

The Role of Islamic Finance for Enhancing Financial Inclusion in COMCEC Member Countries

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Important Note:

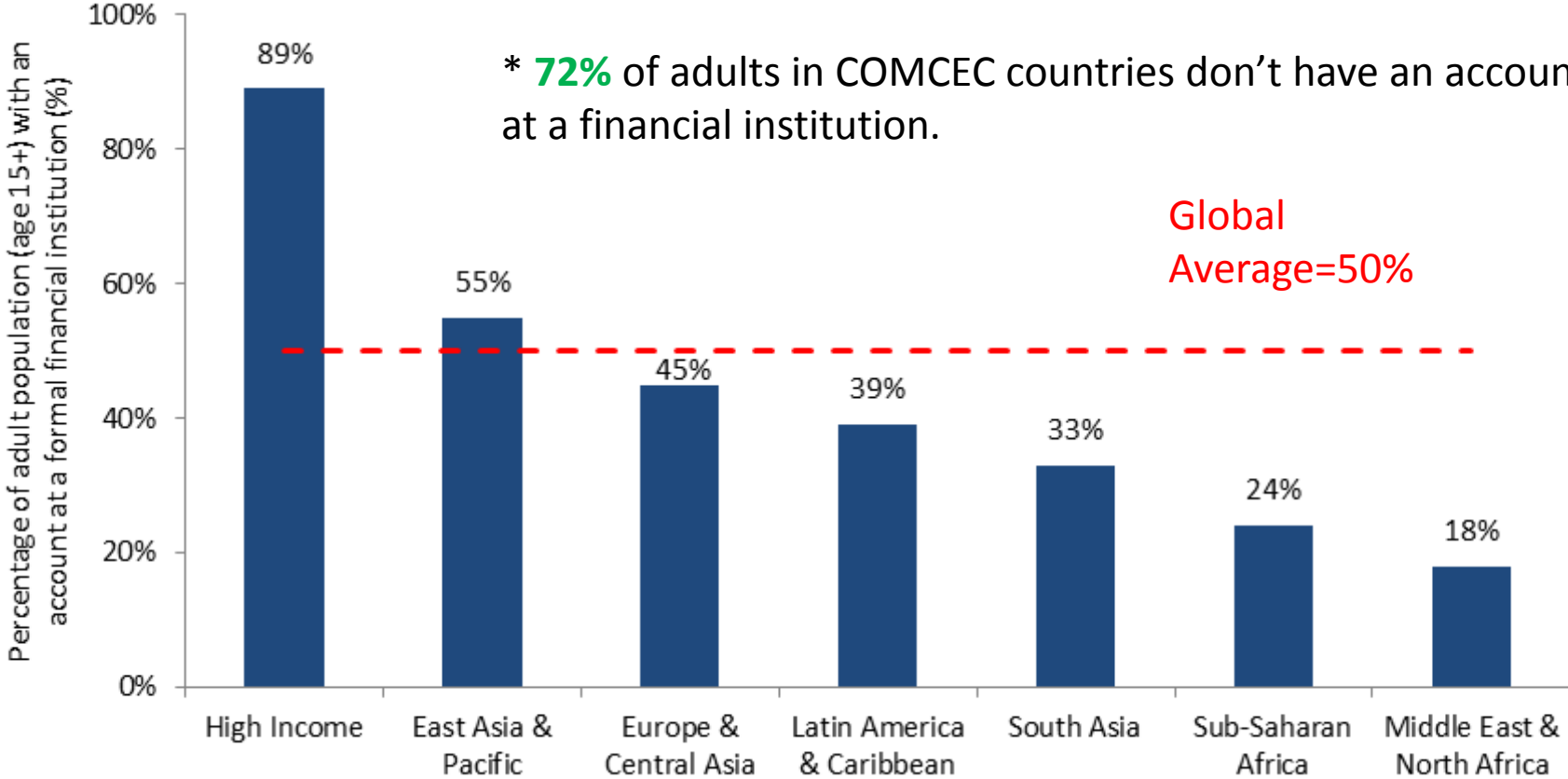
All the data presented in this presentation is for 2011, unless noted otherwise.

Most COMCEC Countries Lag Behind the Rest of the World in Account Penetration Rates

* **2.5 billion** adults (Age 15+) globally don't have an account.

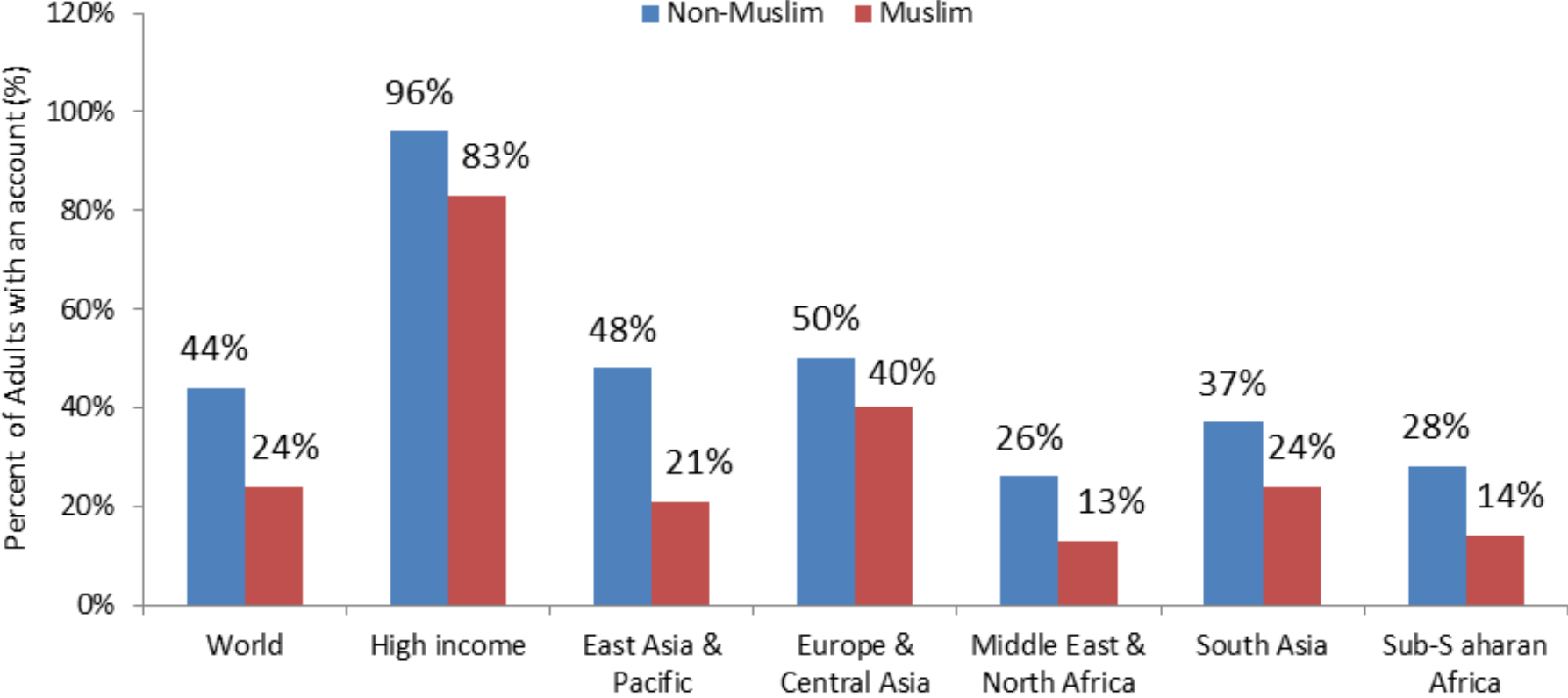
* **723 Million (29%)** are in COMCEC countries.

* **72%** of adults in COMCEC countries don't have an account at a financial institution.



Global
Average=50%

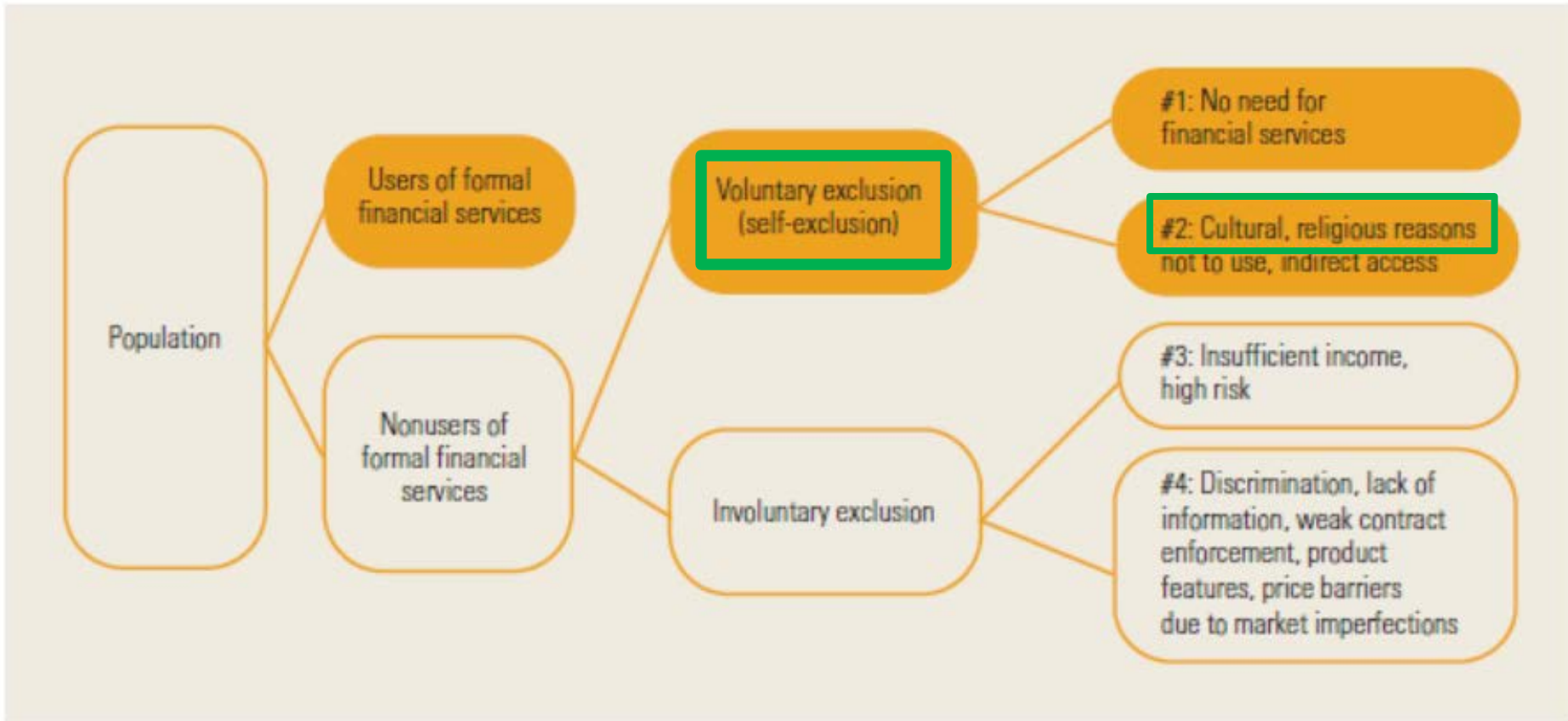
Religion (being Muslim or not) May be a Reason.



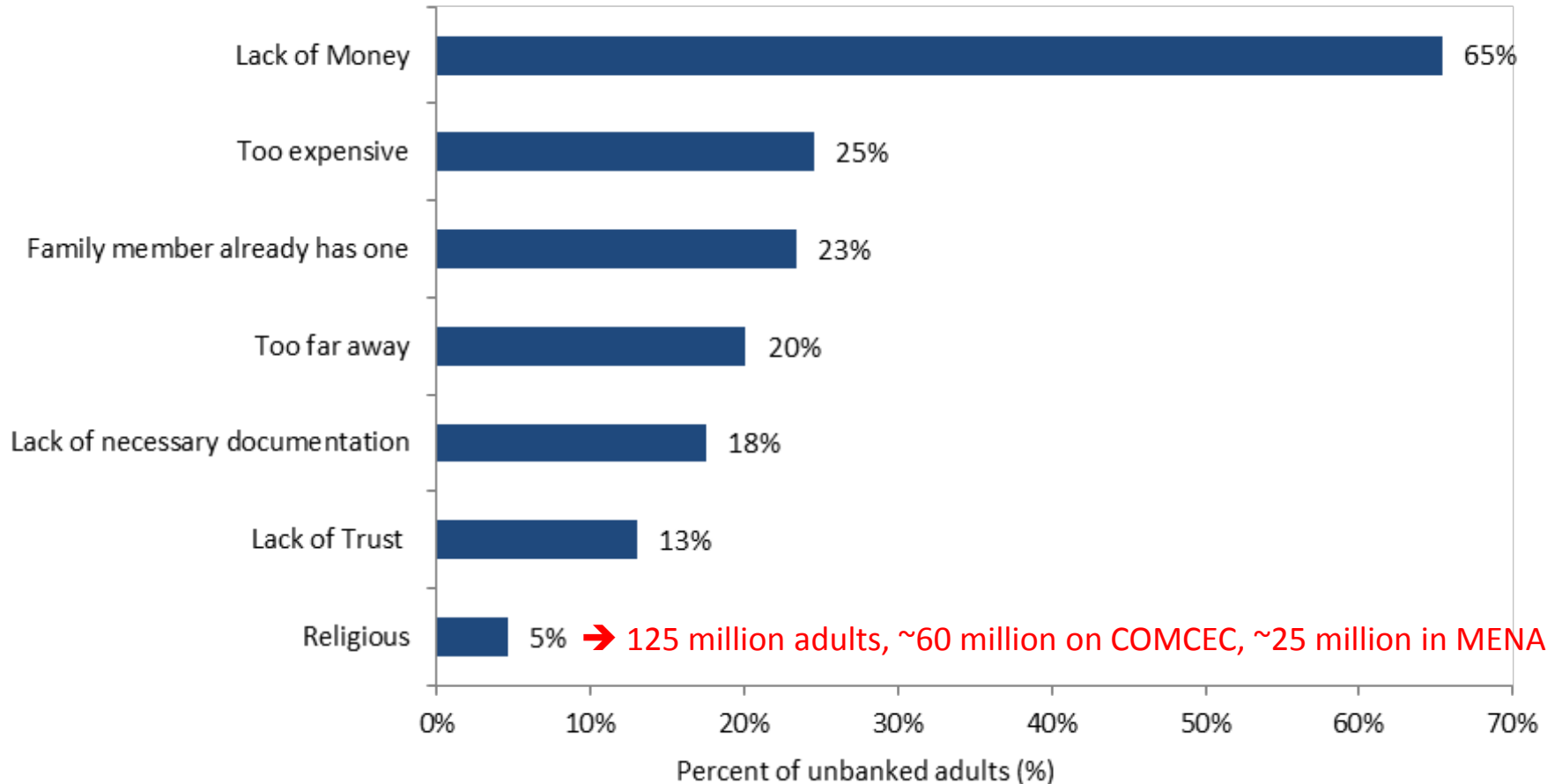
Source: Demirguc-Kunt, Klaper, and Randall (2013).

Note: The difference between Muslims and non-Muslim is statistically significant at 1% level. Analysis is based on 64 countries. Countries with less than 1% and more than 99% Muslim population are excluded from the analysis.

There are Different Reasons for Financial Exclusion Including Cultural and Religious Reasons



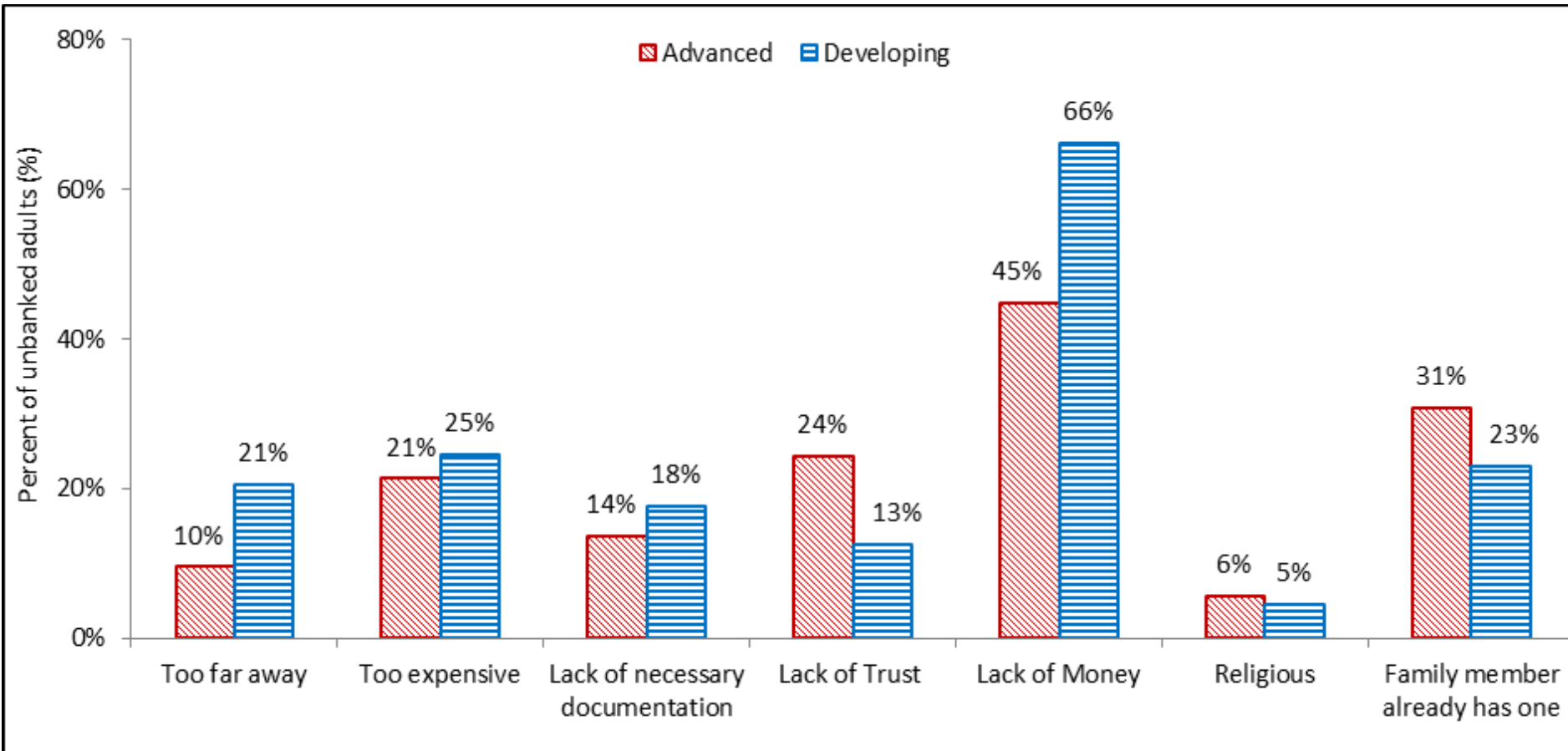
About 125 Million Adults (Age 15 +) around the World Reported Religious Reason for not Having an Account



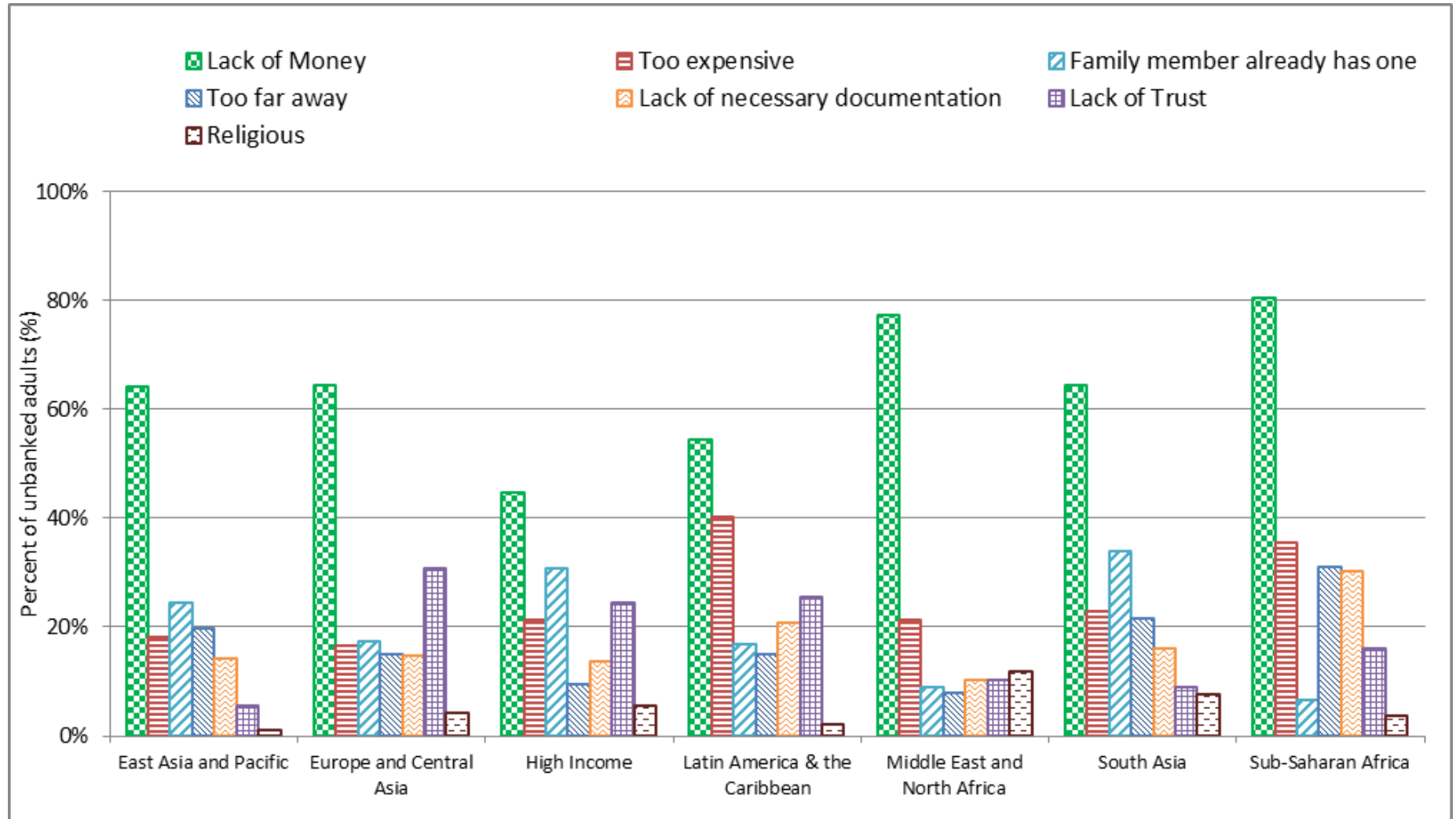
Source: Global Financial Inclusion (Global Findex) Dataset.

Note: Respondents could choose more than one reason.

Reasons for not Having an Account Vary with the Level of Economic Development



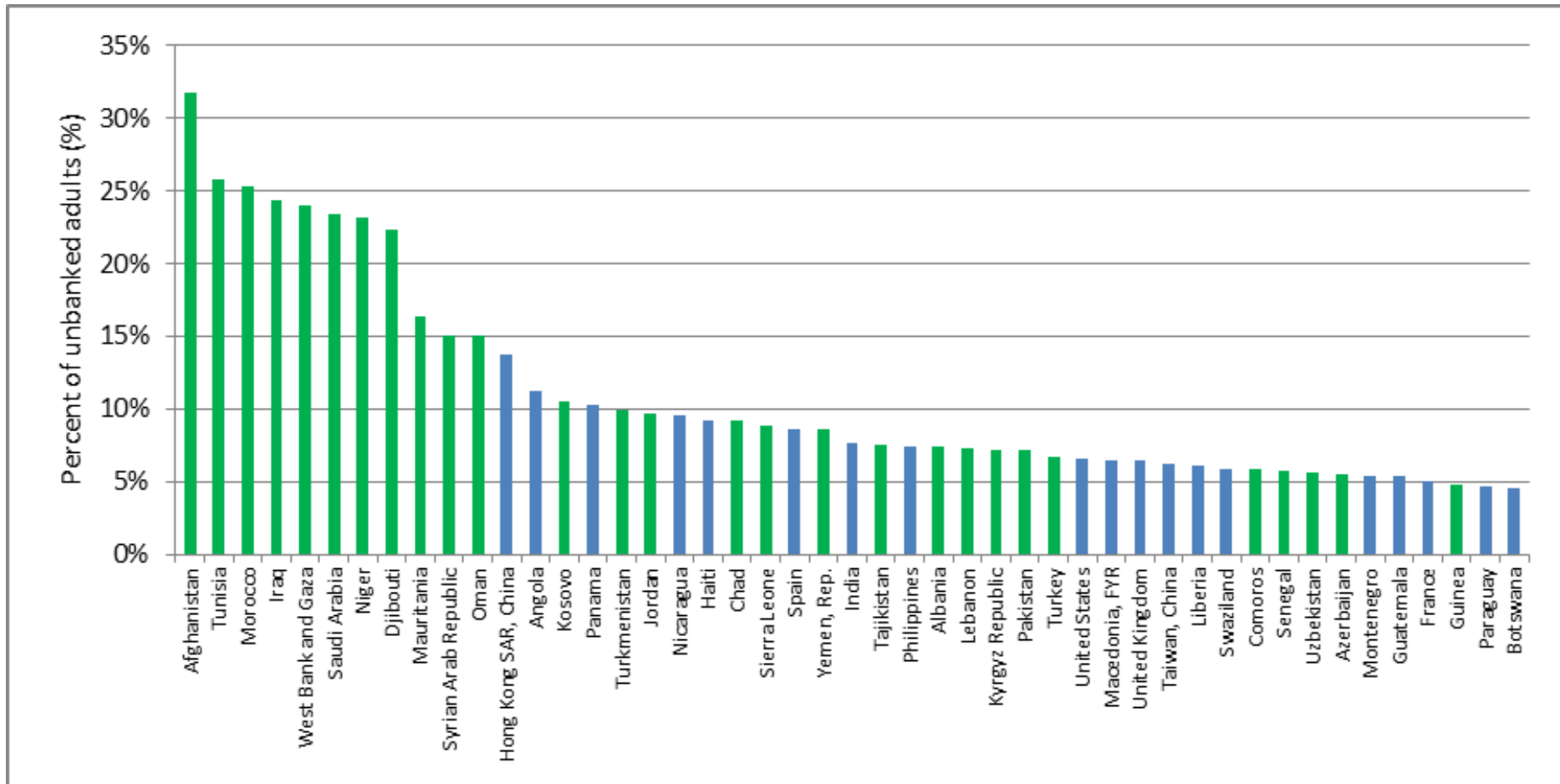
Reasons for not Having an Account Vary Across Regions



Reasons for not Having an Account Could Vary Across COMCEC Countries in Same Region and with Similar Levels of Economic Development

Country	Adults with no account	Too far away	Too expensive	Lack of necessary documents	Lack of Trust	Lack of Money	Religious	Family member already has one
Afghanistan	91%	39%	37%	37%	37%	40%	32%	13%
Bangladesh	60%	13%	30%	10%	9%	71%	4%	23%

All Abrahamic Religions Prohibit Interest in All Economic Transactions, But Muslims seem to be the Main Followers of this Prescription



More Evidence on Financial Exclusion due to Religious Reason Being More Prevalent Among Muslim Communities

	All Countries	Muslim Population <=10%	10%> Muslim Population <=90%	Muslim Population >90%
Too far away	20%	16%	26%	16%
Too expensive	25%	22%	28%	22%
lack of documentation	18%	15%	21%	16%
Lack of Trust	13%	14%	12%	13%
Lack of Money	65%	59%	70%	70%
Religious	5%	2%	6%	10%
Family member already has one	23%	23%	28%	13%

Stronger Evidence on Financial Exclusion due to Religious Reason Being More Prevalent Among Muslim Communities

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9
GDP (2005 Billion \$)	0.000061	0.000255	0.000091	0.00028*	0.00034*	0.00158	0.00032*	0.00054***	0.00036*
GDP per Capita, PPP (2005 international thousand \$)	-0.0694*	-0.0110	0.0152	0.0236	-0.0416	-0.0892	-0.0256	-0.123	-0.0666
Muslim Population (% total population)		0.0927***		0.0914***	0.0762***	0.0512***	0.0755***	0.0624***	0.0626***
Religiosity (% adults)			0.0745***	0.0258	-0.0160	-0.00866	-0.0172	-0.0209	-0.0190
East Asia and Pacific Dummy					-1.480	-1.907	-1.953	-1.674	-1.802
Europe and Central Asia Dummy					-1.476	-0.233	-2.071	-1.487	-1.695
Latin America & the Caribbean Dummy					1.291	0.499	0.978	0.915	0.646
Middle East and North Africa Dummy					6.493*	7.997**	5.906*	9.447**	8.926**
South Asia Dummy					3.018	-3.642	2.044	2.789	2.982
Sub-Saharan Africa Dummy					-0.224	-2.991	-2.382	-1.318	-1.322
Literacy Rate (% people 15+)						-0.0964			
Life Expectancy at Birth							-0.116		
Commercial Bank Branches per 100,000 Adults								-0.00142	
Commercial Bank Branches per 1000 km ²									0.0079***
Observations	133	133	102	102	102	83	102	86	86
R-Squared	0.024	0.361	0.071	0.364	0.455	0.536	0.459	0.500	0.546

Note: OLS regression with robust standard errors. * p<0.10, ** p<0.05, *** p<0.01. Dependent variable is the percentage of adults reporting religious reason for not having an account. Data is from Global Financial Development Database and World Development Indicator.

Islamic (aka Shair'ah Compliant) Financial Services could Boost Financial Inclusion Among Individuals.

	Model 1	Model 2
GDP (2005 Billion \$)	0.000527***	0.000420***
GDP per Capita, PPP (2005 international thousand \$)	-0.0791*	-0.0405
Religiosity (% adults)	0.00559	0.0102
Muslim Population (% total)	0.0718***	0.0623**
Middle East and North Africa Dummy	11.97***	11.31***
Commercial Bank Branches per 1000 km2	0.00748**	0.00636*
Ratio of Shari'ah Compliant Assets to Total Assets (%)	-0.296***	
Shari'ah Compliant Assets per Adult (1000s \$)		-0.563***
Observations	85	86
R-Squared	0.588	0.557

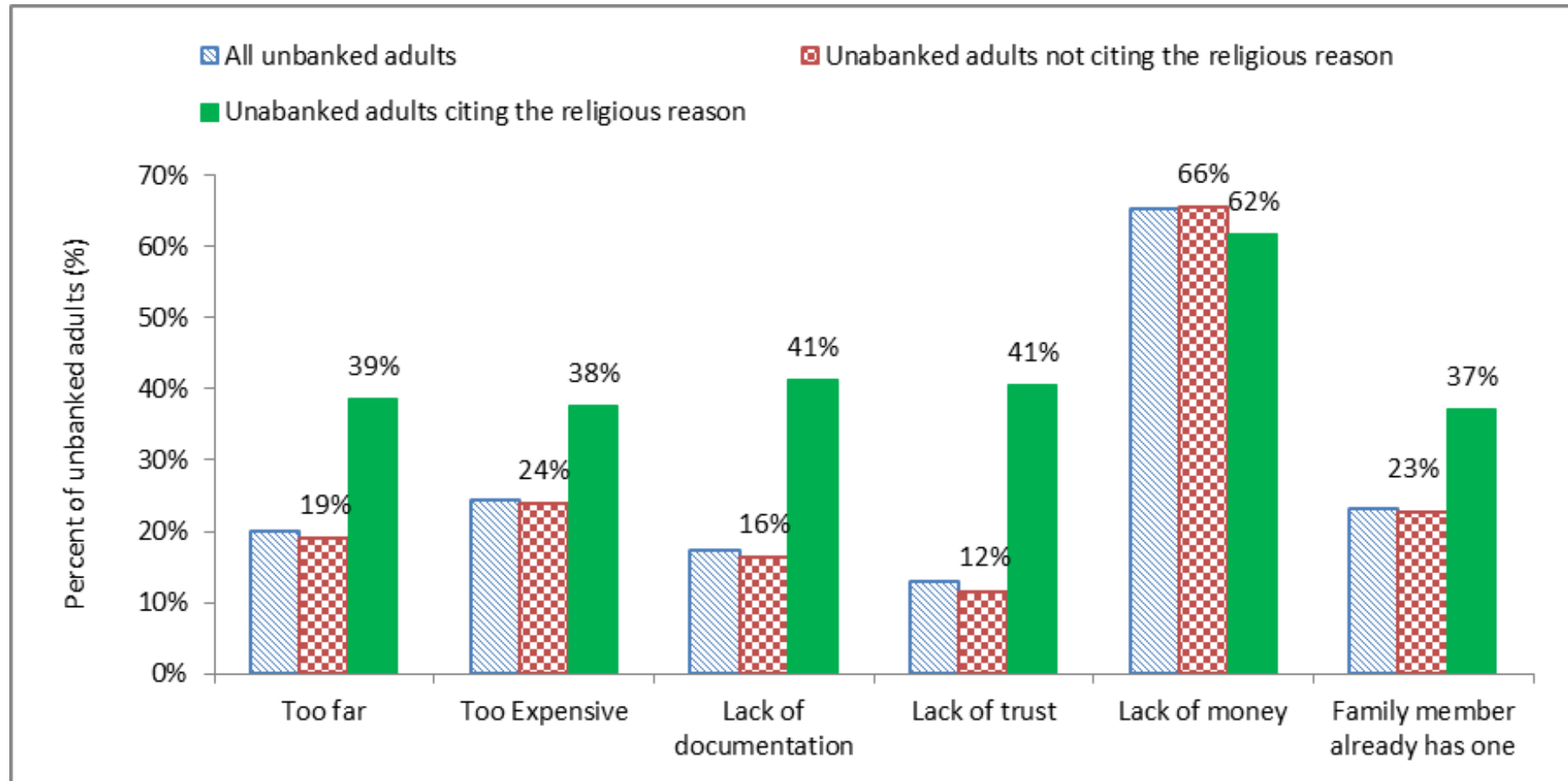
Note: OLS regression with robust standard errors. * p<0.10, ** p<0.05, *** p<0.01. Dependent variable is the percentage of adults reporting religious reason for not having an account. Data is from Global Financial Development Database and BankScope.

Some Evidence that Islamic (aka Shair'ah Compliant) Financial Services could Boost Financial Inclusion Among (Small) Firms.

	All Firms	Small Firms	Medium Firms	Large Firms
GDP (2005 Billion \$)	0.00527	0.00256	0.00437	0.0117
GDP per Capita, PPP (2005 international thousand \$)	-0.648*	-0.670**	-0.466	-0.578
Religiosity (% adults)	0.0449	0.0903	-0.0282	0.0311
Muslim Population (% total)	-0.0107	-0.0219	0.00266	0.00703
East Asia and Pacific Dummy	-7.151	-4.761	-0.674	-14.36
Europe and Central Asia Dummy	6.191	8.228	6.648	4.250
Latin America & the Caribbean Dummy	2.243	3.251	5.120	-6.898
Middle East and North Africa Dummy	14.63	21.39***	22.01	38.76
South Asia Dummy	-2.692	-1.287	3.233	-7.182
Sub-Saharan Africa Dummy	17.36*	20.30**	19.21*	0.186
Commercial Bank Branches per 1000 km2	0.0419	0.169	-0.0225	-0.214
Ratio of Shari'ah Compliant Assets to Total Assets (%)	-0.0723	-0.157***	-0.389	-0.744
Observations	68	68	68	68
R-Squared	0.475	0.482	0.375	0.384

Note: OLS regression with robust standard errors. * p<0.10, ** p<0.05, *** p<0.01. Dependent variable is the percentage of firms reporting access to finance as a major obstacle in their operations. Data is from World Bank Enterprise Survey. Data is from Global Financial Development Database and BankScope.

Other Factors Besides Providing Islamic Financial Services are Important.



Islamic Finance and Financial Inclusion For Individuals

- Reminder: **723 Million adults** in COMCEC countries are unbanked. At the same COMCEC countries are home to about **700 million** of world's poor.
- Make the unbanked population (mostly the vulnerable and poor) bankable through benevolent financial services in Islamic financial system:
 - ❖ *Qard*: Most suitable to cover temporary needs of the non-poor to smooth consumption in the face of unexpected negative shocks to their income.
 - ❖ *Qard al-Hassan*: Providing financial services for those poor who have higher likelihood for growing out of poverty or those in the borderline poverty whom if not assisted have a high likelihood of falling into poverty (such as young adults, students, transitory ill or unemployed, widows, etc ...)
 - ❖ *Waqf*: Providing Social Services (food, shelter, health, and education) to the vulnerable.
 - ❖ *Micro-Takaful*: Protecting the small assets of the poor → Freeing up some assets and wealth for current needs.
 - ❖ *Zakat and Sadaqa*: Providing financial support for mainly the most vulnerable of the poor or those poor who have little or no likelihood of becoming financially independent (permanently ill or handicapped (physically or mentally), children and elderly, etc....)
- Establishes relationship between the vulnerable and the poor with formal financial institutions at various levels → Increases financial literacy and Creates a financial history for the poor → Increase their access and use of formal financial services.

Islamic Finance and Financial Inclusion For Firms

- Risk Sharing contracts between formal financial institutions and firms, specially smaller firms:

- ❖ The borrowers (mostly the poor in the COMCEC countries) are responsible for a portion of the risk and not all of it → encourage more economic activity on the part of the poor.
- ❖ The lenders will be more cautious as they are partner in the project with borrowers and shoulder some portion of the risk with the borrower → Increase success rate of projects.
- ❖ The lenders will be motivated to continue monitoring the borrower and provide technical assistance to the borrower as they are partner in the project with borrowers and shoulder some portion of the risk with the borrower → Increase success rate of projects.

4 Main Challenges for the Growth of Islamic Finance

- Lack of universally accepted set of definitions, standardization, and regulatory and supervisory guidelines.
- Lack of adequate knowledge and training among:
 - Users: General Public
 - Providers: Financial Institutions
- Competition with well-established mainstream conventional financial institutions.
- Lack of coherent, consistent, accurate, and up-to-date data:
 - Policy Makers
 - Researchers
 - Providers