

The Impact of Islamic Banking on the Jordanian Economy Compared with Commercial Banks

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Abstract

This research aims to evaluate the role of Islamic Banking in supporting the economic growth in Jordan, compared with commercial banks. Data was collected from the literature and the annual reports of two Jordanian banks representing Islamic and commercial banks. By analyzing the figures of the two banks, the results showed that Islamic banks have more ability to support the economic development in the Kingdom.

Keywords: Commercial Banking, Islamic Banking, Murabaha, Riba, economic development

1. Introduction

It is known that banks in the current era are the principle engine of the country's economy, especially since banks are pumping money for the various economic and investment facilities such as, securities exchange markets, money markets, and individual and corporation investments in many sectors.

There is no doubt that the provision of funding to investors in the financial markets, working to initialize these markets both in terms of volume and prices, as it contributes to an effective contribution to the creation of new economic projects and expansion of existing projects, which means boost the economy for the better represented by increasing the standard of living, and increased per capita income and corporate income and revenue for the state through taxes and fees, in addition of reducing the unemployment rates through employing new workers in the new projects.

This study comes to compare the role of Islamic banks in economic development with traditional banks, where the focus will be on the methods and quality of funding followed in both sectors in general and in Jordan in particular.

2. Problem Statement and Questions

There is a difference in the ways of funding followed in Islamic banks, than in commercial banks, where commercial banks provide direct money to their customers for many purposes, such as real estate loans, commercial loans, auto loans, maintenance and many others, and these loans are subjected to interest rates. While Islamic banks do not give any money to the authority requesting the funding, but, the bank purchase the item for which the loan was requested by Murabaha. Therefore, the funding through Islamic banks be content to be use for the purpose of investment, to the benefit of the economy of the country, where commercial banks loans may be used for consumption purposes, to be economic impact limited. Therefore, the problem of this study takes the following statement:

“Islamic banks have an effective role in economic development more than commercial banks”.

This problem was discussed through the following questions:

- What are the banking operations that affect the economy of the country?
- How these operations affect the economy?
- Because of practicing these operations differ between commercial banks and Islamic banks, which of these operations differ between commercial banks and Islamic banks, where these sectors has the greatest impact on the economy?

3. Significance of the Study

States around the world still suffer from the consequences of the global financial crisis which was started from the

practices of banking operation in wrong ways, especially the funding operations. Therefore, the importance of this study lies in the fact of the role of banks in economic development and avoiding the occurrence of financial crises, where many of bankers in the world assumed Islamic banking is the safe haven from financial crisis.

4. Study Objectives

This study aims to achieve the following objectives:

- To identify the role of the banking sector in economic development.
- To provide a depth understanding to the banking procedures applied by Islamic banks and their role in the country's economy.
- To compare the extent of contribution of Islamic banks with commercial banks in economic development.
- To suggest some recommendations to activate the bank's role in economic development.

5. Methodology

5.1 Research Type

This research was conducted according to the qualitative approach, where the researcher relies on the financial statements of the banks.

5.2 Research Population and Sample

The population of this research is the banking sector in Jordan, and the sample consists of two banks; Jordan Commercial Bank to represent the commercial banks, and Jordan Islamic Bank to represent Islamic banks.

5.3 Data Collection

The secondary data was collected from the books and related literature, while the primary data was collected from the statistics of Central Bank of Jordan, and the Association of Banks in Jordan, and the annual reports of the two banks.

5.4 Methods and Procedures

Since the financing activity of the banks is the main contributor in economic development, therefore, the researcher has compared this activity in terms of the economic sector benefited from financing granted by the two banks.

6. Literature Review

After reviewing the related literature, the researcher found that the following previous studies are valuable to the purposes of this research.

- A study by Abdul-Majid et al. (2008), under the title: "The Impact of Islamic Banking on the cost Efficiency and Productivity Change of Malaysian Commercial Banks".

The study aimed to identify the impact of Islamic banking on performance compared with commercial banks during the period 1996-2002. The study was conducted on a sample represents 70% of all Malaysian banks. The results showed that declining costs in Islamic banks to more than commercial banks leads to achieve high liquidity that enables Islamic banks to expand the funding scale. The current researcher believes that because Islamic banks grand funds to their customer to establish or expand their business enterprises by *Almurabaha* or participate, so, Islamic banks are more useful to the economy of the country.

- A study by Bodraga, Rehab, Mbtali, and Mariem (2008), under the title: "Islamic Banks, and the Financing Methods and Experiences".

The study aimed to clarify the objectives of Islamic banking in terms of avoiding *Riba* and funding customers through methods consistent with Islamic Sharia. The study was conducted on a number of Islamic banks working in Arab countries, where the researchers analyzed the financial statements of these banks, they provide an example to illustrate the role of Islamic banks in economic development, they indicated that Faisal Bank in Sudan has a large impact on the Sudanese economy through granting Islamic facilities to the industrial and agricultural projects in the country.

- A study by Saleem (2007), under the title: "Role of Islamic banks in Economic development".

This study aimed to define the term "Development" from Islamic perspective. The study has addressed two themes; Islamic and economic development, and use of Islamic banking and finance for economic development In Pakistan. The results of the study indicate that Islam favors the production through participation, increased consumption rather than prodigality, which means enhancing saving and investment, which lead to reduce poverty, therefore,

when Islamic banks implement the real Islam, they contribute seriously in boosting economic growth, rising income of poor bringing them above absolute poverty level.

- A study by Al-Mashharawi (2003), under the title: “Assess the Role of Islamic Banks in Economic development”.

This study aimed to discuss and evaluate the role of Islamic banks operating in Palestine in financing the economic development for the period 1996 – 2002. The study was conducted on all Islamic banks operating in Palestine in addition to the Islamic transactions in commercial banks operating in Palestine. Data was collected from the annual reports of these banks and through distributing a questionnaire on the employees of the Islamic banks. The results showed that deposits and investments in Islamic banks grow high, and most of these investments carried out according to Murabaha style. Also, the results showed that financing the commercial sector takes the first rank, while the agricultural sector still in the lowest rank, and Islamic banks contributed in increasing the GDP for a modest proportion.

- A study by Shammari (2012), under the title: “The Role of Islamic Banks in Supporting Economic Development in the Arab countries”.

This study aimed to confirm the Islamic banks advantage over conventional banks in terms of the process of promoting economic development. The study was conducted on the Islamic banks operating in Saudi Arabia compared with traditional banks. The results showed that Islamic banks are more able than traditional banks in financing different economic projects through Halal, because Saudis prefer to deal with Islamic banks for this purpose.

- A study by Furquani and Mulyany (2009), under the title: “Islamic Banking and Economic Growth: Empirical Evidence from Malaysia”.

This study aimed to investigate the dynamic interactions between Islamic banking and economic growth of Malaysia. The study conducted by analyzing quarterly time series data for the period 1997-2005 for the variables Islamic bank total financing as the independent variable and three dependent variables representing the economic growth, which are GDP, and real gross fixed capital formation and trade activities.

The results showed that Islamic bank financing is positively and significantly correlated with economic growth and capital accumulation of Malaysia, while the Islamic banks financing does not affect directly the international trade.

From the point of view of the current researcher, one can conclude from the previous studies that banks in general and Islamic banks in particular have a big role in economic growth in terms of funding the productive projects, and creating new working opportunities, which contribute in increasing the level of living and supporting the gross domestic product. In this regard, the literature pointed out that banks, especially Islamic banks focus their funding on economic projects and the development of craftsmen, and small and medium enterprises, which leads to the redistribution of wealth, and the reduction of the contraction wealth, and prevent monopoly (Khudiri, 1990).

7. Jordanian Banking Sector and Economic Growth

Perhaps it becomes necessary to start the debate in this section is to identify the banking sector in Jordan. The banking sector in Jordan consists from 26 banks distributed as follows:

- Jordanian banks: 13 commercial banks and 3 Islamic banks.
- Foreign banks: 9 commercial banks and one Islamic bank (Association of Banks in Jordan).

For the purposes of this research, the focus will be on the funding activity in the Jordanian banks in terms of the economic sectors, which were benefited from such funding. Table 1 below shows the distribution of facilities granted by the banks in Jordan according to the benefiting sectors for the years 2009-2012.

Table 1. Facilities distribution (Million JD)

The Sector	2009	2010	2011	2012
Agriculture	231.2	211.8	229.2	254.9
Mining	60.2	55.4	79.5	73.0
Industrial	1631.2	1929.0	2297.2	2672.0
General Trade	3195.4	3594.0	3779.2	3754.9
Constructions	2582.5	3167.7	3463.6	3682.6
Transportation	453.1	484.1	531.6	554.5

Tourism and Hotels	427.9	457.3	493.7	505.6
services	909.5	1050	1135.3	2015.7
Financial Services	434.1	408.3	430.5	486.1
Individual Consumption Loans	3392.1	3093.8	3411.6	3830.5

Source: Central Bank of Jordan.

For the table above table, we can note that the general trade and individual consumption loans won the largest proportion of the granted facilities, however, it is noted that banks of different kinds have a positive role in economic growth, because they grant loans to all economic sectors in the Kingdom as shown in Table 1.

The in order to show a fair comparison between traditional banks and Islamic banks in terms of contribution in economic development, the researcher will review the achievements of one of the commercial banks vs. one of the Islamic banks which started operation in the same year. By reviewing the statistic report of the Association of Banks of Jordan, we find that Jordan Islamic Bank and Jordan Commercial Bank had been established in 1978. The comparison between the two banks should focus on the items that have an effect on the domestic economy, Table 2 below shows these indicators.

Table 2. Comparative indicators

the Indicators	Jordan Islamic Bank	Jordan Commercial Bank
Paid Capital	150,000,000	100,000,000
Total Assets	3,554,739,368	1,168,714,950
Net Funds	2,213,323,375	523,866,661

Source: Annual Reports.

The table above shows that the paid capital of Jordan Islamic Bank is greater than it in Jordan commercial Bank, and this means a higher number of stock holders who benefit from the dividends, which lead to improve their living level. And, for the total assets, the Jordan Islamic Bank beats the Jordanian commercial bank, which makes it more capable of serving the national economy. It is well known that the financing activities of banks have an effective contribution to economic development, especially if they were directed to finance economic projects. Because the Islamic banks to be completely sure about the use of funds granted for the purpose of which funding has been granted, because the Islamic bank does not give money to the borrower, but the bank buys the machine, or goods for example through Murabaha or by participating. While, in commercial banks the borrower may use the granted loan for other purposes. Table 3 below shows the items of funding activity in the Jordan Commercial bank for the year 2014.

Table 3. Funding activity of J.C.B

The Activity	Granted Facilities
<u>Retail (Individuals)</u>	
Debit Current Accounts	358,821
Loans and Bills	127,023,941
Credit Cards	3,254,548
Real Estate Loans	54,163,763
<u>Corporations</u>	
Debit Current Accounts	60,546,766
Loans and Bills	213,652,824
<u>Small and Medium Enterprises</u>	
Debit Current Accounts	25,974,850
Loans and Bills	51,117,828
Government and Public Sector	14,793,364
<u>Total</u>	550,886,705

Source: Annual Report of J.C.B, 2014.

While the Jordan Islamic Bank showed economic sectors benefiting from financing activities. Table 4 below

shows these sectors.

Table 4. Economic sectors benefited from financing activities of J.I.B, Granted facilities (Million JD)

Sectors	Granted Facilities (Million JD)
Agriculture	6,4
Mining and Industry	64,4
General Trade	468,2
Constructions	745,8
Transpirations	308,9
Tourism and Hotels	2,4
Services	500,9
Other purposes	195,1

Source: Annual Report of J.I.B (2014) P. 29.

From here, one can easily note that Islamic banks have the greatest role in economic development in the country.

8. Recommendations

- Commercial banks must clarify the economic sectors that have benefited from funding.
- It is better to commercial banks to set up departments to deal with the Islamic banking.
- Central Bank of Jordan should work to encourage establishing more Islamic banks.

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