PROSIDING PERKEM V, JILID 1 (2010) 173 – 184
ISSN: 2231-962X

TRACKING THE PRE-AND POST COLONIAL BANKING: THE QUEST FOR ISLAMIC BANKING

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ABSTRACT

The aim of this paper is to survey the evolution of banking system from earlier records until now and establish the roles of money in Islamic banking system and objective of the establishment of Islamic banking system and its deviation deviate from the conventional view. The findings show that: first, banking history during ancient times confirms the word bank, meaning the money rather than the institution which put it in circulation. Second, during the middle ages, bank can transfer money over long distances without the risk and inconvenience of carrying coins. Third, during modern times, bank is primarily known as a dealer in credit which charges interest. Also during this time, banks are regulated by the government on a national level and are monitored by a variety of groups to ensure that their practices are just. Fourth, the presence of British in inferior nations also brings together the conventional banking system where money could not be separated from interest. Lastly, the quest for Islamic banking system give a positive approach to the creation of wealth via money without interest, recognize private property, and emphasize the fulfilment of contracts and fair dealings.

JEL classification: Riba; interest; school of thought; Islamic banking.
Keywords: B20; E22; E31; E40.

INTRODUCTION

Normally, the history of banking can best be viewed as a series of changes in business practices, technology, and regulations, for these factors determine the overall structure of banking and banking services. It can be seen before the 16th century, banking consisted mostly of holding deposits or valuables, and making loans. In Greece and Rome, religious temples served as banks, because they often had treasuries and held valuable items for its members. They could also make loans to people that they knew which solved the problem of the informational asymmetry between lenders and borrowers. However, it is the evolution of banks and banking beginning in the 16th century that best illuminates how banks work today.

Colonialism that came out in the late Eighteenth Century was considered as the preferred system for the exploitation of lesser developed nations. By 1914, European nations dominated almost 85 percent of the world in some form of colony, dependency, or control. As colonialism developed it became an established governing process by which governments, especially economically developed ones in Europe, systematically controlled and exploited lesser developed nations.

Colonialist nations believed they had good reasons to promote and develop this system. Among the reasons are: they believe that the profits could be made in forced trade and natural resource exploitation; the ruling nation was assumed to be inherently superior, therefore, they were supposed to help the people of the colony toward civilization, and it was undertaken in the cause of religion and enlightenment. In addition, the conventional tenet of white colonizers held that there was an obligation to "rule subordinate, inferior, and less advanced peoples". The Europeans also viewed their cultures, government, administrative and educational systems as superior, they deemed it worthwhile to transplant

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these institutions to their colonies and to supplant whatever institutions had existed in the pre-colonial region.

Therefore, colonialism has greatly influenced business law and inter-governmental relations over the past two hundred years. As the results, business law was forced to be adopted by the inferior. Event after the post colonialism, the banking system of colonialism (or known as conventional banking system which is based on common law) remains as before.[3] After the post colonialism, the banking system of colonialism remains as before. Interest rates could not be separated from the banking system. For instance, one of the reasons interest holds its place in banking system is because earlier economists believed that every bank has to charge interest for its services or it would not stay in business. In contrast, Islamic economists suggest banking system without interest. Considerable research and historical analysis has also sought to explain why many nations (formerly was the inferior nations) introduced, justified and defended the Islamic banking system.[4] In this paper, we will argue that the Islamic banking system is exclusively established on the different law origin which suggest that money without interest can work and the objective of this law could be attained. Furthermore, how could these suggestions deviate from the conventional view especially the view forwarded by earlier British economists, for example Keynesian and Cambridge Schools?

Therefore, the aim of this paper is to do the survey on the evolution of banking system from earlier records until now and then try to establish on how do the roles of money in Islamic banking system and the objective of Islamic law in introducing the banking system deviate from the conventional view. The remaining discussion of this paper will be divided into four sections. Section 2 will track the pre- and post colonial banking towards achieving its full economic potential for Islamic banking to become a significant feature of the financial landscape in the twenty first century. The influence of British banking system on Malaysia banking system will be touched in section 3. In section 4, we will show that the Islamic banking system itself is derived from the different philosophy and law origin. Then, what is the different impact of law origin on the banking system. Conclusion is presented in section 5.

BANKING ORIGIN

The initial studies do not agree as to the origin of the term "bank."[5] Some trace it to the "banc" or bench where the early money changers kept their coins and plied their trade. Others claim that it is derived from "banck," the German name for a joint stock fund, which was converted by the Italians into "banco," meaning a heap or accumulation of money or stock.[6] While, in the United States, the issue of paper money was referred to as "raising a Banke,", therefore the word bank meaning the money rather than the institution which put it in circulation.[7] However, in modern time, bank is primarily known as a dealer in credit.

Therefore, the discussion in this section will focus on the evolutionary process that has taken place and how it will chart the future of banking system and especially the relationship between the pre- and post colonial banking system.

The Ancient World

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[3] Nowadays banking has become extremely sophisticated but the hidden and usurious mechanism behind it remains the same. By searching on the clauses drafted in the Central Bank Act of Malaysia 2009 and Banking and Financial Institutions Act 1989, we could say that those acts are not drafted based on shariah principles. Also refer to La Porta, R., R., Lopez-de-Silanes, F., Shleifer, A., and R.W.Vishny (1996) Law and Finance. *NBER Working Paper 566*1.

[4] Find out in, for example, Abdus Samad, Norman D. Gardner, and Bradley J. Cook (2005) Islamic Banking and Finance in Theory and Practice: The Experience of Malaysia and Bahrain. *The American Journal of Islamic Social Sciences* 22, no. 2, pp. 69-86 and Ismail, A.G. and Tohirin, A. (2009) Finance and Growth: The Role of Islamic Contracts," MPRA Paper 13744, University Library of Munich, Germany.

5 See Holdsworth (1914). Other sources, such as http://en.wikipedia.org/wiki/History_of_banking#cite_note-0 and argue that the first banks were probably the religious temples of the ancient world, and were probably established in the third millennium B.C.

6 See Davies, G.A. (2002) A history of money from ancient times to the present day, 3rd ed. Cardiff: University of Wales Press. http://projects.exeter.ac.uk/RDavies/arian/origins.html

7 Read further in Brough, W. (1896) The Natural Law of Money: The Successive Steps in the Growth of Money traced from the Days of Barter to the Introduction of the Modern Clearing House and Monetary Principles examined in their Relation to Past and Present Legislation. New York: G.P. Putnam's Sons. Or http://ww.libertyfund.org/?option=com_staticxt&staticfile=show.php%3Ftitle=1164&chapter=35922&layout=html&Itemid=27

The Athenian and Roman bankers began to receive deposits of money (for example, the clients save their coins from the danger of losses on their journey), to make loans, and even to transfer money and credits (for example a moneylender in one city would write a credit note for the client who could "cash" the credit note in another city) as early as in the third millennium B.C.[8] During the ancient Greece,[9] Greek temples,[10] private and civic entities played an important role in conducting financial transactions such as loans, deposits, currency exchange, and validation of coinage.[11]

In the late third century B.C., a banking centre was established in the Island of Delos. This centre made an innovation where cash transactions were replaced by real credit receipts and payments were made based on simple instructions with accounts kept for each client. During the Roman era, the importance of Delos increased. Consequently, it was natural that the bank of Delos became the model most closely imitated by the banks of Rome.

Then, in the fourth century B.C., the regulations governing credit were introduced. The regulations were in the form of judicial proceedings for interest on loans, bankers, usurers, and also the renewal of commercial paper. The regulations were introduced due to an increased use of credit-based banking in the Mediterranean world. This development was catalysed further in the early years of Egypt, where grain were used as a form of money in addition to precious metals, and state granaries functioned as banks.[12] However, when Egypt fell under the rule of a Greek dynasty, the numerous scattered government granaries were transformed into a network of grain banks, centralized in Alexandria where the main accounts from all the state granary banks were recorded. This banking network functioned as a trade credit system in which payments were affected by transfer from one account to another without money passing.

The effort to refine further the banking system was done during the ancient Rome. During this ancient time, the administrative aspect of banking was improved further and at the same time, witnessed greater regulation of financial institutions and financial practices. For example, the regulations on charging interest on loans and paying interest on deposits became more highly developed and competitive. However, the development of Roman banks was limited due to the Roman preference towards cash transactions. In addition, during the reign of the Roman emperor Gallienus (260-268 AD), there was a temporary breakdown of the Roman banking system after the banks rejected the flakes of copper produced by his mints. With the rise of Christianity, banking became subject to additional restrictions, as the charging of interest was seen as immoral.[13] The Torah and later sections of the Hebrew Bible also criticized interest-taking.[14] One common understanding is that Jews are forbidden to charge interest upon loans made to other Jews, but allowed to charge interest on transactions with non-Jews.

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8 See William Smith (1875) A Dictionary of Greek and Roman Antiquities. John Murray, London, 1875. Under the title of Argentarii, see further in http://penelope.uchicago.edu/Thayer/E/Roman/Texts/secondary/SMIGRA/home.html

9 Although, Heidemann (1998) noted that traces of credit by compensation and by transfer orders were found initially in Assyria, Phoenicia, and Egypt before the system attained full development in Greece and Rome, see Stefan Heidemann (1998) The Merger of Two Currency Zones in Early Islam. The Byzantine and Sasanian Impact on the Circulation in Former Byzantine Syria and Northern Mesopotamia. *Iran*, Vol. 36, (1998), pp. 95-112, see http://www.jstor.org/stable/4299978 and

10 Greek temples were meant to serve as homes for the individual god or goddess who protected and sustained the community, refer to http://www.odysseyadventures.ca/articles/greektemple/greek_temple.htm

11 See, Edward Cohen (1992) *Athenian Economy and Society: A Banking Perspective.* Princeton, NJ: Princeton University Press

12 Refer to http://en.wikipedia.org/wiki/History_of_banking. During this period also, Prophet Yusuf (AS) also advised the farmers to keep food grain on the tree. As reported in the verses 43-44, Surah Yusuf, Allah says: The king dreamt that seven lean cows were eating seven fat ones and that there were seven green ears of corn and seven dry ones. He asked the nobles to tell him the meaning of his dream if they were able to. They replied, ***"It is a confused dream and we do not know the meaning of such dreams."***. Prophet Yusuf (AS) interpreted the dream by the power given to him by Allah. He said, "For seven years the crops will yield abundant food-grain for the people of Egypt . After that there will be a famine for seven years during which all the food-grain lying in the storehouses will be finished and people will starve. Therefore, the people should try to grow as much extra grain as possible so that it would stand them in good stead during the time of famine".

13 Young, Frances: Christian Attitudes to Finance in the First Four Centuries, Epworth Review 4.3, Peterborough, September 1977. Refer to http://www.earlychurch.org.uk/pdf/er/finance_young.pdf.

14 Refer to the translations of the Jewish Publication Society of America (JPS) that have become the most popular English translations of the Hebrew Bible. It is based on the electronic text (c) by Larry Nelson, which can be contracted via nelsonlarry@juno.com)

Then, the Roman Empire split into an eastern and western empire governed by separate emperors caused Rome to fall at the end of A.D.476. While the eastern half became the Byzantine Empire, with its capital at Constantinople (modern Istanbul). The western half remained centered in Italy. Many say the Fall of Rome was due to many reasons. [15] The rise of Islam is proposed as one of the reason for Rome's fall, by some who think the Fall of Rome happened at Constantinople in A.D. 1453.[16] Consequently, the banking system was abandoned in Western Europe and did not revive until the time of the crusades.

Middle Ages

The six centuries following the downfall of the Roman Empire are for Europe a period of intellectual stagnation. However, beginning around 1100s, the need to transfer large sums of money to finance the crusades stimulated the re-emergence of banking in Western Europe. In 1156, in Genoa, occurred the earliest known foreign exchange contract. Two brothers borrowed 115 Genoese pounds and agreed to reimburse the bank's agents in Constantinople the sum of 460 bezants one month after their arrival in that city.[17] Other financial activities, where incomes, castles, and colonies were mortgaged for fraction of their real value; and sea-loan also happened.[18]

In the following century the use of such contracts grew rapidly, particularly since profits from time differences were seen as not infringing canon laws against usury.[19] In 1162, King Henry the II levied a tax to support the crusades -- the first of a series of taxes levied by Henry over the years with the same objective.[20] The Templars and Hospitallers acted as Henry's bankers (i.e. by providing the wide scope of financial services for the Popes) in the Holy land. These services ranged from tax gathering, money transferring, foreign exchange and money lending. In addition, the Templars' wide flung, large land holdings across Europe also emerged during the period of 1100-1300. This provides the impetus to the beginning of Europe-wide banking, as their practice was to take in local currency, for which a demand note would be given that would be good at any of their castles across Europe, allowing movement of money without the usual risk of robbery while travelling.[21]

As reported in Brutzkus (1943), during the period of 800-1200 there was a large and growing volume of long-distance and international trade in a number of agricultural commodities and manufactured goods in western Europe; some of the goods traded during that period included wool, finished cloth, wine, salt, wax and tallow, leather and leather goods, and weapons and armour.[22] Individual trading concerns and combines often specialized in one or more of these, as did individual producers; because a large amount of capital was required to establish, e.g., a cloth manufacturing business, only the largest firms could diversify. As a result, the following events occur.

The trade trend grew continuously during the Renaissance period (1400-1600). The European economy grew dramatically, particularly in the area of trade. In the 1300s and 1400s Italy dominated European trade and manufacturing. Merchants in Florence, Milan, and Venice developed large business organizations to carry on their activities across Europe. They manufactured, sold, or traded a wide variety of products. They also provided banking services for governments and other merchants in many areas of Europe.

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[15] The English historian Edward Gibbon (May 8, 1737, to Jan. 16, 1794), is best known for his *The History of the Decline and Fall of the Roman Empire*, which tells about the decline and fall of Rome from the second century A.D. to the 15th century fall of Constantinople. See further in http://ancienthistory.about.com/od/modernauthors/g/EdwardGibbon.htm

[16] While, eastern Europe became the Byzantine Empire, with its capital at Constantinople (modern Istanbul). The western half remained centered in Italy.

[17] In his article, Eugene, H. Byrne (1920) Genoese Trade with Syria in the Twelfth Century. The American Historical Review, Vol. 25, no. 2 Jan., 191-219 mention that Genoese did an extensive trade with Syria.

[18] See footnote 14.By A.D 1160, chiefly bankers of Piancenza were able to redeem those mortgages assets.

[19] Refer to Vermeersch, Arthur. "Usury." The Catholic Encyclopedia. Vol. 15. New York: Robert Appleton Company, 1912

[20] See, Kenneth M. Setton, Robert Lee Wolff (2005) A History of the Crusades, Volume II: The Later Crusades, 1189-1311. Wisconsin: University of Wisconsin Press.

[21] Ferris, Eleanor (1902) The Financial Relations of the Knights Templar to the English Crown. *The American Historical Review*, Vol. 8, no. 1, 1-17 see in http://www.jstor.org/pss/1832571 He also wrote that the soldiers of the temple also expert in accounting, judicial administration, and pioneers in development of credit and its instruments which was destined to revolutionize the methods of commerce and finance.

[22] See Brutzkus, J. (1943) Trade with Eastern Europe, 800-1200. Economic History Society, Vol. 13, No. ½ , pp. 31-41.

Some cities specialized in particular areas of trade and manufacturing. For example, Florence was known for the production of woolen cloth and silk. Milan produced metal goods, such as armor. Venice dominated Mediterranean trade. Venetian merchants bought spices and other goods from Arab and Ottoman traders in eastern Mediterranean ports and shipped the goods to buyers in Italy and northern Europe.

In the early 1500s mining became an important economic activity in southern Germany. The silver, copper, tin, and iron produced by the mines were used to make various metal items, including silver coins. Funding from merchants and bankers in the cities of Nürnberg and Augsburg helped mine operators introduce new techniques and increase productivity. However, after 1550 the flow of silver from Spanish mines in the New World made silver mining in Germany unprofitable.

Overseas exploration contributed to the rapid development of Spanish and Portuguese trade in the 1500s. Spain brought silver from the Americas, and Portugal imported slaves, sugar, and other goods from Africa.[23] The Portuguese also began to trade with Asia, breaking the Venetian monopoly on goods such as spices, which were highly prized in Europe. However, Spain and Portugal did not profit as much as they should have from their overseas trade. They both borrowed heavily from banks in Italy and Germany to finance their voyages. Moreover, the two countries shipped much of the silver, spices, and other overseas goods to northern Europe. Merchants in northern ports such as Antwerp profited as much as or more than the Spanish and Portuguese from the overseas trade.

After the 1550s the centre of Europe’s manufacturing, trade, and banking moved from Italy and the Mediterranean to northern Europe, especially the Netherlands and England. Amsterdam and London became major centres of commerce, in part because of the increased importance of transatlantic trade routes. Italy remained a leader in the production of luxury goods such as works of art and fine silk cloth, but the balance had shifted.

Much of the increase in commercial activity during the Renaissance occurred in the area of international trade. This led the banking industry to expand to provide financial services that made it easier for merchants to conduct business far from home. During the Renaissance merchants also made use of their knowledge of international markets and trade goods to expand their operations. Some of these merchants became important bankers. They began making loans, transferring funds to different locations, and exchanging various forms of money. As the need for financial services increased, banks emerged as important institutions. Two of Europe's most prominent banks were run by the Medici of Florence and the Fugger Family of Augsburg in Germany.

Banks lent entrepreneurs the money to buy materials and equipment, to hire workers, and to pay for transporting goods. Without these funds, few people would have been able to develop large-scale trading enterprises. Banks also simplified the handling of money by introducing bills of exchange, notes that allowed merchants to borrow or deposit money in one city, then repay or withdraw money in another city. Merchants could then transfer money over long distances without the risk and inconvenience of carrying coins.

Modern Banking History

From the above discussion, we can trace modern-day banking to practices in the Medieval Italian cities of Florence, Venice and Genoa. The Italian bankers made loans to princes, to finance wars and their lavish lifestyles, and to merchants engaged in international trade. In fact, these early banks tended to be set up by trading families as a part of their more general business activities. The Bardi and Peruzzi families were dominant in Florence in the 14th century and established branches in other parts of Europe to facilitate their trading activities. Both these banks extended substantial loans to Edward III of England to finance the 100 years war against France. But Edward defaulted, and the banks failed.

Perhaps the most famous of the medieval Italian banks was the Medici bank, set up by Giovanni Medici in 1397. The Medici had a long history as money changers, but it was Giovanni who moved the

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[23] In 1401, the Bank of Barcelona was founded. In 1407, the Bank of Saint George was founded in Genoa. This bank dominated business in the Mediterranean. In 1403 charging interest on loans was ruled legal in Florence despite the traditional Christian prohibition of usury. Italian banks such as the Lombards, who had agents in the main economic centres of Europe, had been making charges for loans. The lawyer and theologian Lorenzo di Antonio Ridolfi won a case which legalised interest payments by the Florentine government. In 1413, Giovanni di Bicci de’Medici appointed banker to the pope. In 1440, Gutenberg invents the modern printing press although Europe already knew of the use of paper money in China. The printing press design was subsequently modified, by Leonardo da Vinci among others, for use in minting coins nearly two centuries before printed banknotes were produced in the West.

business from a green-covered table in the market place into the hall of a palace he had built for himself. He expanded the scope of the business and established branches of the bank as far north as London. While the Medici bank extended the usual loans to merchants and royals, it also enjoyed the distinction of being the main banker for the Pope. Papal business earned higher profits for the bank than any of its other activities and was the main driving force behind the establishment of branches in other Italian cities and across Europe.

Much of the international business of the medieval banks was carried out through the use of bills of exchange. At the simplest level, this involved a creditor providing local currency to the debtor in return for a bill stating that a certain amount of another currency was payable at a future date often at the next big international fair. Because of the prohibition on directly charging interest, the connection between banking and trade was essential. The bankers would take deposits in one city, make a loan to someone transporting goods to another city, and then take repayment at the destination. The repayment was usually in a different currency, so it could easily incorporate what is essentially an interest payment, circumventing the church prohibitions. An example shows how it worked. A Florentine bank would lend 1000 florins in Florence requiring repayment of 40,000 pence in three months in the bank's London office. In London, the bank would then loan out the 40,000 pence to be repaid in Florence at a rate of 36 pence per florin in three months. In six months, the bank makes 11.1 percent, i.e., an annual rate of 23.4 percent. It is also interesting to note that a double-entry bookkeeping system was used by these medieval bankers and that payments could be executed purely by book transfer.

During the 17th and 18th centuries the Dutch and British improved upon Italian banking techniques. A key development often credited to the London goldsmiths around this time was the adoption of fractional reserve banking. By the middle of the 17th century, the civil war had resulted in the demise of the goldsmiths' traditional business of making objects of gold and silver. Forced to find a way to make a living, and have the means to safely store precious metal, they turned to accepting deposits of precious metals for safekeeping. The goldsmith would then issue a receipt for the deposit. At first, these receipts circulated as form of money. But eventually, the goldsmiths realized that, since not all of the depositors would demand their gold and silver simultaneously, they could issue more receipts than they had metal in their vault. In 1696, The Bank of England - the first ever bank to be established in England, was basically initiated on philosophies which focus on its main objective which is to assist the government of its economic ventures. However, in America, the first individuals who ventured into the banking industry were the private entities. The issuance of treasury money was then ordered by the Continental Congress. But due to the existence of war during those years, the value of the continental currency has constantly gone to the deep level of fiscal crisis.

Banks also became an integral part of the US economy from the beginning of the Republic.[24] Five years after the Declaration of Independence, the first chartered bank was established in Philadelphia in 1781, and by 1794, there were seventeen more. At first, bank charters could only be obtained through an act of legislation. But, in 1838, New York adopted the Free Banking Act, which allowed anyone to engage in banking business as long as they met certain legal specifications. As free banking quickly spread to other states, problems associated with the system soon became apparent. For example, banks incorporated under these state laws had the right to issue their own bank notes. This led to a multiplicity of notes, many of which proved to be worthless in the (all too common) event of a bank failure.

With the civil war came legislation that provided for a federally chartered system of banks. This legislation allowed national banks to issue notes and placed a tax on state issued bank notes. These national bank notes came with a federal guarantee, which protected the note-holder if the bank failed. This new legislation also brought all banks under federal supervision. In essence, it laid the foundations of the present-day monetary system.

BRITISH INFLUENCE

During the 16th-18th centuries, the world political economy were influenced by the following patterns: (a) The Dutch Commercial Empire: apogee, and hegemony, and decline during the period of 1520-1760 that also covers the following steps: the Baltic Heartland; the overseas expansion: Asia and the spice trades, the Caribbean and North America; and the aspects of the decline of the Dutch Commercial Empire, 1720-1780; (b) Dutch shipping and shipbuilding: the sources and consequences of commercial supremacy; (c) English

[24] Refer to Klebaner, B. J. (1974) C*ommercial Banking in the United States: A History.* Illinois: Dryden Press.

foreign commerce: the cloth trade, the breakaway from the antwerp market, and the new overseas trading companies, 1520-1600; and (d) the English overseas commercial empire: the 17th century that include the East India company and the Asian trades, the Caribbean and North America; (e) English commerce and the 'general crisis' of the 17th-century, 1620 - 1750: crisis, depression, and the colonial re-export trades ('the new colonialism'); (f) the Mediterranean world: Italy, Turkey, England, and France; and (g) mercantilism and the state in foreign trade: England and France. These changing patterns of regional and international trade in early-modern Europe have created the age of overseas expansion (later known as globalization) and colonization.

Colonialism that came out in the late Eighteenth Century was considered as the preferred system for the exploitation of lesser developed regions.[25] By 1914, European nations dominated almost 85 percent of the world in some form of colony, protectorate, or dominion. [26] As colonialism developed it became an established governing process by which governments, especially economically developed ones in Europe, systematically controlled and exploited lesser-developed areas.

Colonialist nations believed they had good reasons to promote and develop this system. Among the reasons are: they believe that the profits could be made in forced trade and natural resource exploitation; the ruling nation was assumed to be inherently superior, therefore, they were supposed to help the people of the colony toward civilization, and it was undertaken in the cause of religion and enlightenment. In addition, the conventional tenet of white colonizers held that there was an obligation to "rule subordinate, inferior, and less advanced peoples." The Europeans also viewed their cultures, government, administrative and educational systems as superior, they deemed it worthwhile to transplant these institutions to their colonies and to supplant whatever institutions had existed in the pre-colonial region.

This was especially true in Malaysia. British also introduced the modern banking system by establishing the first commercial banking in Malaysia, known as Standard and Chartered (in 1881). One of the main regret of British officials were the unwillingness of the Malays to keep money in banks.[27] The British had invited the Chinese and Indian to work in Malaysia. Then, Chinese traders become money lender and Indian offered money as chertier. These developments also attracted Chinese and many poor Indian. Both were dominant in money-lending activities.[28] In late 15th and early 16th centuries, Indians decided to stay permanently and married local women and formed their families which later were called the "Chettis." On the other hand, single Indian men and those coming here with their families with the intention of returning to India once they made enough money, were referred to as the "Chettiars." Majority of the Chettiars were excellent in credit businesses and they set up their legalised credit companies in Melaka, especially during the colonial times.[29] These activities were later legalised under the Money Lending Act (1952). Although up to now, there are still illegally in operation.Then, the Chinese merchant also

[25] Refer to U. O. Umozirike, International Law and Colonialism in Africa 7-8 (1979). Most of the Muslim countries under Ottoman Empire was sub-divided into several countries under the theme "rules and divide".

[26] Britain had authority over Australia, Ceylon, Hong Kong, Malaya, New Guinea, New Zealand, all of the Asian Subcontinent (known today as India, Pakistan, and Bangladesh), all of East Africa from Egypt to Palestine to the Sudan, most of the Middle East, a large part of Central West Africa, Guiana, some Caribbean islands, Ireland, Canada, and a few scattered Pacific islands. France's colonial holdings consisted of islands in the Pacific and Indian Oceans, as well as the Caribbean, Madagascar, New Caledonia, Tahiti, Guadeloupe, all of Indochina, the Western half of the African continent from the Mediterranean to the Equator and French Somaliland, and Syria and Lebanon in the Middle East. Belgium held Burundi, Rwanda and the Congo. The Netherlands held most of the islands known today as Indonesia and the Molluccas and Suriname as well as scattered settlements in what is modern day Angola. Spain controlled areas in South and Central America, and Germany held colonial possessions until the Treaty of Versailles after World War I ended Germany's ability to control these colonies. Germany's former holdings of Rwanda and Burundi were then shifted to Belgian control.

[27] See, British Colonialism and the Marginalization of the Malays in Penang (2002) by Ariffin Omar. Paper presented at the Penang Story – International Conference 2002, Penang. This paper can also be downloaded from http://www.penangstory.net.my/docs/Abs-AriffinOmar.doc (12 march 2010)

[28] See, The Far East and Australasia, 2003 by Europa Publications Staff (2002), 34th Edition. London: Routledge.

[29] See, chettiars of Melaka. http://www.malaccahigh.net/drupal/malacca/?q=node/138, downloaded on 12 March 2010. Now becomes a dying date due the amended version of the Moneylenders Act of 2003, see http://thestar.com.my/lifestyle/story.asp?file=/2009/7/18/lifefocus/4326140&sec=lifefocus (down loaded on 12 March 2010)

introduced the pawnshop activities. Then, later ar-rahn was introduced in 1993 to compete with pawnshop.[30]

Since the British colonialism had ruled Malaysia from 1786-1956.[31] Because of the organization and strength of many of these supplanted governmental institutions. Colonialism had a profound impact on indigenous Malaysian cultures and institutions.

THE QUEST FOR ISLAMIC BANKING

After the post colonialism, the banking system of colonialism remains as before. Interest rates could not be separated from the banking system. For instance, one of the reasons interest holds its place in banking system is because earlier economists believed that every bank has to charge interest for its services or it would not stay in business. In contrast, Islamic economists suggest banking system without interest. The establishment of this system is aimed to achieve the objective of shariah. How could these suggestions and roles deviate from the conventional view especially the view forwarded by earlier British economists, for example Keynesian and Cambridge Schools?

Money without Interest Rate

Keynes repeated this preposterous fallacy in the *Paper of the British Experts*, 8 April 1943, in which he asserted that "Credit expansion (which, later, can create money) performs the miracle . . . of turning stone into bread".[32] From here, he further discussed on the dire economic consequences of central banks manipulating interest rates. For a period of time, the central bank implemented monetary policy by controlling the monetary aggregates (the quantity of money). However, developments in the financial services industry, changes in the relationship between the money supply and the economy, as well as changes in views on monetary policy, eventually led to the central bank reverting back to implementing monetary policy through changes in interest rates (the price of money).[33]

From the above discussion, it shows that money and interest rates are inter-related. This relationship becomes the basic principle of conventional banking system which is based on money with interest. In Islamic banking system, money to be channelled is without interest. The sources of this prohibition can be seen from two main sources: Al-Quran and Al-Hadith. Riba has been condemned many times in the holy book, Al Quran. Verses related to riba can be found, for example in surah Al-Baqarah 275[34] and surah al-Rum[35]. In Al-Hadith, the prophet Muhammad's (Peace Be upon Him, pbuh) saying also guided us on the prohibition of riba.[36] As he (pbuh) mentioned and preached Riba is the most worst thing.

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[30] See, Wan Abd Rahman Khudzri (no. date) Historical development of Pawning Practices in Malaysia: from Pajak Gadai to Al-Rahn, Jurnal Pembangunan Sosial, pp. 66-80.

[31] Although in between, Japanese invasion during World War II (1942-1945) ended British domination in Malaysia. But, after the war, British invaded again until Malaysia became an independence nation in 1957.

[32] Requoted in Haines, W.W. (1943) Keynes, White, and History. *The Quarterly Journal of Economics*, Vol. 58, No. 1 (Nov), pp. 120-133

33 For further discussion, see Ismail, A.G. (2010) Tools for Controlling Monetary Variables in The Islamic Banking System. ISRA Research paper no. 13.

[34] Allah said (in Surah Al Baqarah verse 275) that "Those who devour Riba will not stand (especially for judgement before Allah) except as stands one whom Satan by his touch has driven to madness. That is because they argue : " Business and Riba similar to each other ."But Allah has made "business" Halal and He is made 'Riba' Haram. Those who after receiving this warning (concerning the Haram of Riba) from their Lord ,(now) desist (from Riba) , may keep whatever they had previously earned (as Riba) ; and their case (will now be judged by) Allah (alone ,i.e. the Islamic State will not deal with that matter); but those who return (to Riba even after this revelation of the Quran) are companion of fire (of Hell) ; they abide therein (forever)."

[35] Allah said (in Surah Al Rum verse 39) that "And whatever Riba you give so that it may increase in the wealth of the people, it does not increase with Allah."

[36] Among the hadith are: (i) " Umar Ibn Khattab said : The last verse to be revealed was on Riba , but Allah's Messenger was taken without having expounded it to us ; so give up not only Riba but also Reebah (i.e., whatever raises doughts in the mind about its rightfulness)." (Sunan Ibn Majah, Darimi); (ii) " The Messenger of Allah Prophet Muhammed (Peace Be upon Him) cursed the one who takes (i.e.,Consumes) Riba, the one who gives (i.e., Pays) Riba the one who records the transaction , and the two witness thereof .He said : They are all equally guilty." (Sahih Muslim); (iii) "Abu Hurairah (Raliyallahu) said that the Messenger of Allah Prophet Muhammed (Peace Be upon

Therefore, both sources indicate how firmly the advice from these sources to avoid Riba base transactions. Which later become a rule of ahkam.

Most scholars (those of the Hanafi, Shafi'i, Hambali and the Maliki schools) also reject and condemn riba. But, they come out with a different definition of riba, which is due to different interpretation.[37] These jurists insisted that the pre-Islamic riba was riba al-nasi'ah, which is riba by means of deferment. They refer this to famous hadith about the exchange of six articles.[38] The Hanafis school, on the hand, argued that riba in the Qur'an is a general term, it would not be restricted only to the one that is referred to in the Qur'an, and it covers any increase in loans or sales that in fact was specified by the Tradition in the exchange of certain articles.

In the Malaysian context, the National Fatwa Committee endorsed the ruling on riba which is haram (or prohibited) [39] It shows that money to be channelled into or channelled to customer should not pay or receive interest. Here, the role of money differs from what is the current cotemporary economists proposed, i.e., money to create money via interest. Instead money is used as a medium of exchange where trading only happen between Islamic banks (as buyer or seller) and the customer (as seller or buyer), or as capital where Islamic banks provide the capital and then, customer use the capital for economic activities. Or Islamic banks together with customers create a partnership.

Here, the relationship between Islamic bank and customer create contract. The Islamic law becomes the sources of knowledge in creating contract.[40] This law origin may suggest for the further research on related topics to the Islamic law as origin of financial transaction. The research questions below need to be addressed. How does Islamic law provide legal right to the contracting parties? Or, in specific, does Islamic law provides both *mudharib* and *rabbul-maal* protection? Do the countries (that adopt Islamic law) have other substitute, mechanism of corporate governance? Because, the differences in legal protections of contracting parties might help explain why firms are financed and owned so differently in different countries. Why do firms practically have no excess to external finance? Why is the ownership of firms so widely dispersed (by contract)? The content of legal rules in different countries may shed light on these corporate governance puzzles.

Wealth Creation via Islamic Banking

Since the end of the nineteenth century significant progress towards the removal of very great disparities of wealth and income, as discussed in Chapter 24 of Keynes's The General Theory of Employment, Interest and Money, has been achieved through the instrument of direct taxation - income tax and surtax and death duties - especially in Great Britain. How would Islam differ from this view?

While in Islam, the objective of shariah (or maqasid al shari'ah) is aimed to make the distribution of economic resources, wealth and income fair and equitable. Islam discourages concentration of wealth in few hands and ensures its circulation among all the sections of society. It means that the wealth should not be allowed to concentrate in few rich hands; rather it should freely circulate among all the people thus enabling the poor and destitute among the nation to also take benefit from it.[41] Thus it is the utmost important that the role of Islamic bank in channelling money would create wealth and hence she could

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Him) said : Riba is of seventy different parts , the least dangerous being equivalent to a man marrying (i.e having sexual intercourse with) his own mother ." (Sunan Ibn Majah,Baihaqi)

[37] The differences among classical jurists on riba can be divided into two inter-related categories. The first category is about the methodological disagreements, especially on linguistic rules of interpretation and the analysis of the effective cause of the ban.

[38] Scanning trough all the Sunni and Shi`i classical texts would validate this assertion. In particular, see al-Sarakhsi, Kitab al-Mabsut, vol. 6, part 12, Burhan al-Din al-Marghinani, Al-Hidayah, vol. 2 (Cairo, n.d.), Khalil Ibn Ishaq, al-Mukhtasar, trans. N. Seignette (Paris, 1911), Ibn Rushd, al-Muqaddimat, vol. 2, Ibn Qudama, Le precis de droit, trans. H. Laoust (Beyrouth, 1950), Abou Muhammad `Abdallah Ibn Abi Zayd al-Qayrawani, Al-Risala, trans. L. Bercher (Alger, n.d.), al-Tusi, Tahdhib, vol. 3 , and Muhammad Shams al-Din Abu Abdallah `Amili, Lum`ah, trans. A.R. Faid and A. Muhadhdhab, vol.1 (Tehran, 1992).

[39] Collection of decisions at the "Muzakarah Jawatankuasa Fatwa Kebangsaan,Berhubung Dengan Isu-isu Muamalat" on June 10-11, 1993. Please refer to http://www2.islam.gov.my/muamalat/sites/default/files/keputusan_muzakarah/2010/05/3_Fatwa_Ketiga.pdf .

40 Before this only LaPorta (1996), op. cit. mention that law origin is crucial in relating law and finance. Refer also in Ismail, A.G. and A. Tohirin (2010) Islamic Law and Finance. *Humanomics* (forthcoming).

[41] Refer to surah Al-Hashr 59:7, Allah says: "That which Allah give that as spoil unto His messenger from the people of the townships, it is for Allah and His messenger and for the near of kin and the orphans and the needy and the way farer, that it become not a commodity between the rich among you."

bridge the gap between the rich and the poor by modifying the distribution of wealth and economic resources in favour of the less-fortunate.

In this section, the above issues are important to be addressed due to three reasons. First, it will address the wealth creation in Islamic banking system. Second, Islamic economic system ensures fair and equitable distribution of wealth through positive as well as negative measures.[42] Third, by abolishing interest rate, does it mean that Islamic banks are able to distribute the income more equitable?

Therefore, in this section, we will examine the wealth created by Islamic banks. How the money invested by customer (depositors), or money invested by banks or money (as capital) utilized by customers (or economic agents like individual, firm and government) can generate profit and then can be distributed to Islamic banks and depositors and hence would be able to preserve the wealth (mal) of economic agents.

As shown in Table 1, Islamic bank A could meet their primary financial objectives of strong value-added growth. This increased from RM17.6 billion in 2008 to RM20.2 billion in 2009. As a result, the distribution of wealth to employees, government and shareholders increased from RM7.6 billion, RM2.8 billion, and RM1.9 billion in 2008 to RM8.5 billion, RM2.9 billion and RM2.3 billion in 2008, respectively. At the same time, the retained earnings also increased from RM5.5 billion in 2007 to RM6.5 billion in 2009. The figures above show a significant contribution by Islamic bank A to the economy during the period of 2004-2009. On the average, the employees, government, shareholders (all are economic agents) and retentions received about 44.2%, 15.2%, 10.2% and 30.4%, respectively of the total wealth.

Further analysis will be done to test whether the wealth are equally distributed. Table 2 compares the Gini coefficient of several financial indicators (i.e., return on customers' deposit (RODc), return on Islamic banks' deposits (RODb) and return on equity (ROE) for six Islamic banks. In this paper, we use the corresponding extreme values of Gini coefficient, i.e., 0% and 100%. The former implies perfect equality (in other words, each Islamic bank has exactly the same amount of return) whereas the latter implies total inequality where one bank has all the return and another bank has nothing. The results show that the Gini coefficients fluctuate over the study period. In 2004, inter provincial inequality accounted for 68.0% of the RODb, but this coefficient increased to 70.9% in 2005, and then peaked at 85.0% in 2006 before slipped deeply to 55.7% in 2007 means the higher amount of RODb over 0%, the higher the inequality.

For RODc, in 2004, inter provincial inequality accounted for 42.1%. After, that the ratio declines and records at 20.8% in 2006. Then, the ratio almost reaches the perfect inequality in 2008. While, the figure for ROE, as shown in row two, shows a clear disparity among Islamic banks.

CONCLUSIONS

In recent years monetary theorists have produced a substantial history on the banking system. The aim of this paper is to survey on the evolution of banking system and then try to establish on how do the roles of money in Islamic banking system and objective of the establishment of Islamic banking system deviate from the conventional view. The findings show that: first, banking history during ancient times confirms the word bank meaning the money rather than the institution which put it in circulation. The bankers began to receive deposits of money, to make loans, and even to transfer money and credits.

Second, during the middle ages, bank can transfer money over long distances without the risk and inconvenience of carrying coins. The trade trend grew dramatically, particularly in the area of trade, manufacturing and banking. This led the banking industry to expand to provide financial services. Third, during modern times, bank is primarily known as a dealer in credit which charges interest. Also during this time, banks are regulated by the government on a national level and are monitored by a variety of groups to ensure that their practices are just.

Fourth, the presence of British in inferior nations also brings together the conventional banking system where money could not be separated from interest. Lastly, the quests for Islamic banking system give a positive approach to: the creation of wealth via money without interest, recognize private property, and emphasize the fulfilment of contracts and fair dealings. There is much successful experience that demonstrates how adherence to religious values brings social development, and that moral financing is good business sense.

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[42] Both measures are introduced via the preservation of mal such Zakat and Sadaqat, laws of inheritance and will; and the identification of things that threaten mal such as payment of interest, prohibition of earning of wealth by Haram (unlawful) means, and prohibition of hoarding

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TABLE 1 : Financial Summary of Islamic Banks

	2009 RM'000	%	2008 RM'000	%
Value added				
Profit, commissions and other revenues	51 391		50 368	
Profit paid to depositors and cost of other services	31 191		32 704	
Wealth created	20 200		17 664	
Distribution of wealth				
Employees				
Salaries and other benefits	8 499	42	7 581	43
Governments	2 914	15	2 770	16
Shareholders	2 277	11	1 857	10
Dividends paid to shareholders	2 150		1 753	
Earnings attributable to outside and preference shareholders	127		104	
Retentions to support future business growth	6 510	32	5 456	31
Retained surplus	5 591		4 625	
Depreciation and amortization	919		831	
Wealth distributed	20 200	100	17 664	100

Wealth distribution over five years (%)

	2008	2007	2006	2005	2004
Employees	42	43	46	44	46
Government	15	16	16	15	14
Shareholders	11	10	10	10	10
Retentions	32	31	28	31	30

TABLE 2: The calculation of the Gini coefficient

	2004	2005	2006	2007	2008
ROE	0.339	0.202	0.235	0.093	1.854
RODc	0.421	0.309	0.208	0.279	0.962
RODb	0.680	0.709	0.850	0.557	1.599

Source: Computed from Annual reports of Selected Islamic Banks