

Islamic Banking And Finance: An Imperative For Sustainable Development In Nigeria

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ABSTRACT

This paper tries to explore the Islamic banking concept (non interest banking) as an alternative and viable system that can achieve sustainable development which the 21st century demands. Islamic finance has grown rapidly over the past decade, and its banking segment has become systemically important in most countries in a wide range of regions. Islamic finance is projected to continue to expand in response to economic growth in countries with large and relatively unbanked Muslim populations. It is also fueled by the large savings accumulated by many oil-exporting countries that are seeking to invest in Shari'ah-compliant financial products. The transformation of the society and the world's economy on a sustainable basis is one of the most significant challenges in the 21st century. This implies that one of human kind's greatest challenges in this century is to ensure sustainable, just and balanced development because the needs of the current and future generations cannot be met unless there is respect for natural system and protecting core economic. Islamic banking and finance with a unique feature of profit and loss sharing paradigm is conducive to a dynamic economy in which the benefits of growth are shared by the community at large. This paper therefore provides an in-depth and insights on the concepts of Islamic banking, rationales for prohibition of interest in Islam, Islamic banking financial instruments and the place of Islamic banking in achieving sustainable development. It is therefore recommended that the numerous advantages accrued to Islamic banking and

finance practices which constitute an integral part of the financial development strategy should be encouraged and mainstreamed to meet need for sustainable development which the 21st century demands.

Keywords: Islam, Finance, Interest, Banking, Development.

INTRODUCTION

Islamic finance is community-oriented and entrepreneur-friendly, emphasizing productivity and the physical expansion of economic production and services. Hence, it shifts the overall focus from financial collateral or the financial worth of a borrower (the current predominant practice) to the entrepreneur's trustworthiness and the project's viability and usefulness. This feature has important implications for the distribution of credit risk as well as systemic stability. Islamic finance, therefore, falls under ethical finance. This implies that Islam may be considered a system of standards based on moral and ethical values. The purpose of Islamic finance is to improve living conditions and well-being, establish social equity and prevent injustice in trade relations. This is precisely the reasoning behind the prohibition of usury and its replacement with a system whereby profits and risk are shared more equally (Novethic, 2009).

Islamic regulatory bodies and standard setters have created principles and detailed technical standards, there is further scope for their implementation by national authorities, who are often more focused on global conventional banking standards. Lower economies of scale, and sometimes an uneven playing field with conventional finance, play a role. Similarly, large differences in practice across countries and limited standardization and securitization create additional uncertainty for Islamic finance customers. Scarcity of Shari'ah scholars with financial sector expertise, and a slow pace of innovation are also weighing on the industry. These challenges may not only be impeding its development, but could also encourage practices and products that are complex, thus carrying heightened risks.

However, Modern banking system was introduced into the Muslim countries at a time when they were politically and economically at a low ebb, in the late 19th century. The main banks in the home countries of the imperial powers established local branches in the capitals of the subject countries and they catered mainly for the import and export requirements of the foreign business. The banks were generally confined to the capital cities and the local population remained largely introduced by the banking system. Borrowing from the banks and depositing their savings with the bank were strictly avoided in order to keep away from dealing in interest which is prohibited by Islamic religion. According to the Institute of Islamic Banking and Insurance (1990), "Islamic Banking refers to a system of banking or banking activity that is consistent with the principles of the Shariah (Islamic rulings) and its practical application through the development of Islamic economies". Nigeria's quest for a virile banking reform had led to the adoption of several strategies that would truly give the nation's economy an edge towards growing sustainability. No doubt, the bail out of "failed banks" and the acquisition of assets from bad banks' did save the economy and Nigeria to a large extent from such kind of economic blows suffered in the Scandinavian banking crises.

LITERATURE REVIEW AND HISTORICAL PERSPECTIVES ON ISLAMIC BANKING

Islamic finance refers to the provision of financial services in accordance with Islamic jurisprudence (Shari'ah). Shari'ah bans interest (Riba), products with excessive uncertainty (Gharar), gambling (Maysir), short sales, as well as financing of prohibited activities that it considers harmful to society. It also requires parties to honor principles of fair treatment and the sanctity of contracts. Transactions must be underpinned by real economic activities, and there must also be a sharing of risks in economic transactions.

The foundation of modern Islamic banking was laid on the notion that commercial banks are needed but inherent challenges that are man-made accounted for a modified banking system that is based on the concept of mudarabha or profit and loss sharing; an interest free banking system. Theoretically, Islamic banking is differ-

ent from conventional banking because interest (riba) is prohibited in Islam, i.e., banks are not allowed to offer a fixed rate of return on deposits and are not allowed to charge interest on loans. Adebayo (2010) posited that voices that rose from various quarters against the flaws, shortcomings and exploitation of the conventional financial system clearly indicate that the authors of the system could not redeem the image without resorting to alternative financial system devoid of the exploitative tendencies in the former system. The worldwide acknowledgement of usury as an economic instrument inimical to human welfare, as well as the havoc and misery associated with a usury-based financial system in the modern society is likely a good reason for the wide acceptance of Islamic financial institutions (Adebayo, 2011).

The Conference of the Finance Ministers of the Islamic Countries held in Karachi in 1970, the Egyptian study in 1972, the First International Conference on Islamic Economics in Mecca in 1976, and the International Economic Conference in London in 1977 were the result of institutional involvement in Islamic banking. The involvement of these institutions and governments led to the application of theory to practice and resulted in the establishment of the first interest-free bank (Alao and Alao, 2012; Ajagbe and Brimah, 2013; Ariff, 1987; Naveed and Kashif 2010). The first modern experiment with Islamic banking can be traced to the establishment of the Mit Ghamr Savings Bank in Egypt in 1963.

According to the conservative estimates of the Islamic Banker in October 2008, Islamic financial assets globally exceeded \$500 billion. The Islamic Bank of Britain for over four years has attracted over 40,000 customers while HSBC Amanah, the Islamic finance subsidiary of HSBC, has been operating for ten years in London, focusing mainly on institutional clients and business finance (Filippo et'al 2013). Historically, in Nigeria, the first recorded attempt at establishing a Non-interest bank was in 2004 when the CBN under the leadership of Charles Soludo granted an Approval-in-Principle Licence to Jaiz International Bank PLC to carry on business as a Profit and Loss Sharing Bank.

INTEREST AND RATIONALE FOR THE PROHIBITION OF INTEREST

In classical Islamic jurisprudence *riba* means surplus value without counterpart or to ensure equivalency in real value (Adekanye, 2010). Ajagbe and Brimah (2013) asserted that Islam categorically and unequivocally prohibits the practice of charging and receiving interest in all forms not only on loans but on other transactions. *Riba* (Usury) in Islam was well established during the life time of the Prophet Muhammed (SAW) and several verses in the Quran Lay emphasis on usury (*Riba*) as an unlawful act and totally prohibited Several verses of the Holy Quran pointed out the prohibition of usury and Hadith (saying and deeds or tradition) of the Holy Muhammad (SAW) were also against any transaction involving interest. For example;

And Allah will destroy *riba* (usury) and will give increase for *sadaqah* (deeds of charity, alms etc). And Allah likes not the disbelievers, sinners (Qur'an 2: 276).

At another verse, it reads: And that which you give in *riba* in order that it may increase (your wealth by expecting to get a better one in return) from other people's property, has no increase with Allah; but that which you give in *zakat* (*sadaqah*, charity, etc) seeking Allah's countenance, then those, they shall have manifold increase (Qur'an 30: 39).

Therefore, the prohibition of *riba* can be viewed as part of Islam's general vision of a moral economy. In Islamic economics, the lender should bear the risk of the venture with the borrower because it is deemed that neither the borrower nor lender is in control of the success or failure of a venture. Thus, a unique feature that differentiates Islamic banking from conventional banking, in theory, is its profit-and-loss sharing (PLS) paradigm. Under the PLS paradigm, the ex-ante fixed rate of return in financial contracting, which is prohibited, is replaced with a rate of return that is uncertain and determined ex-post on a profit-sharing basis. According to Novethic (2009), Islamic banking and finance is a system intended to be fair, with the aim of improving quality of life. This is why the prohibition of usury is based on two moral principles:

1. The application of a fixed interest rate is considered unfair and discriminatory. First, it prevents the lowest-income groups from having access to credit. For investments, it leads to an uneven distribution of risk and profits: the investor receives fixed income without any correlation to the success or failure of the business, while the entrepreneur bears all the risk. Conversely, in the event of significant profits, the investor receives an insignificant share of the profits while the entrepreneur takes the lion's share. In other words, the profit attributed to the capital is fixed, while that attributed to the labour is variable and tinged with uncertainty (Novethic (2009),

2. Earning interest is by definition not correlated with the business itself. This transgresses the principle that the creation of wealth is based on a real asset and that the money itself cannot be a source of added value. Another moral principle linking finance to the real economy is that of not selling what one does not own. This particularly applies to speculation and partly explains why Islamic banks have not been severely impacted by the crisis: they were not exposed to subprime mortgages. The principle of zakat also upholds the idea of social equality. By recommending that believers give a portion of their income (2.5%) to the poor, zakat allows for the redistribution of wealth and helps correct inequality. The prohibition of riba is mentioned in four different revelations in the Qur'an (Abdallah, 1987).

The first revelation emphasizes that interest deprives wealth of God's blessings. The second revelation condemns it, placing interest in juxtaposition with wrongful appropriation of property belonging to others. The third revelation enjoins Muslims to stay clear of interest for the sake of their own welfare. The fourth revelation establishes a clear distinction between interest and trade, urging Muslims to take only the principal sum and to forgo even this sum if the borrower is unable to repay.

ISLAMIC BANKING CONCEPT AND NON-INTEREST FINANCIAL INSTRUMENTS

1. Mudarabah: This practice is a form of business relation in which an investor brings capital (financial or other) and an entrepreneur provides expertise. The entrepreneur is responsible for managing the business and the profits (excluding capital employed and the entrepreneur's management costs) are shared between the two parties based on pre agreed terms. In the event of losses, they are borne by the investor, and the entrepreneur is not compensated for his labour (Novethic, 2009). According to Adebayo (2011), it is a partnership in profit where the bank provides the capital and the entrepreneur works as the manager. Thus, mudarabah contracts are profit-sharing agreements, in which a bank provides the entire capital needed to finance a project, and the customer provides the expertise, management and labour. The profits from the project are shared by both parties on a pre-agreed (fixed ratio) basis, but in the cases of losses, the total loss is borne by the bank.

2. Musharakah: This contract is similar to joint venture agreements, in which a bank and an entrepreneur jointly contribute capital and manage a business project. Any profit-and-loss from the project is shared in a pre-determined manner. The joint venture is an independent legal entity, and the bank may terminate the joint venture gradually after a certain period or upon the fulfilment of a certain condition (Chong and Liu, 2008). Similarly, Novethic (2009) opined that this system is close to mudarabah, except that the parties combine their capital and share profits and losses in the proportion to the capital contributed. Thus, Unlike mudarabah where the bank only provides the capital, in musharakah the bank partners with its client for running a business where both of them contribute capital, either both of them or the client alone take part in the management of the business and later share the profits at a pre-agreed ratio. Where losses are incurred, they are as well going to share them as per their capital ratio (AbdulGhafar. 2010).

3. Murabaha: Adebayo (2011) opined that it involves identification of particular goods by a customer for the bank to secure for him; the bank will add the mark-up profit, deliver the goods and collect the payment from the customer in deferred

terms. murabaha financing is therefore based on a mark-up (or cost plus) principle, in which a bank is authorized to buy goods for a customer and resell them to the customer at a pre-determined price that includes the original cost plus a negotiated profit margin. This contract is typically used in working capital and trade financing. (Chong and Liu, 2008).

4. Ijarah: This involves leasing out an asset by the bank in exchange for rental, where at the expiration of the lease period, the leased asset is returned to the lessor (Adebayo, 2011). This mechanism is similar to the murabaha, except that the buyer actually leases the asset with an option to buy at the end of the lease period. Ijarah therefore mirrors lease financing, except that the buyer is not charged penalties for late payments, and the lessor bears the risk associated with the asset as it is the owner (unless the lessee is guilty of malice or negligence). Novethic (2009) opined that the murabaha and ijara mechanisms can be used as a substitute for a property loan, but the transfer of ownership is gradual in the case of murabaha, and occurs at the end of the contract in the case of ijara. Shariah (Islamic law) permits rental charges on property services, on the precondition that the lessor (bank) retain the risk of asset ownership.

5. Takaful: This term refers to a group of people who insure each other. Takaful companies operate similarly to mutual insurance companies as risk is pooled and any losses shared by all the insured parties. The members of a takaful insurance company are both insurers and insured. They own the funds, while the company acts as manager and receives compensation in the form of fees. The investments made with these funds must of course be Shariah-compliant (Novethic, 2009).

6. Sukuk: The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) defines “sukuk” as certificates of equal value representing undivided shares related to the ownership (and not debt) of tangible assets, usufruct and services or to the ownership of the assets of particular projects or a special investment activity, extending even to contractual rights, which are held in trust for sukuk-holders (IIFM, 2011). To be Shariah-complaint, sukuk must be capable

of being owned and sold legally, in accordance with the rules of the Shariah (Filippo et al 2013). Similarly, Novethic (2009) opines that sukuk instrument is a Shariah-compliant investment certificate equivalent to a private or public bond.

7. Bay' Salam: This is structured based on a forward sale concept. This method allows an entrepreneur to sell some specified goods to a bank at a price determined and paid at the time of contract, with delivery of the goods in the future. (Chong and Liu, 2008). Adebayo (2011) further stated that this contract encourages a bank to enter into agreement with a farmer for the advance purchase of products and payment is made prior to the delivery of such commodity.

8. Istisna: This contracts are similar to the bay' salam contract, but involving a different objects (industrial goods that have not yet been completed). They are based on the concept of commissioned or contract manufacturing, whereby a party undertakes to produce a specific good for future delivery at a pre-determined price. It can be used in the financing of manufactured goods, construction and infrastructure projects (Chong and Liu, 2008).

MAJOR PRINCIPLES OF NON-INTEREST (ISLAMIC) BANKING

The major principles of non-interest banking according to the Central Bank of Nigeria guidelines are summed up as follows:

1. Any predetermined payment over and above the actual amount of principal is prohibited i.e. lender should not charge any interest or additional amount over the money lent.

2. The lender must share in the profits or losses arising out of the enterprise for which the money was lent. Furthermore, Islamic finance is based on the belief that the provider of capital and the user of capital should equally share the risk of business ventures, whether they are industries, farms, service companies or simple trade deals.

3. Making money from money is not Islamically acceptable.
4. Uncertainty, Risk or Speculation is also prohibited on any transaction entered into. Contracting parties should have perfect knowledge of the counter values intended to be exchanged as a result of their transactions.
5. Investments should only support practices or products that are not forbidden e.g. trade in alcohol, construction of casino, lending money to other banks at interest.
6. The policy does not prevent non-Muslims from participating.

ISLAM, ISLAMIC BANKING AND SUSTAINABLE DEVELOPMENT

Islam means the religion of peace and harmony, therefore Islamic way of life entails peace and harmony. An active promotion of the harmonization of individual social and ecological interest would ensure sustainable development. Islam is a complete code of life that converses every sphere of human life. It is a religion that has a theoretical framework that guides its followers to observe and adopt as a system of life. In Islam, man acts as a steward on earth with the role of protecting natural resources. This concept is consistent with sustainable development as defined in the Brundtland report of the 1987 UN Commission on Environment and Development, chaired by Norwegian Prime Minister Gro Harlem Brundtland, which coined the term sustainable development, referring to “progress that meets the needs of the present without compromising the ability of future generations to meet their own needs.” Sustainability means not only the survival of the human species but also maintaining the productivity of natural, produced, and human assets from generation to generation. The purpose of Islamic banking and finance is to improve living conditions and social well-being is in full harmony with sustainability issues.

The Islam economic system which owns its framework paradigm, value system and foundational axioms on doctrines such as oneness (tawhid), justice and charity (adl wal-ihsan), self development (tazkiyah) responsibility (fardh) etc have a guideline for attaining sustainable development economically. Al-Jayyousi (2010)

opined that the combination of Wisdom (hikma), Justice (adl), Public interest (maslaha), Innovation (ijtihad), yields a set of notions that inform sustainability in Islam. Islamic economics is built upon knowledge coming from the basic sources of the religion of Islam which are Quran, plus the accumulated knowledge of Islamic jurisprudence generated by consensus (ijma) analogy (qiyas) and independent interpretation (ijtihad) (Hassan, 2005; Hassan 2006). According to Ahmed (2002) Islamic economics is the science that studies the best possible use of available economic resources endowed by Allah, for the production of maximum possible output of Halal goods and services that are needed for community now and in future and the just distribution of this output within the framework of shariah and its intent.

Ever since the advent of Islam, the ingenuous significance of the economy has been emphasized by the Holy Prophet (P.B.U.H) whose first profession was trade and commerce. In order to ensure sustainable economic development that ensures intergenerational equity, Islam has put in place certain mechanisms such as Zakat and Sadaqat, Waqf (charitable endowment and Prohibition of Riba (Interest) which forms the unique feature of Islamic banking (Ansari, Jamal and Oseni, 2012). Islam operates on the principle of Al-takaful which means meeting the needs of all and ensuring equity. Thus, unjust enrichment through interests is prohibited in Islam. The reason for the prohibition of riba is the resultant harmful effect it has on the economy, social life and the psychological well being of the society. For a sustainable economic development to be achieved, all forms of unjust enrichment must be proscribed to allow for equal opportunities to all. This is why Islam encourages Mudaraba (which is partnership in Labor and Capital) and Musharaka (which is partnership in capital and sharing profits). This, as a matter of fact has led to the advent of Islamic banking system.

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CONCLUSION AND RECOMMENDATION

The fact that the Central Bank of Nigeria recognizes the viability of non-interest banking is a demonstration of it as an alternative system to the conventional interest based system which has failed to rescue the world from its present economic mess. This Islamic principle of profit and loss sharing fosters the spirit of unity, cooperation and brotherhood among those concerned. It is in essence the cornerstone of Islamic banking and finance for the fact that it has its root in the Islamic tradition which promotes equity fairness and justice. However, Sustainable development concept emphasizes on the ability to meet the needs of the present generation without compromising the ability of the next generation to meet their own needs is emphasized in Islam and this as a matter of fact forms the bedrock Islamic banking and finance.

It is pertinent to note that, business organizations and likewise countries around the world are struggling with a new role which is to meet the needs of the present generation without compromising the ability of the next generation to meet their own needs (sustainable development). The important role that Islamic banking and finance practices will play in this regard can therefore not be over emphasized. It is therefore recommended that the numerous advantages accrued to Islamic banking and finance practices which constitute an integral part of the

financial development strategy should be encouraged and mainstreamed to meet need for sustainable development which the 21st century demands. The current financial crisis and the resulting call for a more stable and secure financial system during the 3 wave of COVID 19 pandemic have renewed an interest in Islamic finance.

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