Comments on Global Islamic Finance Report

Ishrat Husain

1. Let me first of all commend the authors for the extreme hard work they have put in to compile this volume. It contains a lot of useful information and data. The chapters on Islamic Banking, Capital Markets, Takaful, NBFIs, alternative asset classes, Islamic Social Finance are quite standard. But bringing them altogether at one place the report renders a useful service to the readers, industry practitioners, researchers and policy makers. However, these chapters appear in one form or other in many other reports and can perhaps be compressed from about the present length of 200 pages to concentrate the attention on the unique features of this report that lie in Chapters 1-3, and 9-11. Given the size of Islamic Capital Markets, Takaful, Alternative Assets and NBIFs the discussion and data presented in Chapters 5 to 8 can be condensed as the same material has appeared in other reports also.

2. I trust that Chapter 10 has been peer reviewed by those who are more competent, than I am, in the estimation techniques, model specification and the underlying econometrics. Are we sure we are able to isolate the pure effect of Islamic Finance on economic growth or is it circular causation or tautological inference that we are observing. Islamic finance is part of financial development which is conducive to economic growth. Hence Islamic finance is conducive to economic growth.

3. Nobody would quibble with the linkages between Islamic Finance (IF) and the Sustainable Development (SD) Goals which are themselves too broad and comprehensive. The real question is: How can these linkages result in the desired outcome? What are the trade-offs and the tensions in attaining different SD goals? Who are the losers and winners? The political economy of reform has enlightened us that the losers are identifiable cohesive group that can coalesce and resist the reforms vigorously. The same would happen if we succeed in mobilizing savings and channeling them to low-income households who are voiceless unorganized while the existing beneficiaries of bank credit are high net worth individual, large corporations and influential names that this aspect ought to be highlighted in the chapter to avoid the impression that this task of financial inclusion can be accomplished smoothly.

4. I agree with many of the propositions, findings and interpretations contained in the report and therefore would not highlight the areas of agreement in this note for sake of brevity. I would rather dwell upon some points that , in my judgement, can make the report more sharp, concise and useful to readers.

5. The fact that Islamic Finance is part of the global financial system and cannot be "pursued in isolation from broader public policy concerning economic development, business, promotion and social advancement" should be laid out right at the beginning. The joint G-20 Draft note reproduced at p.95 reiterates the integration of Islamic Finance into Global Finance. We should not wait until chapter 3 to present this extremely critical premise on which the whole Islamic Finance is anchored. The differentiating points of IF – risk sharing, asset-based financing, links to the real sectors of the economy, promoting social inclusion ,rewarding enterprise rather than rent seeking, prohibiting exploitation and unproductive activities should be discussed in that context. The readers would then be able to get a flavor of the strength of Islamic Finance relative to the existing financial architecture while the former remains an integral part of the global financial system and not as an isolated 'ghetto' or niche mode of financing. How far these differentiating aspects of Islamic Finance are being actually practiced should also be part of the discussion in the report.

Commented [HH/RFC@I1]: 4% match, consider rephrasing the highlighted.

6. It is not true that 'Trickle Down' approach has been applied as a deliberate policy either by the Multi-lateral institutions or the national policy makers in developing countries. The thinking in development literature has constantly evolved starting with the Lewisian theory to the Current Shared Prosperity approach. We now take for granted that rapid growth does reduce poverty but this was not so obvious even in 1996 when the campaign '50 years are enough' made bold claims that poverty was rising despite rapid growth. In the last few decades outcomes such as rapid growth leading to poverty reduction have been achieved but more recent evidence shows other undesirable elements such as inequitable distribution of benefits have surfaced their ugly heads. Nobody wanted inequity as a conscious policy. We should avoid oft misused clichés such as 'neo-liberalism' and trickle down' in an informed report such as ours. In less than 20 years the MDG Report and Fig 1.1 tells us that the world has

witnessed reduction in poverty from 43 percent to 17 percent along with decline in the absolute numbers of poor. How can then it be asserted that 'growth benefits trickle down to the extremely poor only after a relatively long period of time" Brazil which was considered a reference point for income inequality has recorded significant decline in the last decade primarily due to Bolsa Familia. So it is possible for policies and interventions to be designed that can mitigate this menace.. Inter-country inequality at the global level has declined and the income differences between advanced countries and developing countries have narrowed down. Most of the noise about inequality and the numbers cited in report come from the advanced countries and the U.S. The focus of this report should be the changes observed in developing countries. It is quite right to propose that the World Bank and national policy makers should now pay attention to the problem of inter-personal inequality, regional and gender disparities. Islamic finance can be a powerful vehicle for that purpose if implemented in true letter and spirit.

7. OIC countries form a very heterogeneous group and the averages mask a large variation. For example if you put Saudi Arabia and Nigeria in a group and present the metrics based on averages of the two these are hardly useful. Analytically these averages do not make sense and for policy direction they do not provide any meaningful insight for decision makers. I am not sure about the interpretation of Figures 0.1 and 0.2. Wouldn't it be more appropriate to divide this group of OIC Countries into two categories (i) high income (ii) Developing to remain consistent with the discussion in WDR, WEO etc. and also convey a sharper picture of the current situation and also the trends overtime. The comparison between OIC and Non-OIC countries in Chapter 2 is erroneous as the composition of the two groups is highly disparate with most advanced countries clustered in Non-OIC group. The problem commonly associated with aggregation would starkly confront us if we adopt this classification.

8. The report should candidly posit the four pillars of the theoretical framework (i) Institution (ii) Governance (iii) Distribution Channel and (iv) Social and financial inclusion against the current position of the two OIC sub groups in respect to each of these pillars and not for the OIC countries as a whole. We will then be able to identify

in a realistic way, the gaps, distance and road blocks that need to be removed to move forward in the direction of each of these pillars. In my view this would be an extremely useful contribution which the report would be able to make. I do realize that this would involve some additional work but at least we will be able to present a true picture to the policy makers about the intensity of the efforts to transform Islamic Finance into something that may have broader appeal in the ultimate analysis. Unless this vision is clearly articulated based on solid empirical evidence we may be missing a good opportunity. The three case studies on Indonesia, Malaysia, and Pakistan can be a good initial point of departure and progress on these pillars can be assessed in the Annual Report every year along with other case studies. Each one of these countries has announced the road maps for the future and therefore assessment can be made in relation to what these countries want to do.

9. Islamic Finance has been a priority area in Malaysia for three decades. Legal, institutional, regulatory, policy and infrastructure have evolved and are in place. INCEIF, ISRA and Malaysian universities are producing the talent for the industry. A question that needs to be examined in this report is: why isn't Islamic Finance able to make penetration despite such a highly supportive enabling environment. This analysis would be of some value to countries such as Pakistan which have adopted the Malaysian model and are attempting to expand the share of Islamic Finance in the total financial assets of the country. Simply cataloguing some recommendations in absence of such an analysis would not sound persuasive.

10. I hope the above comments are helpful to the authors in revising the current draft both in substance as well as in form. I wish the authors all the success in this endeavor.