



WORLD BANK GROUP

Finance & Markets

Global Islamic Finance Development Center

***What Islamic Finance has to offer to
Global Finance?***

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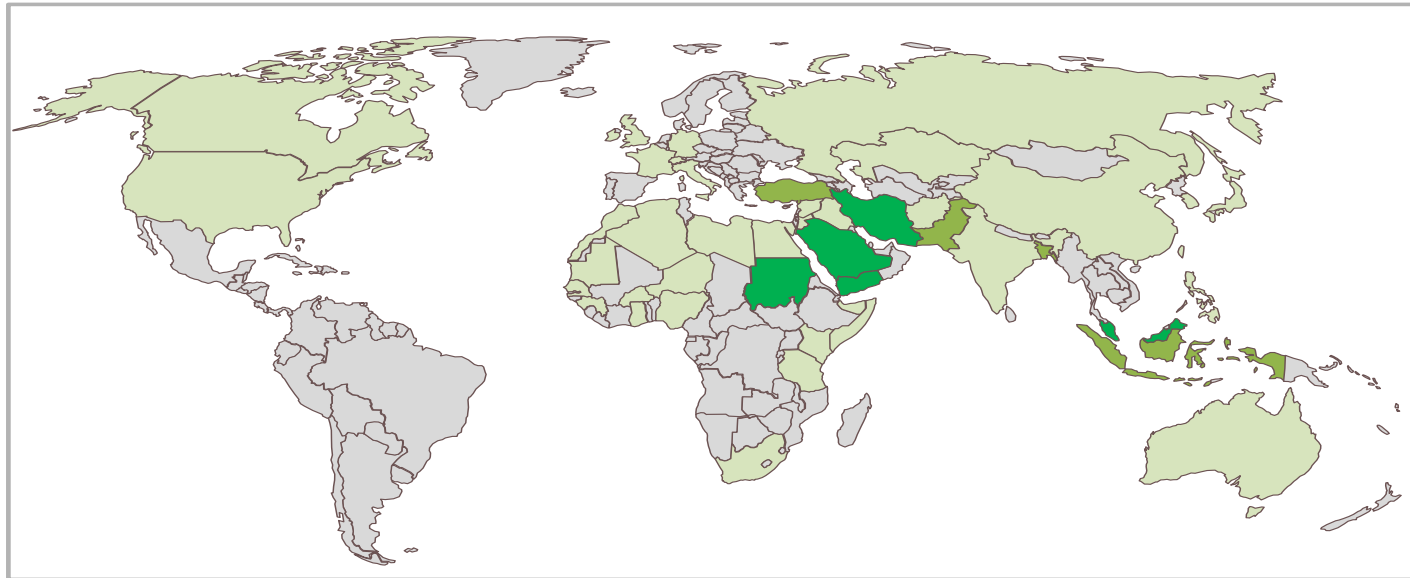
Roadmap

- I. World Bank Global Islamic Finance Development Center
- II. Issues in conventional economics and finance
- III. Islamic Finance as an alternative approach
- IV. How to make it work?

I. World Bank Global Islamic Finance Development Center

Growing Importance and Globalization of Islamic Finance

Islamic Finance Markets by Systemic Significance



- Systemic Importance
- Potential Systemic Importance in Mid-term Given Current Growth
- Minimal Systemic Importance

Source: IFSB Financial Stability Report 2014, KFHR, IMF

Recent transactions include sovereign issuance by United Kingdom (UK), South Africa, Hong Kong, and Luxemburg.

World Bank Global Islamic Finance Development Center



World Bank Group President Jim Yong Kim opened the Global Center for Islamic Finance, together with Turkish Deputy Prime Minister Ali Babacan.

Core Activities of Global Islamic Finance Development Center

Financial Sector Development

- Strengthening Regulatory environment
- Facilitating Standardization
- Enhancing Governance and Transparency
- Financial Stability and Risk management

Research and Knowledge Hub

- Producing quality research on topics with development impact
- Knowledge dissemination through international seminars and workshops
- Capacity building for emerging markets

Markets Development

- Technical and Advisory services for new markets
- Collaborate with stakeholders in developing new products and new markets
- Standardization of market practices

II. Issues in conventional economics and finance

Challenges for Conventional Economics and Finance

- I. **Growing Income and Wealth Disparities**
 - Concentration of wealth in the top tier of society
 - Limited opportunities to share prosperity

- II. **The focus on GDP but ignoring well being and the welfare of individuals and society at large.**
 - Ignoring consideration of the human as the end of the development process, i.e. happiness, spiritual development, etc.

- III. **Instability of Economic and Financial Systems**
 - Excessive leverage and over-financialization of economy

- IV. **Financial and Social Exclusion**

- V. **Negative Impact on Environment**
 - Continuing neglect and degradation of the environment.

Frequent reoccurrence of finance instability

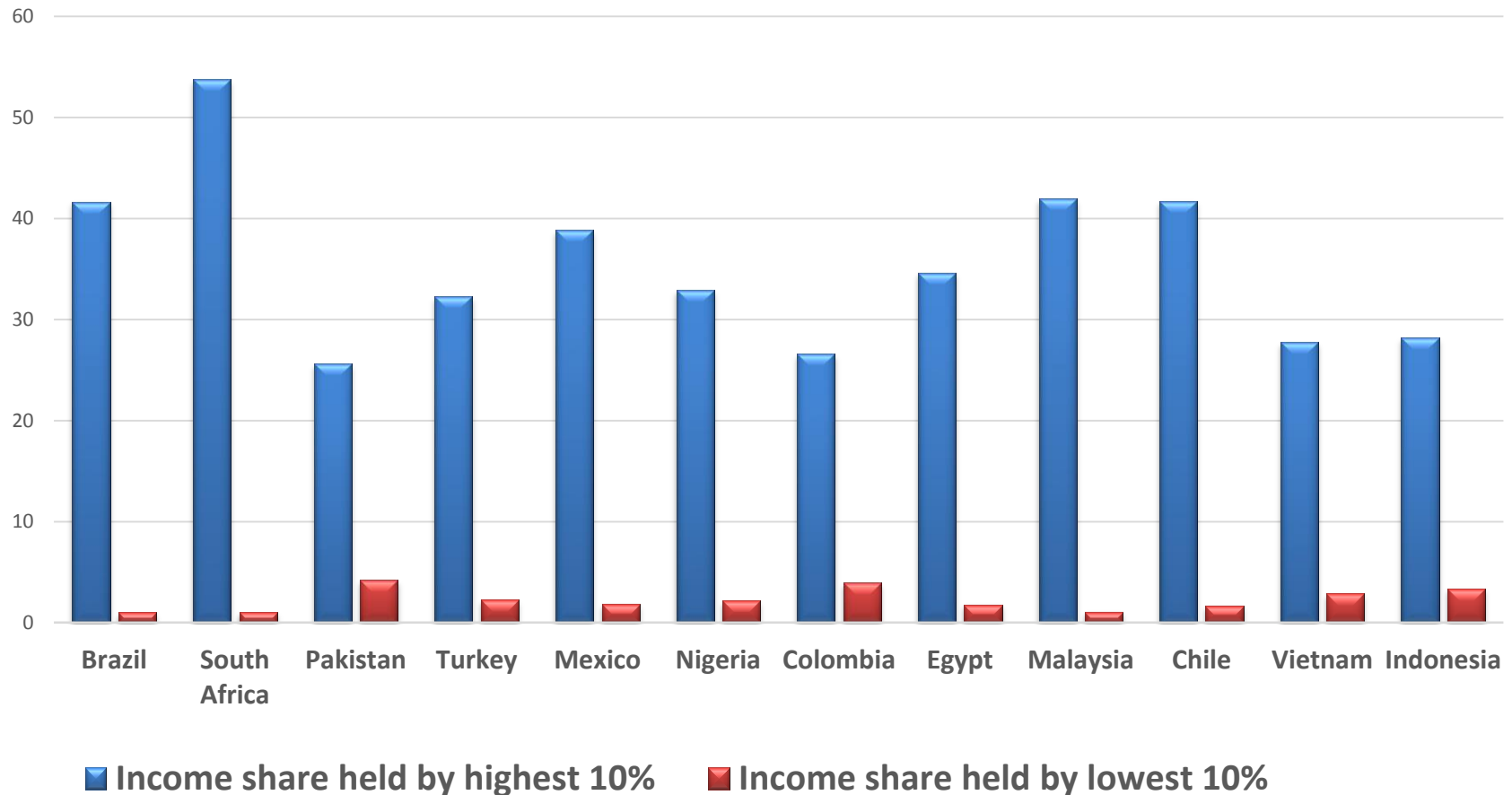
■ **Excessive Leverage:**

- Many academicians and policymakers unanimously agree the negative externalities of high levels of debt could pose to the stability of world financial system.
- Before their failure Bear-Sterns and Lehman brothers were financing overnight mortgage backed securities with 30:1 leverage ratio. (J. Cochrane 2014 Toward a Run-free Financial System)
- Rogoff-Reinhart: Episode of High level of Debt/GDP ratios lower economic growth.
- Richard-Koo who introduced the term “balance sheet” recessions argues that the Japan’s lost decade was due to high leverage ratios of Japanese corporate sector.

■ **Excessive Risk Taking:**

- Use of complex financial instruments and SPVs to put the risks off balance sheet to circumvent the regulatory framework.

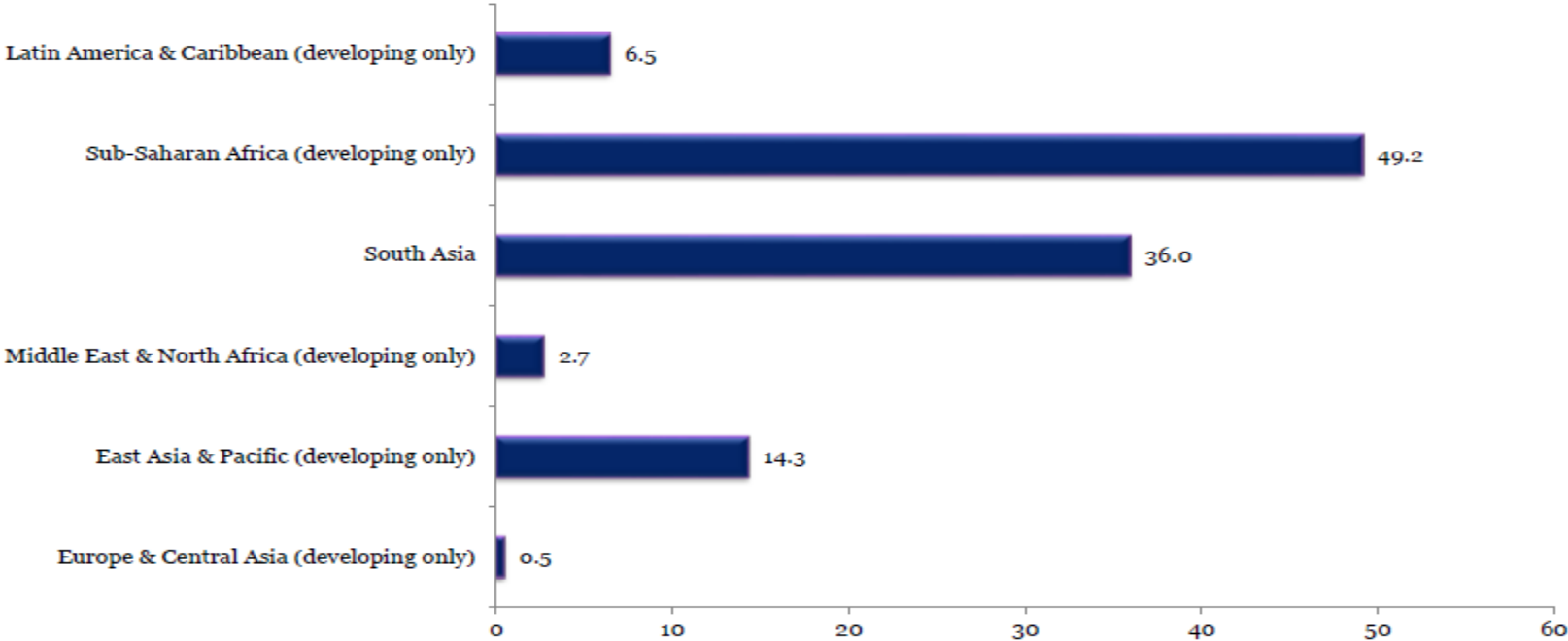
Growing gap in income disparities between top and bottom 10%



Although many countries have experienced substantial increases in prosperity, inequality of income and opportunities continue to persist

Over 1 billion people still live in extreme poverty

Percentage of population living on less than \$1.25 per day (PPP)

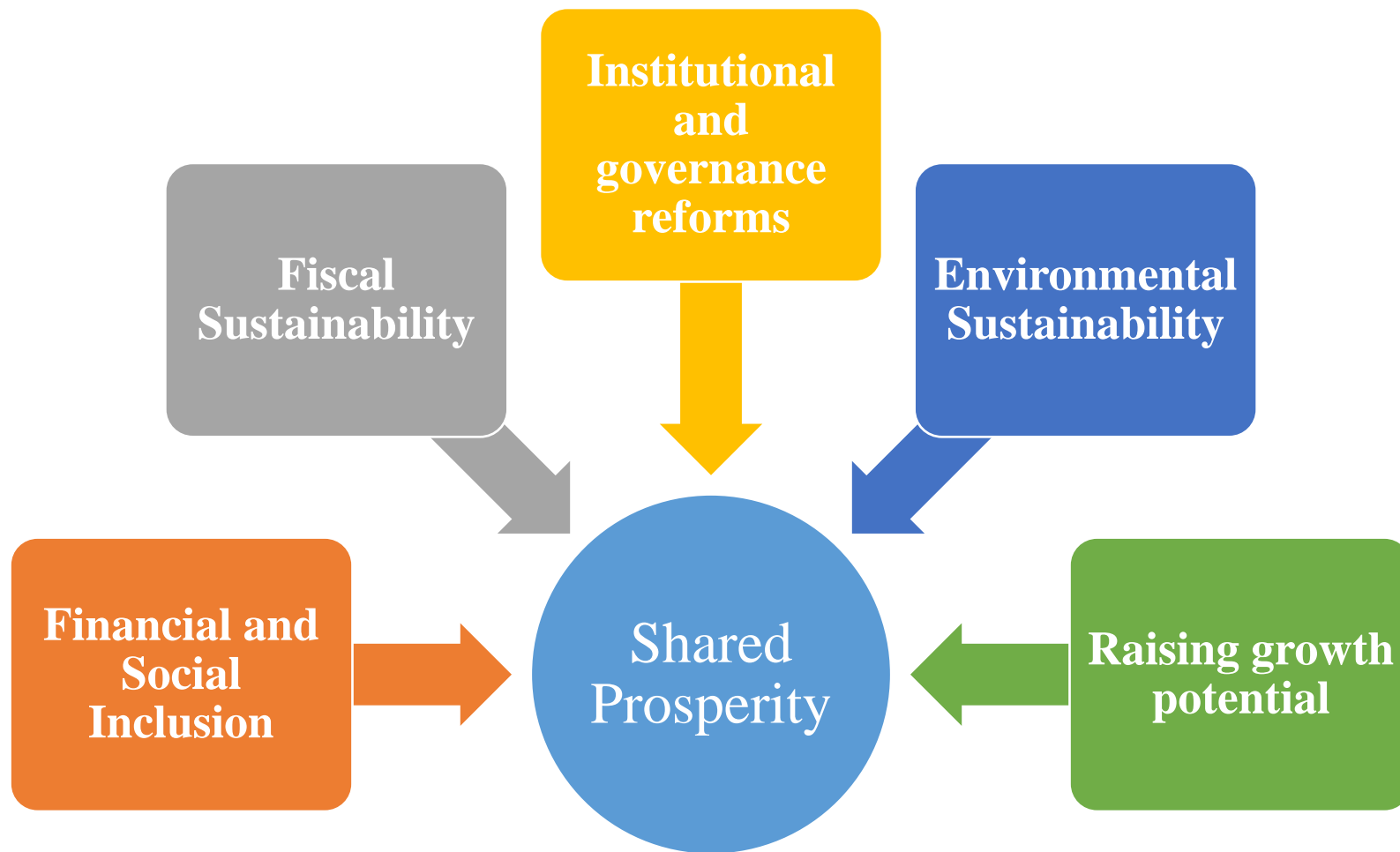


Source: World Development Indicators, World Bank , 2013

The World Bank Group Strategy – Twin Goals

- Historically World Bank Group (WBG) focused on “trickle down” policy in reducing extreme poverty. But this strategy did not prevent inequality from skyrocketing.
- Millennium goal to reduce extreme poverty by 50 percent was achieved ahead of time.
- Hence for the first time in 30 years, World Bank has revised its mission to give priority to inequality and to include it in its main mission.
 1. **Reducing extreme poverty**
 - reduce the number of people living with less than \$1.25 a day to 3 percent globally by 2030.
 2. **Promoting Shared Prosperity**
 - Boost incomes of the bottom 40 percent of the population in every country

World Bank's Strategy of Realizing Shared Prosperity



III. Islamic Finance as an alternative approach

Islamic Finance Response to Key Challenges

Developmental Issue	Islamic Economics/Finance Response
Growing Income and Wealth Disparities	Economic and Social Justice through just market rules, fair opportunity, redemption of others' property rights and inclusive growth.
The focus on GDP but ignoring well being and the welfare of individuals and society at large.	Economic activity is means to achieve materialistic and spiritual goals through a balance between economic and social life. Emphasis on moral and ethical values.
Instability of Economic and Financial Systems	Substitution of risk-transfer with risk-sharing. Elimination of leverage. Asset-based financing discouraging financialization
Financial and Social Exclusion	Financial and social inclusion through risk-sharing and redistributive institutions.
Negative Impact on Environment	Priority to socially responsible financing such as green projects.

Equitable/Sustainable Development

- Islamic finance core theme is risk sharing, furthermore Islamic finance could help creating an inclusive economic development strategy

Risk Sharing

Pre- Production
Redistribution

Islamic Finance is based on risk-sharing where counterparties receive the proceeds of economic growth in line with the risk they bear.

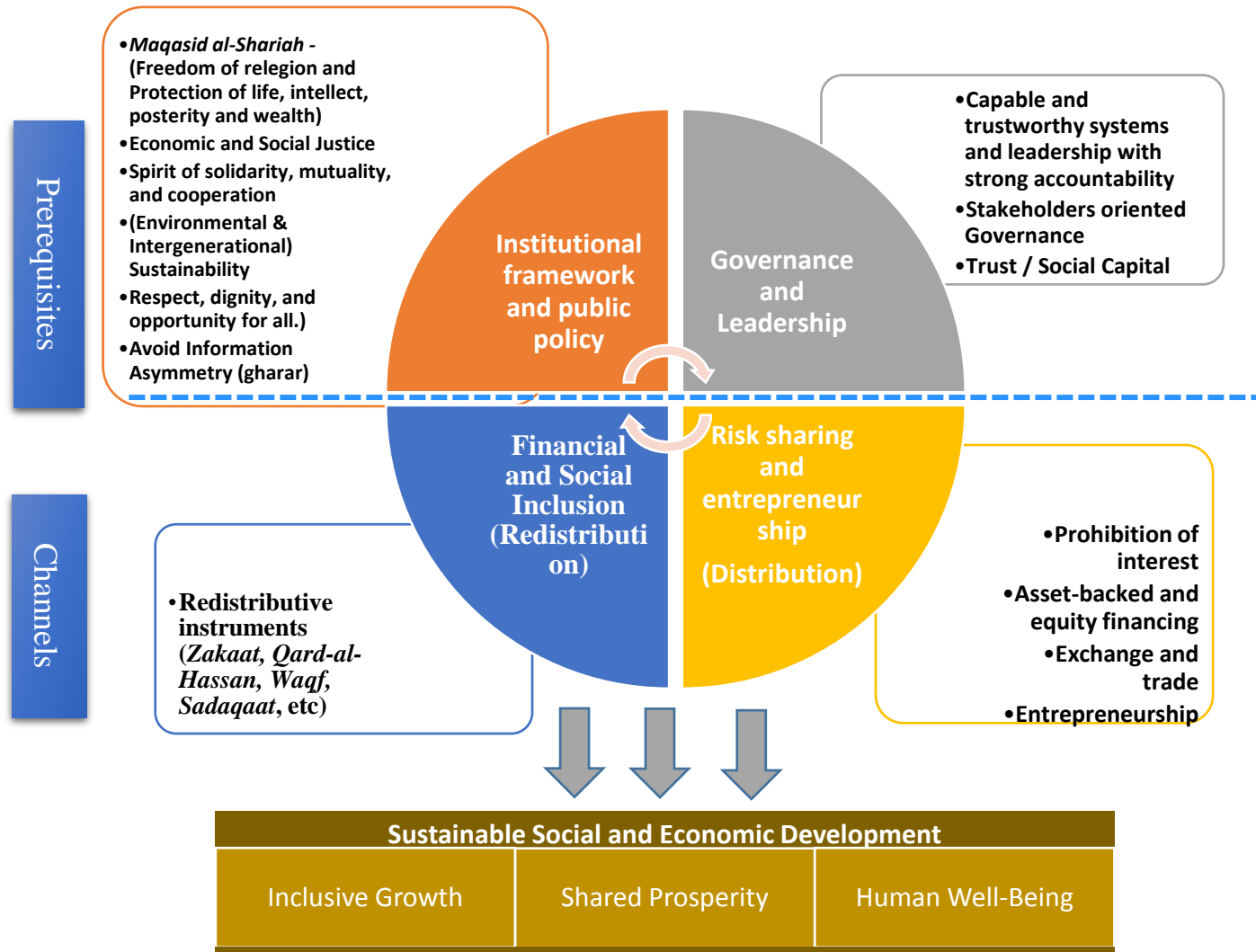
Inclusive-ness

Post Production
Redistribution

Islamic finance could help the proceeds of growth to be distributed to all segment of society through

- * SME financing (Lack of collateral and high interest rate issues resolved)
- * Through redistributive tools

Islamic Perspective on Achieving Shared Prosperity and Economic Development



IV. How to make it work?

How Could Islamic Finance Contribute to Global Finance

- One of the core principles of Islamic Finance is that every financial transaction ought to be based on a real transaction (asset backed nature)
 - Hence the kind of decoupling where financial sector diverges from the dynamics of the real sector is not plausible under Islamic Finance. Speculation on financial system is also forbidden.
- Second core principle of Islamic finance is risk sharing principle.
 - Counterparties share the proceeds of investment based on the risk they bear the kind of “euphoria” and excessive risk taking episodes that precede crashes are less likely.

Opportunities for the future

- Treatment of Islamic finance as structured finance, i.e. **participatory finance**.
- Development of true “**risk sharing**” and “**asset-backed**” financial system should be given priority.
- Utilize full potential of Islam’s redistributive institutions to enhance financial and social inclusion and to alleviate poverty.
- Development of capital market developments promoting risk-sharing and asset-based securities
- Enhanced regulation and supervision to reduce information asymmetries to promote risk-sharing

THANK YOU...

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