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- Kumar S. (2011): "Customer Value: A Comparative Study of Rural and Urban Customers," Thesis, Kurukshetra University, Kurukshetra.

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ISLAMIC BANKING: INDIAN ECONOMIC DEVELOPMENT

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ABSTRACT
Islamic banking is based on the principle of profit-sharing, rather than charging interest. The first Islamic Banking experiment was done in 1963 by Ahmad El Najjar as "Nasir Social Bank" in the Egyptian town of Mit Ghamr under cover of a savings bank following, profit sharing but the interest free concept and was later declared as an interest-free commercial banking without any reference being made to Islam. "The current volume of Islamic banking is USD 1.2 trillion. It is very small and less than 1 per cent when compared to conventional banking, which is nearly USD 243 trillion. Islamic banking has been gaining momentum after the recent global meltdown and many countries, including India, are opening their doors for it. Islamic banking can provide immense opportunities to energize the Indian economy with the participation of previously excluded Muslims in Shariah-compliant banking and at the same time could lead to substantial inward investment to boost India's further development. It would also contribute in our economic development of country. The present paper explores the basic concepts and principles of Islamic banking and reviews the potential of Islamic banking in India and also throws light on the need of Islamic banking for the Indian economic development. The study is focused to know the constraints of Islamic banking in India.

KEYWORDS
conventional banking, indian economy, islamic banking, shariah.

INTRODUCTION
The first and foremost important financial intermediary and essential institution in the present global economic system and in agriculture sector is banking. It plays an important role for the economic development of a country like India. Among the bank sector one of the important bank which is based on Islamic law called Shariah is Islamic bank and is based on interest free banking and permits only profit sharing based banking system of early as 1940's. The concept is based on a verse of the Holy Quran that says "Allah has allowed only legitimate trade and prohibits interest". Islamic banking having the same purpose as conventional banking except that it operates according to Muslim law called shariah. The first Islamic Banking experiment was done in 1963 by Ahmad El Najjar as "Nasir Social Bank" in the Egyptian town of Mit Ghamr under cover of a savings bank following, profit sharing but interest free concept and was later declared as an interest-free commercial banking with out any reference being made to Islam. From Jakarta to Jeddah to Jordan, 280 Islamic banks operate in over 50 countries, with assets estimated between $ 250 million and $ 300 billion.
Islamic banking has unfortunately been misunderstood in India as a religious charitable venture restricted to the country's poverty-ridden and economically downtrodden Muslim community. Even years of successful Islamic banking operations and its phenomenal growth around the World have failed to demolish this myth.

RESEARCH PROBLEM
The concept of Islamic banking is rapidly growing throughout the world, but India is still unfamiliar with this. The research intends to focus on the basic issues and prospects of Islamic banking in Indian context.

OBJECTIVES OF THE STUDY
1. To discuss in detail, the basic concepts and principles of Islamic banking and reviews the potential of Islamic banking in India.
2. To study the need of Islamic banking for Indian Economic development.
3. To explore the major issues and constraints of Islamic banking in India.

LITERATURE REVIEW
It is not possible to cover in this paper all the publications which have appeared on Islamic Banking. There are numerous publications in Arabic and Urdu which have made significant contributions to the theoretical discussion. A brief description of these in English can be found in the appendix to Siddiqi's book on Banking without Interest (Siddiqi l983).
The early contributions on the subject of Islamic Banking were somewhat casual in the sense that only passing references were made to it in the discussion of wider issues relating to the Islamic economic system as a whole.
Qureshi (1946): The early writers had been simply thinking aloud rather than presenting well-thought-out ideas. Thus, for example, the book by Qureshi on Islam and the Theory of Interest (Qureshi l946) looked upon banking as a social service that should be sponsored by the government like public health and education. Qureshi took this point of view since the bank could neither pay any interest to account holders nor charge any interest on loans advanced. Qureshi also spoke of partnerships between banks and businessmen as a possible alternative, sharing losses if any. No mention was made of profit-sharing.
Chapra (l985): The point that there is more to Islamic banking than mere abolition of interest was driven home strongly by Chapra. He envisaged Islamic banks whose nature, outlook and operations could be distinctly different from those of conventional banks. Besides the outlawing of riba, he considered it essential that Islamic banks should, since they handle public funds, serve the public interest rather than individual or group interests. In other words, they should play a social-welfare-oriented rather than a profit-maximizing role. He conceived of Islamic banks as a crossbreed of commercial and merchant banks, investment trusts and investment-management institutions that would offer a wide spectrum of services to their customers.
(Ahmad l952): Ahmad, in Chapter VII of his book Economics of Islam, envisaged the establishment of Islamic banks on the basis of a joint stock company with limited liability. In his scheme, in addition to current accounts, on which no dividend or interest should be paid, there was an account in which people could deposit their capital on the basis of partnership, with shareholders receiving higher dividends than the account holders from the profits made. Like Qureshi, above, Ahmad

also spoke of possible partnership arrangements with the businessmen who seek capital from the banks. However, the partnership principle was left undefined, nor was it clear who would bear the loss if any. It was suggested that banks should cash bills of trade without charging interest, using the current account funds.

BASIC PRINCIPLES OF ISLAMIC BANKING

A) WORKING OF ISLAMIC BANKING

I. Customer deposits money in a bank and the bank guarantees to return the money.
II. The customer is allowed to withdraw the money anytime.
III. Bank may charge customer a fee for looking after his/ her money and may pay *hibah* (gift) to the customer if it deems fit.
IV. This concept is normally used in deposit taking activities, custodial services and safe deposit boxes.

B) MUDHARABAH (PROFIT SHARING)

An Islamic contract in which one side provides capital and other side provides labour. The profits are to be shared in proportions agreed upon before implementation of the contract. Providers of the capital bear all net loss according to the contract unless there has been a violation of the contract terms or neglect from the part of the working partner. Losses suffered shall be borne by the capital provider.

I. Customer supply funds to the bank after agreeing on the terms of the *Mudharabah* arrangement.
II. Bank invests funds in assets or in projects.
III. Business may make profit or incur loss.
IV. Profit is shared between customer and bank based on a pre-agreed ratio.
V. Any loss will be borne by customer. This will reduce the value of the assets/investments and hence, the amount of funds you have supplied to the bank.

C) BAI' BITHAMAN ANJIL- BBA (DEFERRED PAYMENT SALE)

This refers to the sale of goods where the buyer pays the seller after the sale together with an agreed profit margin, either in one lump sum or by installment.

I. The customer picks an asset which he would like to buy.
II. The customer then asks the bank for BBA and promise to buy the asset from the bank through a resale at a mark-up price.
III. The bank buys the asset from the owner on cash basis.
IV. Ownership of the goods passes to the bank.
V. The bank sells the goods, passes ownership to you at the mark-up price.
VI. You pay the bank the mark-up price in installments over a period of time.

D) MURABAHAH (COST PLUS)

As in BBA, a *Murabahah* transaction involves the sale of goods at a price which includes a profit margin agreed by both parties. However, in *Murabahah,* the seller must let the buyer know the actual cost of the asset and the profit margin at the time of the sale agreement.

E) MUSYARAKAH (JOINT VENTURE)

Partnership or more than one party subscribe to the capital of a business undertaking and share profits and losses according to their respective share.

F) IJARAH THUMMA BAI' (HIRE PURCHASE)

It is normally used in financing consumer goods especially motor vehicles. There are two separate contracts involved: *Ijarah* contract leasing/renting) and *Bai'* contract (purchase).

G) LEASE-TO-OWN

This is very similar to the declining balance, except that the financial institution pays just nearly complete capital amount required for the property. The financial investor under this arrangement agrees to sell the house to the actual purchaser at the end of a predetermined time period. From every payment received, both lease and the purchase price of the property are adjusted.

H) ISLAMIC FORWARDS

These are the rarest forms of financing used for certain specific types of businesses only. The price for the item is paid in advance and the object is delivered on a pre-determined future date. This form of financing requires the assistance of an Islamic law expert as it may require a lot of terms and conditions to make it a valid Islamic contract.

I) SALAM

Salam is very useful in reducing agricultural sector poverty easily, by enabling the banks and farmers to contract with each other of the crops and to get finance at appropriate time, instead of usurious loans, which ultimately deteriorate through compounding of interest and farmer, will not pay it easily.

ISLAMIC BANKING IN WORLD ECONOMY

A number of Islamic Banks came up in the Middle East. The region of Asia Pacific was also not also left behind. The Philippines Government, a response to the Muslim community, established a special Bank under a Presidential Decree name as “Philippine Amanah Bank” without any reference to Islamic character. In Malaysia, Islamic Banking made its entry in 1963 as “Muslim Pilgrims Savings Corporation” to help people to save for pilgrimage to Mecca and Medina. In 1969, it was converted to “Pilgrims Management and Fund Board” but its role has been limited as it acted more as a Non Banking Financial Institution. Later, a full-fledged Islamic Bank was established in Malaysia as “Bank Islam Malaysia Berhad”. Even in non-Muslim countries, Islamic Banks have been established. The “Islamic Finance House” was the first Islamic Institution to be established in Luxembourg in the Western world in 1978. Besides this, in Denmark, an “Islamic Bank International of Denmark” was set up. Even in Australia, an “Islamic Investment company” has been set up. Abraaj Capital, a leading private equity Company in the Middle East, North Africa and South Asia region made a joint venture with the Deutsche Bank and Ithmaar Bank to raise US$ 2 billion Islamic Law based private equity fund to capitalise the increasing demand for infrastructure development in the region. The fund money will be invested in Greenfield projects, oil, gas, petrochemicals, telecom, power, water, roads, health care and education sectors. Gulf Finance House (GFH) has signed a one-year renewable US$ 90 million syndicated murabaha facility with a group of nine banks from Europe, Asia and the Middle East. Among them, none is an Islamic financial institution. HSBC Bank in Malaysia’s first Islamic based investment product, the HSBC Amanah Islamic Dual Currency Structured Investment (Amanah). The product is a two component investment product. Dow Jones and Citigroup have launched the world’s first Islamic law based bond index in a way to meet demand for Islamic law based investment instruments. The Islamic law based bonds are treated like an asset which can be sold as well as rented. The hot cake oil prices are putting in lot of money in the Middle Eastern countries. A lot of foreign banks are parking funds for financing the newer projects coming up in the region, but financing from the local banks is quite dismissal because they lack resources to handle big projects. To take this advantage for this excess funds flowing, Singapore and Malaysia are transforming themselves into centres for Islamic fiancé. Singapore has already planned to start an Islamic Stock Index and also to offer Islamic insurance products. Also, to counter competition from Malaysia, Singapore is also trying to establish contracts with the Middle East Islamic Financial Institutions. Finally, for any Economy to project itself as an international centre, it has become essential to allow Islamic Financial Institutions to establish based in their economies. Islamic banks are growing at an average rate of 15 per cent during last decade. USA, UK and Germany like developed countries of the world have embraced Islamic banking to take the tally of countries where this form of banking is already operational as an alternative system.

NEED OF ISLAMIC BANKING FOR INDIAN ECONOMIC DEVELOPMENT

The Indian census 2011 shows population of Muslim as 13.4 % of total population (Census India, 2011). Sachar committee claims that 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 loose around Rs. 63,700 crores which i.e. 27% of their deposits (Vohra, 2008). Therefore, this large number of Muslims population needs Islamic banking services India.

Islamic Banking can contribute towards Indian economic growth and serves as a mechanism to overcome the country's liquidity and inflation problem. India has emerged as the fourth largest economy globally with a high growth rate but still the per capita income of India stood at $1,527 in 2011, this is perhaps the most visible challenge ("Economic survey 2012-13":2012) Muslim avail just 4% and 0.48% credits from NABARD and SIDBI respectively. Islamic banking can boost entrepreneurships in India through its financing services. Therefore, there is desperate need for Islamic banking, which could be a solution for entrepreneurship development.

Islamic banks are evolving financial and investment instruments that are not only profitable but also ethically motivated. Indian economy would benefit from inflow of funds from GCC Countries.Islamic financial services can boost the Microfinance at low cost with its customary tool based on Shariah. Opportunity to promote entrepreneurship by providing finance on the basis of profit and loss and risk sharing.

With the introduction of Islamic banking, the problem related to inadequacy between the labour and capital ratio also can be solved through equity finance, which can be a new revolution in the field of agriculture and unorganized sectors. Therefore, improved capital labour ratio will strengthen the unorganized and agriculture workers to compete effectively with the organized formal sector workers.

SCOPE OF ISLAMIC BANKING IN INDIA

1. Potential to bring FDI in India.
2. Potential to provide loans to those who do not have securities at disposal and better credit rating.
3. Potential to provide low cost, easily available, capital to small poor entrepreneurs in India.
4. Potential to complement conventional banking as well.
5. Potential to contribute substantially in economic growth.
6. Potential to contribute specially in the growth of weaker section in the society.
7. Potential of Islamic banking includes loans to businesses ethically, morally and beneficial to the society causing speculative businesses to starve from financial point of view.
8. Potential to boost entrepreneurship in India.
9. Potential to reduce the rocketing inflation through less artificial money creation and less funding of speculative businesses. (Saleem, 2008)
10. Potential to contribute in the poverty eradication through Small and Medium Enterprise (SME) financing, rural and agricultural growth and their operational expansion. Through Individual and corporate zakat, it could be helped to bring social equality and social welfare in India.

MAJOR ISSUES AND CONSTRAINTS IN ISLAMIC BANKING

In the straitjacket world of Indian banking, something as fascinating as Islamic Banking is a distant dream. The major issues and constraints involved in Islamic Banking are mentioned herein below:

No Power to Issue Cheque: The biggest issue which is a permanent hurdle for Islamic banks operating in countries with interest-based banking is that they cannot function as banks unless powers of issuing cheques are given to them. They cannot be members of settlement/clearing house unless they accept two conditions regarding their liabilities and assets like conventional banks that have to keep fractional cash reserve with the central bank and statutory liquid assets in their assets. Thus banks in India have to maintain deposit account with the RBI over which they get interest. The SLR includes government and approved securities.

Inability to Maintain Capital Adequacy: Another constraint is the inability to maintain capital adequacy and would be unable to interact with interest based banks and money market in India.

Financial Products are Interest Based: A bank licensed by the RBI becomes part of the monetary system, which means it can create money by deposit generation through deposit acceptance. Since these assets are interest based, Islamic bank cannot hold them. Consequently, the central bank cannot act as the lender of last resort because such accommodation by the monetary authority is also interest based. Islamic banks cannot interact with conventional banks based on principles of interest.

Inability to Evaluate Projects: Islamic banking concentrates more on short-term and medium-term operations because long-term lending involves project appraisals and assessing long term profitability. Most such banks are ill equipped to handle this responsibility because of the smallness of their operations.

Tax Procedures: Another important consideration is the tax procedures. While interest is a passive income, profit is defiantly an earned income which is treated differently. If principles of Islamic Banking are incorporated, then how does it comply with the tax procedure is the moot question. Furthermore, RBI cannot act as the lender to such banks because such accommodation by the monetary authority is also interest based.

Not Possible under the Present Legal Framework: Islamic Banking cannot be offered by Indian banks as well as the overseas branches of local banks under the present legal framework. Except a basic offering like current account, almost no other banking product in India can be modified to meet the conditions of Islamic Banking.

Legal Tricks: Some Muslim critics maintain that the Islamic banks hide the payment of interest behind legal tricks. They compare Islamic banking to "contractum trinium" – a legal trick designed by European bankers in the middle Ages intended to allow the charging of interest for borrowed money, which was against Church teachings. The trick was in the form of three different contractual agreements, which in and of them was not prohibited by the Church.

CONCLUSION

The stage for introduction of Islamic banking in India has been set, but it is a matter of time lag before given green signal. But introduction of Islamic banking without a solid framework may lead to chaos and conflicts. Therefore, preparatory work is essential for including the Islamic banking in the mainstream banking sector which at present lies in the domain of Non-Banking Financial Companies. This demands amendments in the banking laws that are governed by the Banking Regulations Act 1949 as amended from time to time. Introduction of Islamic banking will lead to inclusion of certain chunks of population who refrain from the mainstream banking due to their faith and they are a sizeable percentage from among the 13% (2001 Census) of Muslims which are forecasted to be 19% by 2040.

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