

# Contribution of Riba-Free Banking System on Rural Development in Bangladesh: A Projection for Vision-21

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## Abstract

Ribe-Free Banking System (RFBS) is the most economic domain in the micro-finance area for the rural development as well as the economic development of Bangladesh. Rural development Scheme (RDS), the specialized form of Banking operations of Islami Bank Bangladesh Limited (IBBL), is offered for those people who live below the poverty and absolute poverty level in Bangladesh. The basic aim of this study is to examine the impact of RDS of IBBL on National GDP through rural development. The RDS of IBBL is the project sample of this study. The annual time-series data from FY 2002-2003 to FY 2013-2014 are used in this study for justifying the rural development through identifying the impact on GDP. This study has found that deposit and investment of RDS of IBBL have strong and significant impact on national GDP. The findings of the study will be helpful for the economic policy makers of the concerned authority of Bangladesh in reshaping the economic activities aiming at achieving the goal stated for the Vision-21, the golden jubilee of the independence of Bangladesh.

**Index terms**— Riba-Free Banking, rural development, RDS, vision-21, granger causality test.

## 1 Introduction

iba-Free Banking System (RFBS) is the most powerful economic factor in the world. In the session 2006-2007, the World Financial Crisis occurred due to the rival of RFBS instead of Conventional Banking System (CBS) (Nizam, 2012). RFBS had passed golden jubilee in 2013. On that time, Bangladesh had also gathered a 30-year experience, knowledge and the existence of RFBS. At present, RFBS in Bangladesh has a strong market share viz. 45.28%. There are 8 full pledged (15.09%) and 16 conventional banks which comply RFBS in branch or window form (30.19%). Islami Bank Bangladesh Limited (IBBL) is the pioneer (IBBL, 1984), and the largest, fastest growing and best performing (Aminuzzaman, 2010) riba-free bank in Bangladesh.

## 2 a) Riba-free Banking System (RFBS)

Riba-Free Banking System (RFBS) is a kind of banking which is formed according to the rules, regulations and provisions instructed by the Islamic Shariah. Egypt is the pioneer of structurally adaptation of RFBS in the world in 1963 which is also known as Islamic Banking System (IBS). At present, there are 385 commercial banks in 55 countries which have been following their banking operations in riba-free form (GFDR, 2014). Bangladesh has started riba-free banking from 1983. Now a days, Bangladesh has a significant market share (2.08%) i.e. 8 out of 385. Islami Bank Bangladesh Limited (IBBL) is the pioneer riba-free bank which has been passing 30-years glorious journey in the banking sector of Bangladesh.

## 3 b) Rural Development

Rural development is defined as the socioinfrastructure development of a nation where rural people are highly encouraged to involve in the economic development. Rural development can be measured by self-sufficiency, productivity and competence to increase financial worth i.e. deposit and investment of rural people

(Halimuzzaman, 2014). In Bangladesh, out of 160 million people, 77% people live in rural and urban areas (BURU, 2013). IBBL has been surviving in Bangladesh considering as mass banking (Shohrowardhy, 2015). There are some extrinsic programs taken by various banks and NGOs in private and public level for the development of rural and urban area i.e. Rajshahi Krishi Unnayon Bank (RAKUB), BRAC bank, ASA, Proshika and IBBL etc. Rural Development Scheme (RDS) is a specialized project of IBBL to develop the rural and urban area where more incompetent people are involved in the economic development of Bangladesh.

### 4 c) Rural Development Scheme (RDS)

Basic philosophical objectives of Riba-Free bank (RFB), Islami Bank Bangladesh Limited (IBBL) is enhancing the economic system of Bangladesh based on equity and justice in all levels of civilization. In Bangladesh, 38% of the total population maintains their living standard below the poverty line and 18% of the same live in abject poverty (IBBL, 2014). These poverty stricken people are facing a lot of problems like illiteracy, inadequate health and sanitation facilities, discrete of purchase parity, scanty of the sources of income generation etc. Considering the above mentioned problems, IBBL has started a dimension of rural banking. On the above table explores the involvement of IBBL in the development of rural and urban areas of Bangladesh. The most remarkable mania in 2014 is that the growth of RDS investment is 24.57% over 2013 and recovery rate of its investment schemes is 99.30%.

### 5 d) Vision-21

Bangladesh got independence in 1971. Yet, after 40 years of independence, Bangladesh has remained a low-income country (LIC) (GED, 2012), almost two thirds of population remains below poverty line (Bureau, 2013). For improving the situation and recognizing the long-term development challenges, the present Government has adopted the Vision 2021. The Vision 2021 calls for Bangladeshi socio-economic environment to be transformed from a low income economy into the first stages of a middle-income country by the year 2021 (GED, 2012) which also marks as the 50th anniversary of the independence of Bangladesh which is called golden jubilee of the nation. Moreover, Vision 2021 lies down a development scenario where citizens will have a higher standard of living, better education, will have a more equitable socio-economic environment, and the sustainable development will be ensured through better protection from climate change and natural disasters. To achieve Vision 2021, the Government has undertaken "Perspective Plan of Bangladesh (2010-2021): Making Vision 2021 a Reality". The Perspective Plan is a road map for achieving the targets of Vision 2021 and lies down a long-term strategy to make that happen. Thus, it takes two five-year plans: Sixth Five Year Plan (2011-2015) and the Seventh Five Year Plan (2016-2020). Finally, the vision-21 is formed for reaching the country as a middle-income country (MIC) replete with the sign of economic progress.

## 6 II.

## 7 Literature Review

Bangladesh is a growing economic tiger of the third world countries. The majority of the people of Bangladesh live in rural and urban areas (Bureau, 2013) and is contributing to the national economy on the basis of agro-based industry specially small and tinny. According to the statement of Dr. Jahid Hossain, the Lead Economist of the World Bank, Bangladesh is a Lower Income oriented country (LIC) up to 2014. Bangladesh Government has taken sufficient strategic programs to develop our national economy viz. Millennium Development Goals (MDG). In that perspective, banking sector is playing a pivotal role in the economic development in Bangladesh i.e. 1.4% of GDP in service industry (Bangladesh Bank, 2012) but agricultural sector specially crops, animal farming, fisheries, hotel restaurant, community and social service contributions are more significant i.e., 11.4%, 2.7%, 4.6%, 0.7%, 6.9% share of GDP respectively. Economic development is covered by economic, political and social states of the people of a nation including the economic procedure and policies and social well-being (Wikipedia). Kifle (1997) stated that a strong relationship is existed between poverty alleviation and economic development. The basic principle of Riba-Free Banking System (RFBS) is to realize and ensure the well-being of mankind using equity based economy that is necessary for development economy (Chapra, 1985). RFBS as well as Islamic Banking System (IBS) ensures all kinds of banking activities (Fund collection-Deposit and investment avoiding interest (Riba) (Iqbal, 2001). It is mentioned here with that RFBS ensures steadfast economy considering fair distribution of income, reducing injustice, risk sharing, financial crisis, facilitating production and business activities (Siddiqi, 1985). In the recent world, banking is much more significant than banks (Bill Gate, 2008). Therefore, RFBS always strives itself to ensure its contributions to different aspects of national economy through specialization of its services i.e. Rural development Scheme (RDS) (Ahmed, 2004; Aulader, 2008; Parveen, 2009; Jahur, 2010 and Huyian, 2011).

Islami Bank Bangladesh Limited (IBBL) is the pioneer, the largest and most performing bank in Bangladesh in the field of riba-free banking sector as well as Islamic banking sector. A nominal zero interest rate (Riba-Free) is a required condition for absolute resources allocation (Friedman, 1969). Islamic Shariah based RFBS is playing a pivotal role in economic development contributing a lot to the advancement of the society (Siddidi, 1973). IBBL is providing satisfactory community services through job creation and ensuring consistency in the field of service

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sector in Bangladesh (Rashid, 2009). IBBL has to deal in equity based profit and Loss Sharing (PLS) contracts that are more suitable for Bangladesh economy but social awareness, rehabilitation, economic and psychological support and strict enforcement of laws are the basic pitfalls for its success (Begum, 2004).

Rural Development Scheme is the specialization of banking expansion aim to incorporate the mass people who live below the poverty level (Hawladar, 2008) in the economic development activities of Bangladesh (RDS Manual of IBBL). A few numbers of scholars engage themselves to explore the different aspects of RDS. RDS is a successful project in retaining the people in the economic development activities (Rahman, 2008). This indicates that riba-free banking sector provides its contribution to the economic progress in Bangladesh through generating employment, earning foreign remittance, strengthening rural economy, promoting ecology and green banking and enhancing industrialization through tiny sector RDS emphasizes the industrial sector devoting huge investment. Alam (2000) found that industrial development and RDS investment has a strong positive relationship. For enhancing industrialization, banks play vital role to encourage fruitful investment (Iqbal, 2001). Hawladar (2008) proved that RDS positively assets the poverty alleviation existed in Bangladesh encouraging micro scale savings. RDS activities are highly expanded considering the terms of number, investment and deposit (Jahur, 2010). Under RDS, investment is higher than deposit that indicates, investment insecurities are covered by RDS memberships with association (Bhuyian, 2011). Covering all socio-economic factors, RDS is the highest performance oriented micro finance activities in Bangladesh (UNDP, 2012; Ahmed, 2004). RDS plays a vital role in the improvement of standard of living through the relationship of household income and expenditures (Rahman, 2008).

Considering the existing literature, it is evident that the contributions of RDS of IBBL are justified by the jurisdiction of scholars' views. Poverty alleviation, socioeconomic contributions, high performance oriented micro finance activities were found as scope of operations of RDS. But no evidence has been found regarding the contribution of RDS on the national economy through rural development. Hence, the study attempts to examine the RDS contributions to the development of Bangladesh economy considering the projection of Vision-21 as the golden jubilee of the independence of Bangladesh.

## 8 a) Objectives

This study examines the impact of Rural Development Scheme (RDS) of Islami Bank Bangladesh Limited (IBBL) on national GDP of Bangladesh through the contribution on rural development. In light of the basic objectives the study covers the following extensions: IV.?

## 9 Findings and Analysis

This section of the study is comprised with three sub-sections considering rural contribution on the basis of various welfare activities, village coverage employment-members incorporated in the RDS program, and deposit & investment of RDS.

### 10 a) Contribution of RDS in the rural development on the basis of various welfare activities

The basic mechanism of RDS is to encourage micro savings in an association formatted by a homogeneous group in a village. This saving tendency has created an economic driven force for their selfconsistency of motivation towards the investment. On that prevail, the incompetent people of rural and urban areas involve themselves in the self-income generation activities as well as micro investment modes. RDS creates a wide span of rural investment modes for rural people in various economic activities i.e. service, trading, processing-manufacturing, shop keeping, selling-marketing, rural transport (rickshaw), irrigation equipment, tube well, housing materials etc. (RDS Manual). Formally, RDS encourages the people to retain in a group or association through some significant welfare activities. Table ?? RDS deposit per year and investment is 1494.00 million BDT. This is very fact that investment is three times greater than deposit but recovery rate of investment is 99% on an average (IBBL, 2014). These trends are emphasized that customers (members) show the trustee with the performance of RDS functions. Therefore, the study states that RDS is the integral part of rural and urban economy in Bangladesh. It is expected that in the Vision-21, deposit of RDS will reach the level of 8092 million BDT while Investment will be 24533.00 million BDT.

### 11 d) Correlation Analysis

Correlation expresses the linear relationship between two variables considering direct causation, indirect causality or statistical change (Ferdousi, 2009). Generally, correlation coefficient usually explores the degree of association of defined variables. Table ?? All coefficient of correlations are positive significant at 5% level. This result indicates that deposit and investment of RDS is highly correlated with GDP since all coefficients are more than 0.90 at significant level.

## 12 e) Granger Causality Test

In the time series data correlation do not absolutely imply causality since there is a chance to existence to ignore common factors in correlation (Lin, 2008). Therefore, causality test can be used to find out causal influence (Granger, 1980). Generally, causality measures the supernatural representation of data and make interpretations more informative and useful by extending frequency domain. In this study, we use Eviews version-7 for pair-wise Granger causality test expressed in the Table-7. From the above table, the study has found that GDP, Investment and Deposit of RDS are existed in Bangladesh economy as independent variables since null hypotheses of all causality are not rejected at 5% level.

## 13 f) Impact of Investment of RDS on GDP

Investment and industrialization have positive relations (Iqbal, 2001). Industrialization is the basic requirement of economic development which is positively depends on poverty alleviations (Kifle, 1997). It should be mentioned here that growth of investment of RDS has positive impact on the growth of GDP of Bangladesh i.e.,  $GDP-GINVRDS = 0.76$  ( $t = 3.6451$  and  $P = 0.000$ ). More significantly it is mentioned here that constant of the model is significant at 1% level. Therefore, the study states that the contribution investment of RDS of IBBL is fairly justified to the national GDP of Bangladesh.

## 14 g) Impact of Deposit of RDS on GDP

Generally, Deposit is defined as the blood circulation of an organizations and unique elixir (Shohrowardhy, 2015) of investment. The study attempts to determine the impact of RDS deposit on GDP of Bangladesh. Due to the no causality (Table ?? From the equation-8, it is found that growth of deposit of RDS has positive impact on the GDP of Bangladesh since constant of the model is found significant at 5% level ( $C = 0.15$ ,  $t = 4.254$ ,  $P = 0.002$ ). The impact of RDS deposit on GDP is found through the significant value of standard regression weight i.e.,  $GDP-GDEPRDS = 0.89$  ( $t = 6.022$  and  $P = 0.000$ ).

V.

## 15 Conclusion

Riba-Free banking is one of the leading micro finance private sectors in Bangladesh. Specially, Islami Bank Bangladesh Limited is the pioneer of riba-free Banking in Bangladesh. Rural Development Scheme is specialized project of IBBL for rural and urban development. The study has found that RDS is competent to integrate people who live below poverty level and absolute poverty level in the economic development activities especially in the rural areas. RDS encourages these people to save money and investment their savings in a cooperative environment for economic development of Bangladesh. This study has found that deposits of RDS collected from the people (below poverty level and absolute poverty level) and investment have positive and significant relationship with national GDP. It is mentioned here with that impact of deposits and investment of RDS of IBBL on national GDP is significantly positive. Generally, it is mentioned that if more un-scattered people of a country are involved in the economic development activities than percapita income must be increased. It is proved that RDS is the most significant effective factors in the economic development of Bangladesh. Now, Bangladesh is lower middle income oriented country (LMIC) due to increase per capita income in \$1085. In 2021, if, Bangladesh will be established as a middle income oriented country (MIC), below poverty and absolute poverty level people must be incorporated in the economic development activities. This study is proven experiment of economic development that RDS of IBBL is sample project by which below poverty levels people are contributing themselves to the economic development of Bangladesh. Using the experiences of RDS of IBBL for rural development, it may possible to establish Bangladesh as middle income oriented country in the world which is the basic goal of Vision-21.

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Figure 1: Global

1

named Rural Development Scheme (RDS) from 1995.

Contents

Target Group Rural people with 0.50 to 1.50 acres of land. Both men and women

Program Basically micro-investment.

Criteria Applied for Selection Land ownership and permanent residence.

Sanction of Investment Two months after the formation of group  
Core Product-BDT 25,000.00 (For 1 Year)  
Nursery-BDT 50,000.00 (For 1 Year)

Year Size of Investment Agriculture Implements-BDT 50,000.00 (For 1-3 Years) Live Stock-BDT 50,000.00 (For 1-3 Years)  
Rural Transport-BDT 20,000.00 (For 1 Year)

VolumeMode of Disburse- Rural Housing-BDT 50,000.00 (For 1-5 Years) Off-firm Activities-BDT 50,000.00 (For 1-5 Years)

XV ment Profit Rate

Is- Repayment-Period

sue Starts Sources of

VIII Funds Activities

Ver- Financed Savings

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( Required Personal guarantee and savings.

Global Source: Jahur (2010) As shown in Table-1, RDS provides various through financing in the fulfillment of the need of the rural people.

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[Note: R]

Figure 2: Table 1 :

## 2

Areas of performance	Fig. in million BDT No. & Vol- ume/Amount
No. of Branches covering RDS	250
No. of Field Officers	2,492
No. of Project Officers	217
No. of Zone Officers	14
No. of Villages	18,591
No. of Districts	64
No. of Centers	28,122
No. of Groups No. of Members	176,765 915,209
% of Women members in the Scheme	79%
No. of Clients	580,251
Financial Statement	
Cumulative disbursement (From 1995)	107,307.21
Present outstanding	17,830.10
Overdue	132.00
Recovery	99.30%
RDS Savings	5,992.50
Source: RDS Manual	

Figure 3: Table 2 : A Brief Profile of Rural Development Scheme (RDS) of Islami Bank Bangladesh Limited

## 3

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[Note: C]

Figure 4: Table 3 :

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Year	Staff	Village Coverage	Members
2003	639	3700	130465
2004	731	4230	163465
2005	868	4560	217445
2006	1368	8057	409573
2007	1819	10023	516725
2008	1712	10676	577740
2009	1732	10751	492475
2010	1837	11482	523941
2011	2024	12857	608703
2012	2191	15371	735628
2013	2286	17104	816274
2014	2499	18086	891485
Mean	1724	11191	538394
Average Growth Trend	164.40	1303	82541
R 2 =	0.939	0.973	0.942
Expected in Vision-21	3696	26824	1319859
Skewness	-0.4105	-0.0468	-0.1594
Kurtosis	-0.7668	-1.1113	-0.9188

Source: IBBL Annual Report from 2003-2014

Figure 5: Table 4 :



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### 3

Modes of welfare

Graduation Program  
Welfare Activities  
Education Program

Academic award

Training Program

Skill Development  
Self-Employment  
Health Program  
Welfare & sanitation  
Medical Assistance  
Relief and Rehabilitation Program

Relief-donation

Source: Annual Report of IBBL, 2014

b) Rural Contribution of RDS on the Basis of

Employment Generation, Area Coverage, and Members Involvement Rural Development Scheme (RDS) is th

an integrated factor of Bangladesh economy. This program has been familiarized due to its contribution to poor people living below the poverty level. This program also enhances income generation, moral, social and ethical values of the rural and urban people. For justifying the rural development contribution of RDS, the study uses simple trend equation expressed in the below:

$$Y = f(x) \quad (i)$$

$$Y = ? + ?x \quad (ii)$$

Figure 6: Table 3 :

4

Year	Staff	Village Coverage	Members
2003	639	3700	130465
2004	731	4230	163465
2005	868	4560	217445
2006	1368	8057	409573
2007	1819	10023	516725
2008	1712	10676	577740
2009	1732	10751	492475
2010	1837	11482	523941
2011	2024	12857	608703
2012	2191	15371	735628
2013	2286	17104	816274
2014	2499	18086	891485
Mean	1724	11191	538394
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Skewness	-0.4105	-0.0468	-0.1594
Kurtosis	-0.7668	-1.1113	-0.9188

Source: IBBL Annual Report from 2003-2014

Figure 7: Table 4 :

6

	GDP	DEP RDS	INV RDS
GDP	1		
DEP RDS	0.986** (0.000)	1	
INV RDS	0.985** (0.000)	0.999** (0.000)	1

Source: Calculated by Authors

Figure 8: Table 6 :

7

Sample: 2003-2014				
Lags: 2, Observation-10				
Null Hypothesis:	F-Statistic	Prob.	Hypotheses	Types of Causality
Dep. $\hat{GDP}$	0.32836	0.7345	H 0 =A	No Causality
GDP $\hat{Dep.}$	1.97996	0.2326	H 0 =A	No Causality
Inv. $\hat{GDP}$	0.52090	0.6230	H 0 =A	No Causality
GDP $\hat{Inv}$	2.19209	0.2072	H 0 =A	No Causality
Inv. $\hat{Dep.}$	3.96789	0.0929	H 0 =A	No Causality
Dep. $\hat{Inv.}$	4.89208	0.0665	H 0 =A	No Causality
H 0 =A Null hypothesis of causality is not rejected since $p > 0.05$				
H 0 =R Null hypothesis of causality is rejected since $p < 0.05$				
$\hat{=}$ does not Granger Cause				
Source: Calculated by Authors				

Figure 9: Table 7 :

8

Variables	Standardized Weight (?)	S.E.	t-Value	P-value
Constant	0.24	0.04	6.6124	0.000
INV RDS	0.76	0.12	3.6451	0.000
	R <sup>2</sup> =	0.571		
	Adjusted R <sup>2</sup> =	0.528		
	F-Statistics	13.287		
		(0.000)		
	D-W=	1.973		
Dependent Variable: GDP				
Independent Variable: Investment under RDS of IBBL(INV RDS )				
Source: Calculated by Authors				
The measurements values of the Table-7				
indicate goodness of fit of the model. So finding is				
expressed in the following equation.				
$GDP = 0.24 + 0.76 \text{ GINV RDS}$				
(v)				

Figure 10: Table 8 :

**9**

Variables	Standardized Weight (?)	S.E.	t- Value	P- value
Constant	0.15	0.04	4.254	.002
DEP RDS	0.89	0.08	6.022	.000
	R 2 =	0.784		
	Adjusted R 2 =	0.762		
	F-Statistics	36.270 (0.000)		
	D-W=	1.717		
Dependent Variable: GDP				
Independent Variable: Deposits under RDS of IBBL (DEP RDS )				
Source: Calculated by Authors				

*[Note: C]*

Figure 11: Table 9 :

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