

ISLAMIC FINANCE IN INDIA

Introduction

Dr Shariq's name has become synonymous with Islamic finance in India. He works as consultant to many Islamic finance and investment companies within and outside the country. In the last few years we have seen Dr Shariq in many roles; as a teacher, researcher and also as an activist striving hard to bring Islamic finance to his country. During his recent visit to Al Jamia Al Islamia, Santhapuram for teaching Islamic finance to the students of Post Graduate Diploma in Islamic Economics and Finance (PGDIEF), Mohamad Palath got an opportunity to interview him.

1. What is Islamic finance? How it is different from the conventional finance?

Islamic finance derives its strengths from the values of Islam. Among others it mainly differs from conventional finance on three accounts. Prohibition of Riba, Gharar and Maysir. In conventional finance all these are practiced, whereas in Islam these things are strictly prohibited.

Riba is the rent charge on lending money, while gharar is a condition in which rights and obligations of the contracting parties are unclear. Maysir is pure gambling where one party profits at the cost of others. In addition, under Islamic finance the participants are under obligation to certain industries concerned with activities repugnant to Islam such as alcoholic beverages, non-halal foods etc.

2. What is the current situation of Islamic finance in the world?

Islamic finance is one of the fastest growing businesses in the world today. It is practiced in over 75 countries. The whole of the Middle East is on a fast track to converting its financial system purely to the Islamic system. The growth in other parts such as South East Asia, Europe and North America is also fabulous. In

Africa too it is growing at a steady pace. Total assets under Islamic finance is now assessed to be about US\$ 1000 billion. This does not include the size of Islamic funds and the worth of shariah compliant stocks in various countries. It is estimated that now 50% of all fresh investments coming to the financial sector in the Middle East are shariah compliant.

3. What are the important methods of Islamic finance? How it is made shariah compliant?

The essence of Islamic finance is equity and justice in financial dealings. Any product that conforms to these values and avoid Islamic prohibitions is acceptable. Islamic finance mainly relies on products called Mudarba, Musharka, Murabaha, Ijarah, Salam and Istisna etc.

Not all these products are created by Islamic scholars but many of them were already in practice when the religion of Islam came. Few of the products were slightly modified to conform to Islamic requirements.

Mudaraba is simply a trust partnership in which one partner provides capital and the second provides his entrepreneurial services. Profits are shared between them in pre-agreed proportion whereas losses, if any, are borne by the capital provider.

Musharaka is simple partnership in which profits are shared among partners according to the agreed proportion and losses are borne according to the capital contribution.

Murabaha is a marked-up sale transaction mostly used by Islamic banks and financial institutions for providing financing facilities to its customers. Under this arrangement Islamic banks, instead of giving cash to their customers for buying the goods they require, purchase the goods first and then sell them to the customers. If the sale is on credit, then Islamic bank receives the payment in

agreed installments. In case of delay in repayment the Islamic bank cannot charge more.

Ijarah is a simple lease agreement where the beneficiary pays rental in lieu of using a durable asset provided to it. An alternate to the conventional financial lease is Ijara wa Iqtina wherein Islamic bank or financial institution purchases the asset required by the customer and then rents it to the customer. At the end of the lease agreement the asset is either gifted to the customer or sold at the nominal price.

Salam is a forward contract wherein the price of the assets (item) required is paid in advance. The asset is delivered at a future date.

Istisna is a manufacturing contract in which payment is made according to the progress of the work. Istisna is mainly used for made-to-order products. While Salam can be used for either existing or non-existing goods to be delivered at a future date.

There are some other products also which are not commonly practiced by Islamic banks and financial institutions the world over.

4. Is Islamic finance possible in India? What are the constraints?

Islamic finance is possible in any country including India. In fact it is more beneficial for a debt-ridden economy like India where thousands of poor commit suicide every year due to their stressed economic situation caused by debt and interest. Islamic finance can be very beneficial for sectors like real estate, infrastructure and other areas requiring heavy investments. Even much of the planned expenditure of government can be met through Islamic structuring.

There are many constraints to Islamic finance in the country. The first and foremost among them is the non-recognition of Islamic financial products such as some of those mentioned above. In comparison to other secular countries,

India's response to Islamic finance is also very lukewarm. Last year (2006) the Central government asked the RBI to give its opinion about the possibilities of Islamic banking. Presumably, without going into the merits of the case in depth the RBI gave a negative report and the matter was put in cold storage.

The most important constraint which I have personally experienced in India is the psychological one, on the part of the regulator (RBI), as well as the practitioners. The regulator feels that it will lose its regulatory power to the shariah board and the practitioners think that they might be branded as communal if they start practicing Islamic finance. None of them wants to face the ire of certain active political groups. Unfortunately the experience of the general public has also not been very enthusiastic.

5. In the past few Islamic finance companies have failed in India. What were the reasons for their failures and how do you think it can affect the new entrants?

Yes, it is true that a few Islamic finance companies have failed in the past but failure is part and parcel of business. In US every year hundreds of banks fail or get liquidated but that has not deterred the growth of banking in the country. In fact US banking sector has played a very positive role in the overall supremacy of United States in the world.

Similarly in India too, thousands of non-banking companies have failed in the last ten years. Today we hardly have fourteen thousand non-banking finance companies in India as against over fifty five thousands in 1990s.

Unfortunately we the Muslims of India have developed a sort of fear psychosis. Some-times we also tend to feel that these failures were caused due to un-Islamic practices of these companies. This is not true to a very large extent. If a Muslim, despite being upright and sincere, can fail in his business so can an Islamic finance company. It was the overall business condition and also to an extent some tactical mistakes that led to the collapse of Islamic finance

businesses. If the business conditions are good, as they are now, and we don't repeat our mistakes, then the future of Islamic finance in the country is as great as the future of any other business.

6. Islamic banks are not allowed to operate in India but cooperatives can function on Islamic principles. How do you look at their prospects?

Yes, I agree that Islamic banks cannot function unless they are given certain relaxations by the government but cooperatives can function within the regulatory jurisdiction of the country. At the moment cooperatives are the best option available in the country for loan based operations.

7. Most of Islamic finance institutions in other countries are heavily engaged in Murabaha financing but many scholars feel that current application of Murabaha is at variance from the shariah what is your opinion?

Yes, there is no doubt that current application of Murabaha is at variance with the classical murabaha found in our history. A few scholars are very much against the current distortions in Murabaha practices while others allow it on the reasoning that even distortions are better than violating the rule of *Riba*. These scholars believe that through constructive criticism and with the evolution of more shariah compliant methods, such distortions can be rectified over a period.

8. Islamic banks and financial institutions are alleged to offer loans & finance to only rich people. Do you think if they are allowed in India they will help the poor?

Islamic banks and financial institutions are business entities. They will put their money where they see the opportunity of profit. They cannot be asked to spend on the poor, which is the duty of society as well as the government. To my knowledge Islamic banks are spending large amounts of money as charity, which conventional banks never pay. Islamic banks are very small in number, size as

well as age. They cannot be compared with conventional banks, which are many centuries older.

If Islamic banks are allowed in India that will affect society positively, the reason being that Islamic banks are not allowed to rotate money in the money market. To be eligible for profit Islamic banks will have to bring money into the real economic sector, which is not necessarily the case with conventional banks. This mandatory change will bring more prosperity to society.

9. Is investment or trading in share permitted? What are the conditions for investing in share market. Is it possible to trade in share market without getting involved into speculation and gambling?

Investment in shares and equities is like buying ownership in businesses. It is allowed in Islam but being an owner an investor will be accountable for the businesses of the company. Therefore, he should not invest in the businesses prohibited in Islam like interest, gambling, pork, vulgar entertainment, tobacco etc.

Further an Islamic investor has to take care that un-Islamic activities of the company in which he has invested are within the tolerable limits set by the contemporary shariah scholars.

A few other malpractices which are very common in stock market trading like short selling, provisional buying, margin trading, leveraged buyout etc should be strictly avoided to comply with the shariah.

10. This is the second year you have come to teach Islamic finance at Al-Jamia Al-Islamiya, India. How do you look at the prospects of courses like these?

Islamic finance is one of the fastest growing business segments in the world today. Prospects for career in this area are great. There are lots of vacancies

coming up especially in the Middle East and South East Asia. The step taken by Al Jamia to start this course is laudable. Insha Allah soon we will see its positive results. At the same time students should be encouraged to go out and work for the Islamic banks and financial institutions.

11. In India there are many Islamic micro credits institutions. What would be your suggestions to improve the services of these institutions?

Our Islamic financial institutions whether engaged in micro credit or other businesses are the custodian of Islamic values in business. They should take care of these values as much as possible at the same time they should also strive to help the poor as much as possible, which is one of the most pious and highly rewarding activity in our religion.