

ISLAMIC ECONOMICS THE CONNERSTONE OF ISLAMIC BANKING

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ABSTRACT

Islamic Banking is a system of banking that is consistent with the principles of Islamic law (Shari'ah) and its application through the development of Islamic economics. Its most important features are: the abhorrence of interest rate, profit and loss sharing between the investors and the entrepreneur. The bank has grown very rapidly over the years. It is the most rapidly growing enterprise in the world economy. Islamic Bank now operates in many Muslim and non-muslim countries all over the world. Many attempts made to establish Islamic banking in Nigeria failed because the operators lacked the basic knowledge for its operation. The banking principles were examined. It was found that Islamic economic principles form the bedrock of Islamic banking. Well structured and certificated academic training in Islamic economics and awareness programmes were recommended for all stakeholders in the banking industry to prevent charlatans from destroying the industry at infancy.

Key words: Islam, Shari'ah, Amanat, Usury, Asset

1. INTRODUCTION

Islamic Banking has been described as a system of banking that is consistent with the principles of Islamic law (Shari'ah) and its application through the development of Islamic economics. The most important features of Islamic Banking are: the abhorrence of interest rate, profit and loss sharing between the providers of funds (investor) and the user of the funds (entrepreneur). In Islamic banking both the investor and entrepreneur share the results of the project in an equitable way. In the case of profit, both share this in pre-agreed proportions. In the case of loss, all financial loss is borne by the capitalist and the entrepreneur loses his labour (Iqbal et. Al 2005)..

Some of its financing instruments include;

- Mudaraba: investment on asset which involves profit sharing by the investor and the bank.
- Wakala: it is the use of a third party to do business for the investor.
- Musharaka: which deals with joint venture on capital.
- Murabaha: it is an Islamic mortgage transaction.

All these are interest free and founded on profit and loss sharing.

The first modern experiment with Islamic Banking was undertaken Egypt in 1963 under cover without projecting an Islamic image for fear of being seen as a manifestation of fundamentalism that was an anathema to the political regime. In 1975, Islamic Development Bank and the Dubai Islamic bank were established.

2. GROWTH RATE OF ISLAMIC BANKING

Islamic banking has grown steadily over the years. However, its popularity increased with the increasing failure rate of the conventional banks. In 2005, Islamic Banking was growing at a rate of 10-15% per year. The growth went up to about 20% in 2008. Expected growth in 2013 was put at 24%. Islamic Bank now operates in many Muslim and non-muslim countries including the United States through companies such as the Michigan-based University Bank. Islamic Banks currently operate in many African countries including Egypt, Sudan, Algeria, Kenya and South Africa.

The Secretary General of Islamic Financial Services Board (IFSB), Rifaat Ahmed Abdel Karim has reported that, Islamic Finance is the fastest-growing segment of the global financial system. He reported that the assets of the top 500 Islamic banks grew from \$639 billion in 2008 to \$822 billion in 2009 (Collins Nweze, 2010).

Many unsuccessful attempts have been made by banks in Nigeria to provide some products on the tenets of Shari'ah. The main cause of their failure was the operating framework which forbade funds to be mixed (Islamic products and conventional products) even when both funds are owned by the same bank (Oluwaseyi Bangudu, 2010). Prospective operators and consumers of Islamic banking products are very cautious. They are skeptical over the transparency, expertise and efficient transaction procedures which they considered as vital for a growing industry. In very recent years some investment houses have offered shari'ah complaint products which they refer to as "Halal Investment and Takaful Products.

Recently the Governor of the Central Bank of Nigeria (CBN) was reported to have said that the new phase of bank reforms which he introduced will positively impact on the provision and requirements of Islamic bank. He opined that Islamic Banking would create an enabling environment for attracting the multi billion dollars of global Islamic finance industry in Nigeria. He argued that the current global financial crisis had exposed the deficiencies in

the conventional banking system. He admonished the scholars, lawmakers and bankers to reassess the opportunities the current financial crisis has provided.

The central bank of Nigeria (CBN) in March 2009, issued a draft policy framework towards the establishment of the Islamic financial industry in Nigeria. This was aimed at promoting the development of Islamic Banking in Nigeria. In the framework, the CBN adopted the following strategies:

- Extensive capacity building through collaboration among the various stakeholders to develop cognate expertise in non interest banking.
- Development of an adequate regulatory supervisory framework for the effective operation of non Banking interest in Nigeria.
- Promotion of greater co-operation and coordination among relevant regulators and other stakeholders such as the Securities and Exchange Commission (SEC) Nigeria Stock Exchange (NSE), National Insurance Commission (NAICOM), Nigeria Accounting Standards Board (NASB), the Economic and Financial Crimes Commission (EFCC), Federal Inland Revenue Service (FIRS), The Federal Ministry of Finance, the National Assembly and all bodies that may have important roles to play in the successful implementation of the Islamic Banking in Nigeria.
- Sensitizing of the general public through conferences, seminars, workshops etc. on the benefits to be gained from Islamic Finance.

The CBN Governor added that from the resilient nature of Islamic Finance, it was quite evident that opportunities were enormous as well as the challenges. He partitioned the challenges into three sectors:

- Theoretical
- Operation and
- Implementation

Some other challenges have been found to include doubt of the transparency, expertise and efficient transaction procedures which intending operators and prospective customers considered as vital for growing industry.

These challenges are considered very important and this paper was prepared to provide information proffer solutions appropriately particularly the academic framework as suggested by the Governor of the Central Bank of Nigeria (CBN).

3. ISLAMIC ECONOMICS

Islam has been generally acclaimed to be a way of life wherein every activity and conduct of a muslim has been provided guidance according to the Qur'an and the practice of Prophet Mohammad (SAW), the shari'ah. Islamic Economics is the economic aspect of the Islamic ways of a muslim dealing with a fellow man. Ziyaad Mohammed (2010) described Islamic economics as part of a dynamic, universal way of life that promotes social interaction at the highest possible level. He added that Islamic Economics promotes the overall economic well-being of the individual, his family, his community and mankind as a whole. The core values of Islamic economics are: social economic justice and equitable distribution of income and wealth (Ziyaad, 2010 and Farooq (2007)).

Islamic Economics has some similarities with the western philosophy. There are also significant differences which clearly distinguished one from the other. Islamic economics may be new to this part of the world, it has been known to the muslim world at the same time that, the Qur'an was revealed. The fundamental source of Islamic economic laws and principles are the Qur'an and the practices of Prophet Mohammad, the hadith. However, prominence was given to it as a subject in recent years.

For a better understanding of the subject, we look at the general economic principles of the western and Islamic philosophies. Thereafter examine the major differences that make one different from the other. See table 1.

Economic Resources

The western philosophy of economics places high premium on scarcity and competing means when it described economics as the allocation of scarce resources among competing means. Islamic Economics does not recognize the sanctity of scarcity of resources. On the contrary, it works on the premise that resources have been provided bountifully by Allah. Allah provides resources from sources man can not imagine and who ever puts his trust in Allah, He will suffice him (Q 65:3). Allah gives wealth and sustenance to whom He wills without limit (Q3:27).

To Allah belongs all that is in the heavens and all that is on the earth and all that is between them and all that is under the soil (Q20:6). Allah cursed those who make resources scarce when He said "Woe to who gathered wealth and counted it thinking that his wealth will make him last for ever whereas the accumulated wealth will cause him to be thrown into crushing fire on the day of judgment" (Q104:1-4). He swore that among the people who are described for the hell fire are those who collect wealth and hide it, thus creating scarcity (Q 17:18). There is painful torment on the day of resurrection (Q 9:34).

Table 1. General Economic Principles

Western Philosophy	Islamic Philosophy
Factors of productions are land, labour, capital and entrepreneurship.	Factors of productions are land, labour, and entrepreneurship
Money is an asset	Money is merely a medium of exchange and a measure of wealth
Resource is scarce, without scarcity there would be no economics.	Resource is a bounty of Allah which has been graciously provided by Allah and HE gives to who He wills for the betterment of all.
Equitable distribution of wealth.	Equitable distribution of wealth.
Capitalism, wealth accumulation, monopoly etc.	Social economic justice to include: <ul style="list-style-type: none"> ▪ Self benefit ▪ Benefit to others ▪ No harm to others ▪ No exploitation
Opportunity cost is factored.	Opportunity cost is not costed.
Risk is factor.	Risk is recognized but not costed.

Role of Money

Islamic economics in breaking down the components of capital, removed money as a factor of production. In Islam, money is not a commodity. It is argued that money is a potential capital rather than capital, meaning that money becomes capital only when it is invested in asset. Islam placed more value on the human effort, initiative and risk involve by entrepreneur in a productive activity are more important than the money that is used to finance it. Money becomes capital only when it is invested in the real sector. Money is simply a medium of exchange, a measure of value and unit of accounting. Islam does not encourage individual accumulation of money to the detriment of others.

Islam encourages trade or investment in real asset but discourages keeping money idle as keeping money in idleness amounts to hoarding. Again it should be noted that money and wealth are entrusted to mankind by Allah to be used by the keeper in a manner that will gain the keeper Allah's pleasure.

Trade:

Allah has permitted trading and forbidden Riba (asury) (Q 2: 275). However, Islam forbids trading in those items that He has declared prohibited and allowed trading of what he has made lawful (Q5:5). Allah commands traders to observe their measurement and weight with equity and avoid making their weighing balances deficient (Q55:9) as Allah loves those who deal with equity (Q60:8). Allah cursed those who when they give, they give less in measure and weight but when they have to receive, they demand full measure (Q 83:1-2)

Interest:

God has forbidden *riba* which is the amount that was increased for the capital owner because of his extension of maturity for his debtor, and deferment of repayment of the debt. (Abdullah Saeed,1996). Islam does not permit money to be made on money via interest payments simply by placing money in a bank or lent to somebody else. Islam considers interest (usury) as *riba* which is categorically prohibited in all forms. *Riba* is any unfair return involving loan or debt contract that results from (a) borrower's known condition of vulnerability at the time of initial contract, especially in case of a person who is eligible to receive *zakah* or *sadaqah*, and (b) any terms in contract that would involve exorbitant rate (relative to a competitive market and regulated environment) that could also be predatory; and/or (c) in case of default/bankruptcy, increase or markup on the amount due on the basis of a term that was NOT stipulated in the original contract (Nyazee, 2000). The instrument of interest has a constant tendency in favour of the rich and against the interests of the common people (Tabari, 1996).

Allah cursed the one who takes or gives *riba*, either that, that deals with money or that, that deals with commodities and those increases and advantages obtained by the lender, or any advantage as a precondition of the loan or an excess (Q3:130).

Equitable Distribution of Wealth:

Allah commands the strong not to deprive the orphan or the weak his property. Neither should the strong exchange his bad things for the good ones of the weak. Doing otherwise is a great sin (Q 4:12). Allah enjoins Muslim not to eat up their property among themselves unjustly (Q 4:29). He decreed that the wealthy in a community must know that the beggar, the poor and the unlucky who has lost his property and wealth has right in his property (Q 70: 24-25).

Allah warned that those who are miserly on other men and hide what Allah has bestowed upon them of these bounties would receive disgraceful torment (Q 4:37). Allah abhors ostentation and admonished man not to spend his wealth wastefully in the manner of a spend thrift (Q 17:26). Rather man should spend neither extravagantly nor niggardly but hold a middle way between these extremities (Q 25:67).

Social Justice:

Allah enjoys everybody to give full measure and full weight with justice (Q6:152). Islam abhors arrogance and social injustice. "And those who spend their substance to be seen of men are the friends of satan" (Q 4:38). A man who does deeds of charity and reminds the beneficiaries of his generosity renders such deeds in vain (Q 2:264). Allah is always wanting His creation in justice. He commands justice, the liberality to kith and kin (Q 16:90 and 42:15). Allah wills no injustice to mankind (Q 3:18). He admonished that when man judge between people, he should judge with justice and fairness (Q 4:58).

Trust:

All Financial Institutions thrive in trust. Islam places very high premium on trust. Allah enjoins man to be faithfully true to is Amanat {That is, all the duties which Allah has ordained, honesty, moral, responsibility and trusts} (Q23:8). Believers admonished not to betray their Amanat as such would amount to the betrayal of Allah (Q8:27). Allah described those who are faithfully true to their Amanat and to their covenants as the inheritors of firdaus (paradise) wherein they will dwell for ever.

Table 2. General Finance Principles

Conventional Bank	Islamic Bank
Money financing	Asset finance
Interest Based	Profit Based
Less participation in trade	Active participation in trade
Gambling is allowed	Gabling is prohibited
Speculation is allowed	Speculation is prohibited

Examining the above analysis, it is clearly seen that there is a shift. Presented in table 2 are the comparison between the principles upon which the conventional and Islamic banks stand. The table shows clearly the dichotomy in the principles of these two banks. It thus shows that the operation of Islamic banking require a paradigm shift from the hitherto known conventional banking. These new principles which form the bedrock of Islamic banking are addressed only in Islamic economics. Except the prospective operators have a good grasp of this subject, operation of Islamic banking would not only be inefficient, it will also be ineffective. The consequence would be a failure and a colossal loss investments.

4. RECOMMENDATIONS

- Islamic economics should be introduced to the curriculum of all students of economics, accounting, finance and banking in their first year programme.
- The academia must provide the stake holders particularly students and holders of certificates in banking, accounting, economics and finance with well structured and certificated academic training in Islamic economics.
- The academia must collaborate among its peers to prepare study texts for the training of the subject.
- The academia must collaborate with the prospective operators in the industry to organize seminars and conferences to educate practitioners in the banking industry on Islamic economic principles and finance. These fora would provide opportunities for the well informed to answer regularly asked questions on the subject else charlatans would provide wrong answers that may destroy the industry at infancy.

5. CONCLUSION

Islamic banking has been growing very rapidly in the world consequent upon the failure of the conventional banking largely because of its economic principles particularly its discouragement of keeping money idle instead of its investment in trade or real asset. With the current rapid fall in time deposit rate from 14.25% in December 2010 to 3.5% in April 2010. it is expected that Nigerian would find the Islamic banking a better alternative for investment. Since Islamic economic principles have been found to form the bedrock of Islamic banking, no effort must be spared to provide structured and certificated academic training in the subject and its awareness programes.

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