Research Paper Economics

ISLAMIC BANKING IN INDIAN SCENARIO- A THEORETICAL ANALYSIS

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ABSTRACT

Islamic Banking refers to a system of banking consistent with the principles of Islamic Laws or Shariat which prohibits the payment or acceptance of interest or riba for the lending or acceptance of money. The advocates of Islamic banking have been trying their best to propagate this concept over the years, yet there is no full- fledged Islamic bank currently working in India. Islamic banking is a distant dream in the world of Conventional interest based Indian banking. RBI and other legal institutions of India are not issuing license to banks to work as per the principles of Islamic banking due to several reasons. In order to set up Islamic banks in India, a lot of amendments need to be carried out in the prevalent legal set up. The main objective of this paper is to study the relevance of Islamic banking for the economic and social development of developing countries like India and finally conclusion has been provided whether Islamic banking is worthwhile to be persuaded in India or not. It has been concluded that Islamic banking has good prospects in India, given the diverse Indian canvas and holds good for India from a development point of view.

KEYWORDS Islamic bank, Shariat and India

Introduction

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 Shar'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). Islamic banks are seen to involve themselves as financial intermediaries and investment oriented institutions in bringing about wellbeing of the community, society and the economy in the light of Shar'ah.

The advocates of Islamic banking have been trying their best to propagate this concept over the years, yet there is no full-fledged Islamic bank currently working in India.. The main focus of this paper is to study the relevance of Islamic banking for the socioeconomic development of developing countries like India by analyzing its merits and demerits and finally conclusion has been provided whether Islamic banking is worthwhile to be persuaded in India or not. As per the census, India has the second largest Muslim population in the world Muslim population will also be able to improve their socio economic conditions and this system must be helpful in eradicating poverty among Muslims and will certainly help in their overall uplift. Around 80% of the Indian Muslims are willing to lend or borrow from Islamic Finance Institutions. Muslim owned businesses have achieved a sizeable proportion. The demand for Islamic Banking Products is visibly huge.

Principles of an Islamic Bank:

- The absence of interest-based (riba) transactions.
- The avoidance of economic activities involving oppression (zulm)
- The introduction of an Islamic tax, zakat;
- The discouragement of the production of goods and services which contradict the Islamic value (haram)
- Any predetermined payment over and above the actual amount of principal is prohibited.
- The lender must share in the profits or losses arising out of the enterprise for which the money was lent.
- Making money from money is not Islamically acceptable Gharar (Uncertainty, Risk or Speculation) is also prohibited.
- Investments should only support practices or products that are not forbidden -or even discouraged- by Islam

Advantages of Islamic Banking

- Islamic banking is becoming very popular among international investors. It is not a closed system. It has no regional, ethnic or class affiliations.
- In Islam banking, only one kind of loan and that is qard-el-hassan (literally good loan) whereby the lender does not charge any interest or additional amount over the money lent.
- Islamic banking is more efficient in that it allocates investable funds on the basis of the expected value of projects rather than on the criterion of the creditworthiness of those who own the projects, which is the case in debt-based finance.
- Islamic banking is less prone to inflation and less vulnerable to speculation, which is currently being fueled by the presence of huge quantities of debt instruments in the market.
- Islam encourages people to invest their money and to become partners in order to share profits and risks in the business instead of becoming creditors. As defined in the Shari'ah, or Islamic law, Islamic finance is based on the belief that the provider of capital and the user of capital should equally share the risk of business ventures, whether those are industries, farms, service companies or simple trade deals.
- Interest Free Islamic Banking in India helps to develop Inclusive Growth and Social Uplift.
- Financial inclusion: Islamic banking would open new doors for the Muslim communities.
- Broader range of Financing options: Islamic banking introduces new modes of financing not available in India and these would make the financial market more competitive.
- Equity finance is extended by lower cost of credit.
- Poor people can easily avail loans to promote self employment .Thus reducing income disparity in India.
- It would add real estate boom.
- Islamic banking helps to promote the inflow of funds from GCC countries.
- It leads to increase in the work participation of Muslims in banking industries.

- It helps to counter terrorism
- Islamic banking will help to promote Muslim entrepreneurships in India.
- Islamic banking through equity financing can help to reduce the burden of keeping current account and fiscal account deficit under control.
- It promotes economic growth in the country.

Disadvantages of Islamic Banking

- 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.
- Investments should only support practices or products that are not forbidden or considered unlawful, or haraam, by Islamic law. Trade in alcohol, for example would not be financed by an Islamic bank; a real-estate loan could not be made for the construction of a casino.
- The bank could not lend money to other banks at interest.
- Islamic banking goes against the secular fabric of nation.
- It may bridges financial segregation, so regulatory authority may oppose.
- Micro finance is a good competitor.

Though Islamic banking has a few drawbacks, it has its own advantages to stand on.

Islamic (sharia) banking and its prospects in India

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". 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, 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.

Major challenges in India

- Establishing appropriate risk and liquidity management techniques.
- Achieving consistent Shariah supervision.
- Lack of experts and man power shortage in Islamic banking.
- Modification in banking Act regulation needed.
- Standard non uniformity.
- Addressing legal and tax restriction.

Infeasibility of Islamic Banking

Total revenues of Muslim owned businesses touched INR 31000 Crores in 2008. In the absence of Islamic Banking in India, they use the conventional banking and finance for their business needs However, corporate India has started taking cognizance of Islamic Banking and Financial products However, Islamic banking is infeasible under the current RBI regulations Indian Banking system is based on certainty of Capital and Returns, both of which are in conflict with Shariah principles.

Few Islamic products are permissible through the NBFC route. RBI can learn from the experiences in countries like Pakistan and Iran, where the entire banking system is based on Islamic principles and from countries like Malaysia, Jordan, Bangladesh and Egypt where Islamic banks operate along with conventional commercial banks.

Key Stakeholders: RBI, Islamic Banks and Tax Authority

In order to accommodate the Islamic banks within the conventional banking system, existing procedures require modifications and new procedures need to be developed.

Changes required in the existing system

- RBI Policy Changes
- RBI has to allow riba free deposits-lending on PLS basis
- Allowing Profit- Loss sharing for Islamic Banking
- Accepting and granting interest free loans to Islamic Banks
- Lender of last resort
- Developing Islamic Bond market

Changes in the Tax Laws:

- Avoid double taxation of Islamic activities (bai inah).
- Treating' Income from partnerships' as' interest income' in Islamic banking.
- Indian banking guarantee deposits.
- Follow AAOIFI accounting standards.
- Total regulatory compliance with RBI
- Maintain SLR and CRR requirements

The above changes are aimed at attacking the three major impediments for Islamic Banking: Certainty of Capital and Return, Liquidity Management: Integrating Islamic Banking in financial system, Supervision and control

Conclusion:

Even though there are some barriers in the path of Islamic banking in India we can accommodate it by making the above changes in the existing operational and regulatory aspects of RBI and Tax Authorities. With the above mentioned minor changes in their practices, Islamic banks can get rid of their cumbersome and can offer an efficient and effective interest free banking which will make it favourable to India. To conclude, Islamic banking has good prospects in India, given the required changes in the existing banking system and holds good for India from a development point of view. Islamic banking will be able to improve the socioeconomic condition of not only Muslims but also the downtrodden section and this system will be helpful in eradicating poverty and leads to the overall upliftment of Indian economy. Hence we personally believe to refer 'Islamic Banking' as 'Interest Free Banking' so that it could be looked through the broad economic kaleidoscope and not a narrow religious prism. It is hoped that their participation in Indian banking will lead to further infrastructural development in India and better allow it as a part and parcel of our Indian conventional cum organized Indian banking system. Because, around 170 million Muslim community people will get benefit on the basis of religious beliefs and further, Indian industries will grow by getting lot of foreign funds from Gulf region and can use these funds on win-win basis.

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