

ISLAMIC BANKING & FINANCE

PRINCIPLES, INSTRUMENTS & OPERATIONS

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Hanifah Haydar Ali Tajuddin*



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CHAPTER 1 ORIGIN AND DEVELOPMENT OF ISLAMIC BANKING AND FINANCE

by Md. Abdul Jalil*

Before we embark on what is Islamic banking and finance, it is pertinent to write on the origin and development of Islamic banking and finance. We should know when exactly Islamic banking and financial institutions started its operation, how it gradually developed and the present position of Islamic banking and finance in the Muslim and Western world. These issues will be discussed in this chapter.

1.1 Shari'ah-based Capital Financing in Pre-Islamic Arab Society

Muslims used Islamic banking and financial system from the very early stage of the Islamic History. They invested money in trade without interest. The financial business was based on a profit and loss sharing mechanism, such as *mudarabah* (passive partnership) and *musharakah* (active partnership).¹ At that time Muslim traders used coins as a medium of selling and buying goods and the coins were made of precious metals.²

Dynasty and government serve as the world's marketplace (*sug*), attracting to it the products of scholarship and craftsmanship alike Whatever is in demand in this market is in general demand everywhere else. Now, whenever the established dynasty avoids injustice ... , the wares on its market are as pure silver and fine gold. However, when it is influenced by selfish interests and rivalries, or swayed by vendors of tyranny and dishonesty, the wares of its marketplace become as dross and debased metals.³

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1 Chapra, M.U. and Ahmed, H., 'Corporate Governance in Islamic Financial Institutions', 2002, Occasional Paper No. 6, Jeddah, IRTI/IDB, at 2-6.

2 Chachi, A. K., 'Origin and Development of Commercial and Islamic Banking Operations', (2005) 18(2) *Journal of King Abdul Aziz University: Islamic Econ*, 3-25, at 11.

3 Ibn Khaldun (d. 1406), *Muqaddimah*, at 23.