banking regulations act. Indeed, a strong support from the political and social environment is also essential for the establishment of Islamic finance in India.

After reviewing the report from Sachar committee, it is understood that majority of the Muslim population in India is being financially excluded due to the interest based banking system by the conventional banks. In order to raise the financial inclusion, it is inevitable to include all the communities of the population to obtain the financial services in India. Credit Deposit Ratio (CDR) is a tool to measure the monetary progress and availability of credit to all sections of the communities. It is used to maximize the flow of credit by ensuring better credit deployment. As per RBI report, the CDR of Muslim community stood at 47% whereas the average of the nation is at 74% which highlights that the credit flow is not fully deployed to all the sections of the society. Thus it increases the gap between financially sound sections and weaker sections in the society by limiting the credit flow. To reduce the gap, it is required to provide the financial services at micro level and increase the financial inclusion. This can be fully attained by reconsidering the launch of Islamic banking services in India by adopting the models followed in the banking industry of non-Islamic countries like Thailand, United Kingdom, United States of America etc.

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