



# IAS PARLIAMENT

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## Islamic Banking

### Why in news?

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RBI has proposed the opening of an 'Islamic window' in banks to 'gradually' introduce Sharia-compliant banking in India.

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### What is Sharia banking?

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- Sharia banking refers to banking activity **that conforms to Islamic law or Sharia.**

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- Usury is seen as the levying of unreasonably high-interest rates while lending money.

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- **Interest is Riba**, which in its current interpretation, covers all interest — not just excessive interest. Under Islamic law, a Muslim is prohibited from both paying and accepting interest.

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- Thus, Sharia banking means money can only be parked in a bank without interest — and this money cannot be used for speculative trading, gambling, or trading in prohibited commodities such as alcohol or pork.

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### What is the rationale for Sharia banking?

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- **The Sachar Committee report** released in 2006 said that Muslims hold 12.2% of accounts in public sector banks and 11.3% in private sector banks

— lower than their share of 13.4% cent in the population as a whole.

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- A large chunk of Muslims are, however, a part of the conventional banking system, and both pay and receive interest.

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- This concept is **aimed primarily at devout Muslims** who do not participate in the conventional banking system due to religious restrictions, including not taking credit from banks to expand businesses.

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- Some religious scholars have noted that the interest in the conventional banking systems is not the same as usury, and the levying and receiving of interest at a fixed rate is allowed.

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- Large parts of the Islamic world, including Pakistan, adhere to conventional banking practices.

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- Introduction of Sharia or Islamic banking could bring more Muslims into the banking system, and help in the inflow of institutional wealth from entities operating in the Islamic world to the Indian economy.

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- Sharia banking is not restricted to Muslims alone, and other communities could be allowed to participate.

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### **How can a bank work without interest?**

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- While banking itself is premised on charging interest, certain banks do structure their accounts in Sharia-compliant ways. For those who want credit from a Sharia compliant bank the instrument of **Ijara** (Leasing or Renting) is available — in which the bank purchases the asset on behalf of the client and allows its usage for a fixed rental. After a mutually agreed time, the ownership of the asset is transferred to the client.

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- Another instrument is the **Murabaha**, in which the asset is purchased by the bank at market price and sold to the customer at a mutually-decided marked-up cost. The client can repay in installments.

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- **Musharaka** is a joint investment by the bank and the client, in which both contribute to funding an investment or purchase and agree to share the profit or loss in agreed-upon proportions.

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- For savings accounts, there are two kinds of deposits. In one, customers can deposit their savings and allow the bank to use this money.

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- In the other kind, the holder allows the bank to invest his money in specific projects and gets returns after a stipulated term based on how the business performs.

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### **How prevalent is Sharia banking?**

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- A 2015 World Bank report estimated Sharia-compliant financial assets to be in the range of US \$ 2 trillion. The Islamic Finance Industry has been expanding at a rate of 10%-12% annually.

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- In many Muslim countries, Islamic banking assets have been growing faster than conventional banking assets. There has also been a surge of interest in Islamic finance in non-Muslim countries such as the UK, Luxembourg, South Africa, and Hong Kong.

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### **What are the hurdles to implementing in India?**

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- There is some political opposition against its introduction.

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- Because of the strict adherence to not paying or taking the interest, Sharia banking will call for a **complete overhaul of the banking regulatory system**.

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- There is also concern that India lacks **adequate manpower** trained in Sharia banking.

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### **What are the steps taken?**

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- In a report submitted to the government in 2008, a committee headed by **Raghuram Rajan** had suggested the need to have interest-free banking in India.
  - **The Kerala government** had subsequently tried to co-promote an Islamic finance institution, but the move was challenged in the High Court.
  - **The RBI** has now said that given the complexities, Islamic banking may be introduced in a gradual manner.
  - A few simple products which are similar to conventional banking products may be considered for introduction through the Islamic window of the conventional banks. Introduction of full-fledged Islamic banking with profit-loss sharing complex products may be considered at a later stage on the basis of experience
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**Category: Mains | GS - III | Mobilization of Resources**

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**Source: The Indian Express**

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