Global Calls for Economic Justice: the potential of Islamic finance

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Suggested hashtag for Twitter users: #lseislamfin
Global Calls for Economic Justice: The Potential of Islamic Finance

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1. Economic Justice: Concepts and Calls
2. The Potential of Islamic Finance
3. Realities of Islamic Finance
4. Drivers of Conventionalisation
5. Activation of Potentials
## Economic Justice: Concepts and Calls

### [Discussion of] Principles (abstract) in

- **Religious teachings**
  - Christianity
  - Islam
  - ...
- **Economic theory**
  - Welfare economics
  - Public Choice
  - Game theory
  - ...
- **Political philosophy**
  - Natural law
  - Libertarianism
  - ...

### [Calls for] Action (concrete) by

- **Religious movements** (e.g. liberation theology, Muslim brotherhood)
- **Human/Civil rights movements**
- **Green parties**
- **Political uprisings (Arab spring)**
- **Occupy movements (OWS)**

**for**

- Participatory justice (opportunities, procedures)
- Distributive justice (outcomes)
- Employment and income opportunities
- Minimum wages/living standard
- Fairness, dignity
- Financial system reform
- Poverty alleviation
- Social security
- Health, housing, education
- Growing inequality (total wealth US 20/87%)
- (Youth) Unemployment
- Political system (authoritarian, inactive)
- Unbridled capitalism (excessive debt, socialising losses, impoverishment of the middle class)

**against**

- Growing inequality (total wealth US 20/87%)
- (Youth) Unemployment
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The Potential of Islamic Finance

Islamic economic system

Islamic banking

Prohibition of
• Riba
• Gharar
• Maysir

• Finance for real economy
• Support for entrepreneurs
• Mobilization of savings
• No reward without risk
• Participatory finance (no collateral, SMEs)
• No speculation

Shari'ah

• Participatory justice (opportunities, procedures)
• Distributive justice (outcomes)

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• Minimum wages/living standard
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Islamic capital market

• Equity (stocks, VC)
• Sukuk

• Solidarity (Takaful)
• Zakat
• Waqf

• Private property with social obligation
• Fair competition
• Basic infrastructure and social services

Superior allocation, distribution, systemic stability
The Potential of Islamic Finance

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Superior allocation, distribution, systemic stability

Claim or reality?

Shari'ah

- Participatory justice (opportunities, procedures)
- Employment and income opportunities
- Fairness
- Financial system reform
- Poverty alleviation

excessive debt
Realities of Islamic Finance

Islamic banking

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Yes, but not always, and

- Predominantly short-term trade finance (little impact on employment, income generation, and poverty alleviation)
- Longer-term finance mainly for real estate (= investments in bubble-prone and often speculative markets)
- Increasingly project financing for public infrastructure (little impact on domestic SMEs)
- Little corporate finance, very little SME finance, hardly any participatory finance
- Sophisticated techniques to minimize the risk that results from the use of trade/rent contracts for financing purposes (e.g. customer as agent, purchase orders)
- No financing without collateral
- No evidence for additional net savings (deposits transferred from conventional banks)
Realities of Islamic Finance

Islamic banking
- Prohibition of Riba, Gharar, Maysir
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Results of contractual engineering:
- Finance (largely or completely) detached from the real economy (e.g. tawarruq, commodity murabaha, Islamic repos, asset based securities)
- Development of Shari’ah compliant functional equivalents of conventional structured products (options, swaps, plugs)
- Prototypes of securities (derivatives) suitable for trading within the financial sector
- Inadequate corporate governance structures (no voice for ultimate risk bearers: investment account holders, takaful participants)
- Systemic risks not fully recognized (e.g. threat of bank run due to ineffective deposit guarantee schemes)

→ Significant divergence between claims and realities of Islamic finance
Drivers of ‘Conventionalisation’

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Inroad of conventional financial institutions into a profitable market segment
- Conventional mindset
- Structuring expertise
- Profitability of trading
- Shareholder value orientation

Shari’ah scholars in board positions:
- Main role: legal advisors
- Board positions attractive (reputation, compensation)
- Appointment by BoD/shareholders
- Micro-legalistic approach
- Lack of macro-systemic understanding
- Pragmatism in the name of maslahah (public good)

Status quo as a challenge; ways forward?
Activation of Potentials

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Product development

- Participatory finance with limited downside risk
- Participation certificates
- Accounts with transparent risk/return profile

Regulation

- Reconsider systemic stability qualities of IF
- Consumer protection
- Shari‘ah governance system

Market discipline

- Best practice examples
- Performance analysis
- Islamic benchmarks
- Competition (intra- and inter-sectorial)

Public awareness

- Islamic economists
- Financial literacy
- Specialised media
- Rating and ranking
- Academic study programs and research

Islamic capital market

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More distinctiveness from conventional finance and authenticity with a systemic perspective

Growth potentials as ethical finance and socially responsible investment, contributing to economic justice (instead of complicated and restrained replication of conventional finance)
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