

An Introduction to Islamic Banking (Rise and Development)

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Abstract

In the present age a nation is identified by its economy. Shah Waliullah Muhadhith Dehlvi (1703-1762) said, "*When an economy of the nation is stable, morality shows the signs of progress.*" Islamic banking is the alternative by which Muslims nations make their existence strong and progressive. Since its inception, it uplifted Muslims economic depletion to the heights of economy. Before taking this work into our hands we have been suggested with various topic but we chose this topic only we have intimate interest in Islamic banking. Our main objective and aim in this research is to limelight the socio-economic factor that resulted emergence of Islamic banking. Various notable scholars had thrown light on various aspects of Islamic banking but less attention had been given on the socio-economic factors that compelled Muslims to go for this initiative. When Islam knocked at the doors of Arabia, the Socio-economic conditions of Arabia were gloomy. The people of Arabia were suffering from socio-economic crisis. But as soon as Islam emerged, it provided solution and vanished every type of activity that was against humanity. The drastic step took by Islam was opposite to those activities that came as a hindrance in economic progress. It managed the economic system in such a way that economy of the then society progressed simultaneously by establishing *Bait-ul- Maal* . Later on same more economic institution were set up like Bait-ul-Maal-al-Khas, Bait-ul-Maal al-Muslimeen, Diwan, Jahbadh etc.

Islamic banking is a capital management completely based on the tenets of Islamic code for the betterment of economic expedients. This system of banking is secure from economic peril posing system i.e *Riba* or interest which has been meticulously verboten by Quran.

"Those who devour will not stand except as stands one whom the Satan by his touch hath driven to madness.

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That is because they say: "Trade is like usury", but Allah hath permitted trade and forbidden usury. Those who after receiving admonition from their Lord, desist shall be pardoned from the past: their case is for Allah (to judge): but those who repeat (the offence) are companions of the Fire: they will abide therein (forever)"²....Quran :(2:275)

"Allah will deprive usury of all blessings but will give increase for deeds of charity: for He loveth not any ungrateful sinner"³.Quran: (2.276)

This system was scrupulously practiced by Prophet Muhammad (Peace be upon him). Later on a financial institution was under

The name of *Bait-ul-Maal*; by the same time functioned as central bank of Muslims. *Bait-ul- Maal* carried out all the necessities and exigencies of the then society⁴. The source of *Bait-ul-Mall* was *Jizyah* (poll tax), *Zakat* and *al-Ghanimah* (booty). This money was distributed by Prophet Muhammad (peace be upon him) to the Muslims of that age. The motive behind the set up of *Bait-ul-Maal* was to eradicate and to fulfill their basic needs and make them economically sound. The initiative took by Prophet Muhammad (Peace be upon him) decreased poverty day by day among the penniless Muslims.

During the reign of Abu Bakr Siddiq (*R.A*), the *Bait-ul-Maal* and its functions remained the same and it was during the Prophetic period. But only a minor change took place that was the shifting of *Bait-ul-Maal* to *Masjid-al-Nabawi*.

With the passage of time the financial needs of Muslims increased and as a result, the *Bait-ul-Maal* couldn't fulfill the functionalities relating to finance of the then society⁵. In order to subdue the problems associated with finance, Caliph Hazrat Umar Ibn Al-Khattab (*R.A*) introduced *Diwan*, borrowed Persian institution. The *Diwan* covered almost all the financial needs of Muslims. Be they solieders in the battlefield or staying at home as did the woman and the aged as compared to the *Bait-al-Mal* because there were sufficient amount of money in the treasury of *Diwan*.

Hazrat Umar (R.A) widened the stuff of *Diwan* to orphans and infants and after some time he (R.A) increased it when an infant grew up and attained the age of maturity. In the same way he (R.A) also fixed 100 dirhams for orphans to be payed out to its guardian.⁶

In 636-37 C.E. Caliph Umar Ibn AL Khattab (R.A) approved Diwan as a permanent treasury of Muslim state and Sub-treasuries were installed in very province of Muslim state which was headed by the governor of the particular state.⁷

Structure of Bait-Ulmaal During the Reign of Umar Ibn A-Khattab

In the period of Caliph Umar Ibn Al-Khattab (R.A), the structure of *Bait-ul-Maal* was changed officially. Some special officers were appointed to look after the affairs of *Bait-ul-Maal*. A special officer was assigned called *Khazin al-Maal* or *Sahib al-Makhazin* and local treasurer *Khazin* or *amin*. These officers were considered among the elites of the Muslim community.

The system of financial institution remained same in the period of Hazart Uthman (R.A) and Hazrat Ali (R.A). The process of working of financial institution continued to be interchangeable. But in the latter period a drastic change brought by the Caliphs of Umayyad dynasty of Damascus. They introduced private treasuries and there were three types of treasuries running throughout the Umayyad period. Those were

1. Biat-ul-Maal Al-Khas.
2. Bait-ul-Mall.
3. Biat-ul Maal al-Muslimin.

- 1. Biat-ul-Maal al-Khas:-** This treasury was meant for personal use of Princes and the people associated with the Royal palace for instance the Wives of Kings, Palace guards and the present given by Caliphs to foreign Nobles. The sources of emoluments and earnings were their own.
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2. **Bait-ul Maal:-** It was also called as a State bank for the whole domain of Muslims located at the capital of the empire. Both at central and Provincial level, it was treated as an exceptional institution supervised by The governor of the province and at central level it was headed by the Caliph of the Sate. It was specially meant to carried out the basic necessities of citizens of an Islamic state like food, clothing and shelter.⁸
3. **Bait-ul-Maal-al-Muslimin:-** The third public treasury was established for the prosperity of citizens of an Islamic State. It includes both Muslims as well as Non-Muslims. The fund in the *Bait-ul-Maal al-Muslimin* was used to construct roads, bridges, mosques, churches etc. It was located at the chief mosque and was looked after level it was administered by the same *Qadi*.

The Abbasid Caliph of baghdad (750-1258 A.D) initiated a system of credit in the Muslim world based on the profit and loss sharing method. In 908 C.E, Abbasid caliph Muqtadir Bilah registered a list of Bankers and Physicians.⁹ It clearly shows that there was a concept of banking during the middle ages of Abbasid period. A financial institution namely *Jahbadh*, originated from Persian word *Kahbadi* meaning money-changer, banker or tax collector was introduced by renowned Sasanid ruler Jamshid. The Abbasid rulers expanded and developed the functions of *Jahbadh*.¹⁰

A separate institution *Diwan al-amwal* was established for the collection of tax and converting silver coin into gold. To manage the activities of *Diwan al-amwal*, a number of officers were designated to regulate the administration of *Diwan al-amwal*. The first *Jahbadah* who was appointed was a Christration namely Ibrahim b. Ayyub. In a very single *Diwan al-amwal* various officers were appointed to govern the administration. An another financial equipment which was used for the exchange of currency was *Sayraf* (Babylonian Institution for financial management) by a small group of Christians in Mad'ain. These Christians transformed *dinar* into *dirham* and dirham into *dinar* and clear up the problem of the variation between the attribute and quantity of the same coin. They performed crucial functions in the outgrowth of the system of banking in Iraq. The Abbasid dynasty (750-1258 A.D) shaped and intensified it and officialise it for change of currency.

The third financial instrument *Suftajah* was introduced. It was a kind of letter of credit or draft issued by the money changer to the traveler or merchant on talking a certain amount of money.

The issuing of a letter credit or draft used to instruct his agent in the remote village or country where the traveler or trader wanted delivery of the sum to make payment on receiving this letter.

From 13th century onwards, Muslim domain was ruled by Ottoman Turks. The Ottoman Empire (1258-1924 A.D) covered a large part of the world. Various new nations were now the part of Muslim world for instance Russia, Austria, Bulgaria, Yugoslavia etc. This huge part of the world which was under the rule of Muslims resulted in the rapid economic development because of the collection of *Kharaj* and *Jizyah* from Non-Muslims. In order to govern the financial affairs new financial institutions came existence and new financial equipments like *Suftajah*, partnership (*Mufawadah*), limited partnership (*Mudaribah*), capital accumulation (*Nama-al-Mal*), cheques, trust (*waqf*), transactional accounts, loaning ledgers. A new innovation was introduced under the name of agency institution.¹¹

Origin and Development of Modern Islamic Banking

Islamic economic system for many centuries remained torpid. The history of modern Islamic banking commenced with a thought and it remained a thought till two decades. As the time passed on this thought turned into factuality by the efforts of Muslim scholars and private initiatives in some countries and also through the constitution of the countries, Islamic economics was legalized.

Several Muslim economists like Anwar Iqbal Qureshi (1946), Naiem Siddiqui (1975), Mahmood Ahmed (1952), Maulana Mawdudi (1950) and many others took the initiative of installing an Islamic banking on the model of *Mudaraba* (co-partnership).¹² Economists strived to achieve the goal of establishing Islamic banking system.

For instance in late 1950's the State bank of Pakistan in 1959 set up an Islamic economic section within the research department of the bank to carry out organized research work in the field Islamic banking.¹³ This experiment didn't work out. But the first man who championed this vision of establishing a full fledged Islamic bank by giving it a practical shape was a Egyptian economist and social activist Dr. Ahmed el-Nagger.

In 1963, he founded the first Islamic bank in Egypt by the name of Mit Ghamr.¹⁴ In 1967 nine Islamic banks were established in Egypt which was running on the module of *Mudaribah*.¹⁵

"The Arab-Israeli conflict fueled the momentum, which saw its climax in the form of the organization of the Islamic Conference (OIC) that was established in 1970. From its inception, the OIC was involved in planning Islamic monetary and financial systems. At its fourth summit held in Pakistan in 1974, the OIC resolved it create the Islamic development bank (IDB). As a result of this summit IDB came into being in 1975".¹⁶ IN the same year first private interest free bank (Dubai Islamic Bank) was set up by a group of Muslim businessmen from different countries. The Dubai Islamic Bank talking deposit in current as well as investment accounts and engaging in profit making activities directly as well as through working partners. In 1979, Pakistan Islamized its banking sector. Pakistan was the first country to do so. After this private venture more private interest free banks were founded in different parts of the world. For example Faisal bank in Egypt (1976), Faisal Islamic Bank of Sudan (1977), Kuwait Finance House (1979), the country's sole Islamic bank. In 1981 in Iran several steps were taken to eliminate *Riba* in order to establish interest free banking and this Project got succeeded in March 1985.

An important out growth took place in the Islamic banking sector in late 1970's and early 1980 were the arrival and rapid multiplication of *Murabaha* or Cost plus Financing. Islamic banking was introduced in Bangladesh in 1980's by Dr. Ali.S. al Ghamdi with more than 150 branches throughout the country.¹⁷ Ahead of 1990's, Islamic banking and finance progressed swiftly.

In between 1996 and 1997, Islamic financial institution development at an average rate of 25% and held assets exceeding USD\$ 200 billion.¹⁸

Zamir Iqbal and Abbas Mirkhoir in 1999 reported that Islamic banking grew from asset base of USD\$ 5 billion in 1985 to a level of over USD\$ 100 billion in late 1990's. In the mid 1990's the dawn of Islamic banking in Sudan commenced. Later on Islamic banks in West Africa, Malaysia, Indonesia and Turkey came into existence as a result of private initiatives.¹⁹

Islamic banking industry has been progressing since 2000 at an average rate of 19% per annum in terms of assets. The total assets of Islamic banking sector has gained to RM 111.8 billion, accounted for 11.7% of the banking system's total assets.²⁰ In the same year there were 200 Islamic financial institutions with US\$8 billion in capital and over \$ 100 billion in deposits, managing assets worth more than \$ 100 billion. In the Middle East, there are 40% of these institutions, another 40% are in south and south East Asia and the rest are partitioned equally between Africa, Europe and America.²¹ In the year 2002 HSBC Islamic banking arm, Amanah Finance involved in Malaysia global Sukuk worth Us\$ 600 Million'.²² In the same year, Islamic financial board was installed in Kuala Lumpur (Malaysia). The board members were from diverse countries of the world. The goal of the board is to raise the expansion of a prudent and transparent Islamic financial service industry by bringing in new or adapting existing, international standards consistent with nation of Shariah by suggesting these for adoption in to providing direction on the effective oversight and management of institutions giving Islamic financial products.

Lord's bank, London in Nov, 2005 introduced Islamic products at 22 branches. In the year 2006, Noor Islamic bank (NIB) was set up in Dubai. Is a Shariah complaint commercial bank owned by the Emirates Investment Authority and Noor Investment Group? There were fully fledged Islamic banks in Pakistan at the end of the year 2006.

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The Islamic bank of Asia was founded in May, 2007 and its main office is located in Singapore. This bank is a joint undertaking between DBS, one of the biggest financial service group in Asia and 34 investors from notable families and industrial groups based in the Gulf Cooperation Council (GCC) countries.

Islamic banking developed 30% in 2008 surpassing \$200 billion worldwide. Total Islamic assets under management will be \$1 trillion by 2010, growing 20% annually. According to "Islamic finance 2010" published by International Financial Service London (IFSL), almost certainly crossed the combined number of Islamic financial Institution of Europe.

The world Islamic banking Conference: Asia Summit (WIBC Asia 201) now it is annual edition held in Singapore on the 8th and 9th of June with the official support of the Monetary Authority of Singapore held under the theme "Islamic Finance in Asia: Enhancing cross border connectivity to drive global growth.

Footnote

¹Abdullah Yusuf Ali, the Holy Quran, New Delhi, 2009, p. 52.

²Ibid.

³M.A. Mannan, Islamic Economics: Theory and Practice, Lahore, 1970, p. 237.

⁴Muhammad Taher (ed), Studies In Islamic Economics, New Delhi, 1997, p. 215.

⁵Ibid, p. 217.

⁶Ibid, p. 140.

⁷M.A.Mannan, Islamic Economics: Theory and Practice, Lahore, 1970, p.236

⁸Muhammed Taher, (ed.), Studies In economics, New Delhi, 1997, p.147.

⁹Ibid, p. 149

¹⁰www.imf.org

¹¹Muhammad Anwar, Modeling Interest free economy, New Delhi, 1987, p.11

¹²Abbas Mirkhor and Zameer Iqbal, Developments in Islamic Banking, Washington, 1987, p.7.

¹³www.islamic-world.net

¹⁴www.usc.edu

¹⁵Nejatullah Siddiqi, "Islamic Banking and Finance in Theory and Practice: A Survey of State of The Art", IRTI, Jeddah (2006):p.3.

¹⁶www.islamicbankbd.com

¹⁷Ausaf Ahmad and Salman Syed Ali, (ed.), Islamic banking and Finance: Fundamentals and Contemporary Issues, Jeddah, 2007, p.16.

¹⁸Monazer Kahf, "Islamic Banks: the Rise of New Power Alliance of Wealth and Shahrhi Scholarship", Edinburgh University (2004):p.9.

¹⁹www.irti.org

²⁰www.international.ucla.edu

²¹www.islamicbankingwy.com