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LA FINANCE ISLAMIQUE ET LA FINANCE CONVENTIONNELLE : QUELLES INTERACTIONS ET QUELS ENJEUX ?

ISLAMIC FINANCE AND CONVENTIONAL FINANCE: WHAT INTERACTIONS AND WHAT ISSUES?

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Abstract

Islamic banks have come to challenge the established institutional order with notions of solidarity development and sustainable development, atypical forms of organization, structures, completely new financing operations.

This work seeks to study the contribution of Islamic financial development in terms of economic growth and financial stability. On the one hand, it shed lights on a theoretical analysis of the causal link between financial development and economic growth. On the other hand, it highlights on the meaning of the relationship between Islamic finance and development.

Moreover, the article examines the literature relating to the treatment of the interaction between Islamic finance and development while studying the main theoretical currents. The article also reviews the contributions of empirical studies that have tested the link between Islamic finance and economic growth.

Keywords: Islamic finance; economic growth; development.

Résumé

Les banques islamiques sont venues bousculer l'ordre institutionnel établi avec des notions de développement solidaire et de développement durable, des formes d'organisation atypiques, des structures, des opérations de financement totalement nouvelles.

Ce travail vise à étudier la contribution du développement de la finance islamique en termes de croissance économique et de stabilité financière. D'une part, il apporte un éclairage sur une analyse théorique du lien de causalité entre le développement financier et la croissance économique. D'autre part, il met en lumière la signification de la relation entre la finance islamique et le développement.

En outre, l'article examine la littérature relative au traitement de l'interaction entre la finance islamique et le développement en étudiant les principaux courants théoriques. L'article passe également en revue les contributions des études empiriques qui ont testé le lien entre la finance islamique et la croissance économique.

Mots-clés : finance islamique;; croissance économique ; développement.

Introduction

Although there is a flourishing literature on the relationship between finance and economic growth, the examination of the relationship between Islamic finance and economic growth remains understudied so far.

Though the correlation between conventional finance and development is nowadays widely accepted which is subjected to generating inflationary tension and cyclical crises of varying intensity and the interaction between Islamic finance and development; still the nature of the relationship between Islamic finance and conventional finance poses a thorny unresolved question. The fact that the relationship between Islamic finance and development is very little

studied by economists; that's why , we are still trying to find out whether the relationship between the two forms of finance is complementary or substitute alternative.

Our research therefore aims to verify the nature of the relationship between Islamic and conventional banks and whether Islamic finance can be an alternative to conventional finance.

Our section will be subdivided into three levels. First of all, it presents a review of literature which relates to the interaction between the conventional finance and development. Then, we make a comparison between the two types of finance in terms of economic growth. Finally, it seeks to explain the need for

the interrelation between Islamic and conventional finance to better promote economic growth.

1- Economic development and economic growth

The interrelation between financial development and economic growth highlights the conditions of the relationship between the financial aspect and the economic aspect and also the mechanisms through which finance influences economic growth.

The correlation between the development of the financial sphere and economic development seems widely accepted within the community of economists. Conversely, the split between economists is about the question of causality between the two phenomena. The latter is so controversial not only theoretical, but also empirical through which dozens of estimated econometrics presented divergent result. These results depended either on the period chosen, or on the economy or space of the economy chosen, or both at the same time.

Theoretically, not every interaction is a one-way direction; a question of causation arises. Thus, we can consider financial development as a driving force

of economic growth, as we can suppose the first as being the result of economic development, and finally it is possible to suppose the existence of a reciprocal influence between the two.

a- Islamic finance: a source of economic growth

- Literature paper

For several authors, Islamic finance is a lever for financial development and therefore a way to accelerate growth. So this finance is a real vector of growth.

Indeed, Islamic finance also seems to play a role in economic development through the mobilization of savings3. Khan and Mirakhor (1994)4 complete this vision by showing that the central banking and Islamic monetary policy will try to develop financial institutions as well as instruments that facilitate efficient mobilization of savings and provision of resources which goes hand in hand with the objectives of Islamic economy. All possible conventional tools available in a modern economy will be at the disposal of Islamic monetary authorities apart from those which involve the use of interest.

Moreover, the idea of sharing risks and returns, and materiality or a direct link between finance and the real economy, is central to Islamic finance. The above principles helped shield Islamic finance from exposure to the reckless conduct and toxic assets that were at the heart of the global financial crisis. Islamic banks do not have the same attributes as conventional banks. The central question is how this Islamic financial system (the development of Islamic finance) as a trend contributes to the stability of economic growth even in the presence of conventional finance.

Existing theoretical works study the role of Islamic finance in accelerating and improving economic growth (Siddiqui, 1983; chapra, 1993; Kazarian, 1993). Through its function of mobilizing savings, the Islamic financial system improves

the efficiency of the economy and stimulates economic growth (Zaher & Hassan, 2001; Khan &Mirakhor, 1994).

In terms of financial stability, Islamic finance as an ethical finance especially through its principles which is based on risk sharing as well as the backing of all financing to real assets can contribute to promoting better risk management. This can be for both: financial institutions and their customers. This risk of sharing makes banks more careful when granting financing to maintain the stability of their net assets [Hassan, 2009; Cihak & Hesse, 2010; Syed Ali, 2007). The Islamic financial system, due to its inherent stability, is more resilient to shocks (Mirakhor, 2008; Siddiqi, 2008). Recent researches have found that Islamic banks reduce macroeconomic volatility and stimulate economic growth (Benes & kulhof 2012; Wolf 2014). Thereby, recent studies have sought to analyze the resistance of Islamic banks to the subprime financial crisis. This was particularly analyzed by (Kan et al. 2009; Wilson 2009; Boumediene &, 2009; Asa'ad & Abdlouahab, 2012; Lutuf Ali Phulpoto & Turk-Ariss, 2010a) who showed that Islamic banks resisted more than conventional banks during the subprime crisis. On the contrary, Other authors found out that there is no difference in the degree of resistance between the two types of banks (Islamic and conventional) when it comes to the financial crisis (Thorsten, B., Asli, D. , & Ouarda, M, 2013; Kassim & Abd Majid, 2010).

b- Islamic finance is a bridge between the real economy and virtual finance

The differences between Islamic finance and conventional finance lie mainly in the prohibition of “Riba”. This term comes from the verb “Raba” which means in English “to increase”. It therefore designates an increase in value and corresponds to two very distinct notions in the terminology of Western finance: usury and the interest rate.

The Koran explicitly prohibits, on several occasions, the practice of Riba. Muslim philosophy therefore vehemently condemns any rate of interest, whether usurious or not. The perception of a fixed remuneration, based solely on the passage of time and completely disconnected from the real profitability of the underlying investment project, is contrary to Muslim ethics, because it is considered socially destructive.

Proponents of Islamic finance thus advance the idea that the existence of this mechanism encourages a non-productive allocation of resources in an economy, by allowing investors to receive a return on their capital without taking any active role in the process of investment. If this observation is somewhat extreme and questionable from an economic point of view, it has at least, the merit of giving us a clear idea of the inviolability of this fundamental norm of Shariah.

Still in this order of ideas, certain Islamic economists advance the idea that a financial system based on the principles of Islam, and in particular on the prohibition of "Riba" could have avoided the greatest financial disasters of the fifty last years.

Recently, the Anglo-Saxon countries put their banking system in difficult situation and that was due to the debt crisis. Moreover, part of the responsibility of the subprime crisis precursors of the current economic and financial crisis lies with banks which assigned credits easily and without much discernment.

Also, hoarding is prohibited as it diverts funds from productive activities. Hence, what is even more fundamental is that any financial transaction must be backed by a real asset. This argument highlights the scope of the intangible principles of Islam on the Islamic financial sphere. In a beautiful way, it shows that finance in the Islamic finance serves to a large extent the real economy and it is deeply linked to it; therefore, it must imperatively contribute to financing in compliance with Islamic moral principles.

2- Comparison of the theoretical principles of Islamic finance and conventional finance

The raison d'être of an Islamic financial system, just like that of a "classic" financial system is the mobilization of financial resources and their allocation between different investment projects as already mentioned in the previous paragraphs. However, if the objectives converge, the principles which govern the functioning of the Islamic financial system are fundamentally different from the spirit of conventional finance.

Islamic finance ultimately has the same purpose as conventional finance. It will therefore be obliged to evolve in order to adapt to the market needs and to tolerate convergence with the practices of conventional finance owing to the globalization of certain financial markets. However, it is also a discipline which charged from an emotional, symbolic and conceptual point of view. Additionally, It embodies a certain number of ethical principles which are added to the usual operating constraints of any financial institution.

This implies significant and unavoidable differences between Islamic finance and conventional finance on several points: in terms of risk, structuring of financial products, know-how and required skills, etc…

What matters most in participatory finance is the purpose of the investment (clearly identified) and the traceability of the money. More than interest, what is prohibited is the resale of credit as it is, cutting it off from its purpose.

Moreover, if the total prohibition of Riba, which is one of the pillars of participatory finance seems difficult to apply outside the Muslim world, there are correspondences between many other principles of Shariah and certain ethical standards of non-Muslim countries. For example, in the field of economics and finance, there are markets that share common ethical requirements with participatory finance. Some are relatively old, such as "Christian" funds (which have existed for over 100 years).

The use of the funds must be in accordance with the wishes of the investors and it is necessary to be able to remunerate them according to this use (link between purpose and remuneration and link between remuneration and risk-return pair).

“Two important points sum up the main difference between Islamic banks and conventional banks:

- The taking into account of a moral dimension in financial decisions which entails a modification in the internal organization of the bank (with in particular the creation of a (chariah board), and which also implies a certain number of additional obligations (such as the management of funds collected by zakat).
- The rules on which the operation of participatory banking is based will also modify the bank-customer relationship as it exists in the world of conventional finance. Since the depositor becomes, to a certain extent, an investor and bears, in part, the same risks as the bank, we cannot speak only of a depositor-bank or lender-borrower relationship but of a true investor-entrepreneur relationship similar to that what exists in direct investment operations. Thus, in its credit allocation decisions, the bank

will take into account not only the solvency of the customer but also his quality of entrepreneur as well as the economic potential of his project.[1]".

For his part, the client takes into account not only the profitability of the investments offered by a bank but also his social commitment as well as his adherence to the principles of Sharia.

However, in reality, the edge between these two categories of financial institutions is less and less clear and we observe a certain number of convergences between conventional banks and participatory banks:

[1]Jouini and Pastre report, challenges and opportunities in the development of Islamic finance for the Paris marketplace, December 8, 2008

- In search of greater profitability, conventional banks are expanding their investment activities for their own account and for the third account.
- Participatory banks, for their part, are developing products such as Murabaha which is similar to traditional debt instruments in order to diversify their portfolio of activities.
- Finally, more and more often, conventional banking establishments are integrating extra-financial criteria into their day-to-day management and into the decisions to allocate their loan or investment portfolio.
- The participatory bank requires of any promising project that presents a feasible study which must, in principle, provide information on the financial, economic, commercial, technical, and organizational aspects. As the files presented rarely contain all these elements, the participatory banks have set up departments so that they can study and monitor projects.

In this case, the bank is responsible for the total financing of the investment, but it owns the invested capital; this type of financing is ideal for a start-up SMEs to obtain the funds necessary to set up the investment.

At the level of the participating banks, what matters most is the profitability of the project to be financed insofar as the bank's remuneration depends on this profitability. This sharing of profits between the client and the bank is explained by the fact that the profit is only the fruit of two closely linked elements: labor and capital.

Instead of interest, the participatory bank earns capital gains, rental income or even profit margins. The fragmented space of participatory banking is therefore confronted with a global financial environment oriented towards the creation of value for the shareholder.

At the level of participatory banks, the problem of guarantees arises less acutely than for traditional banks because the securities are real and generally owned by the bank.

3- Conventional finance versus participatory finance: rivalry or complementarity

Whatever the angle from which we propose to study this tangential relationship between conventional finance and participatory finance, we will find ourselves either faced with a situation of contradiction[2], or faced with a situation of synergies both at the microeconomic and macroeconomic levels.

In order to provide some answers to this emblematic situation. We suggest briefly recalling the principles of conventional and participatory finance before reducing, in the conclusion of this section, the nature of the relationship between conventional finance and participatory finance within a given economy.

a- FC AND FP: a rivalry of principles backed by economic synergy

By browsing the main theoretical works focusing on the comparison between conventional and participatory finance[3], it has not been emphasized anywhere that participatory finance can definitively replace conventional finance.However, no one will be able to question the contradiction in principle existing between the two aforementioned branches of finance.

The opening of financial systems to Islamic finance thus opens the way to a more intense mobilization of the financial resources available in society and to the realization of additional investment projects which otherwise would not exist nowadays. It thus gives large masses of the population the opportunity to participate in the development process without having to renounce their religious convictions. By preventing the financial exclusion that could affect large segments of the population in Muslim countries as well as in Muslim communities

[2]Principles, objectives, operating methods
[3]Essentially the scientific production, relating to this field, published after the financial crisis of 2007.

in non-Muslim countries, the presence of Islamic finance alongside conventional finance contributes to the increasing mobilization of development potential. For all those who have no objection to go through the interest loan system, the coexistence of Islamic finance and conventional finance offers the advantage of widening the range of financing choices for their development projects. It therefore contributes to achieving greater efficiency in the allocation of resources, which has a positive impact on development.

Conventional finance allows, thanks to securitization, an unconstrained multiplication of credit transactions involving debt securities not backed by real assets, which has resulted in gigantic indebtedness and a disproportionate growth in monetary flows and actual transactions in goods and services. This is an eloquent expression of the real-monetary dichotomy induced by the mode of operation of conventional finance.

By contrast, Islamic finance rejects the trade of money; money is returned to its primary function, that of an instrument of exchange. There is no room for an exchange of present money for future money. All Islamic financing methods are backed by real assets. Credit is granted for specific uses involving the purchase or rental of real assets; it can only grow in harmony with the growth of transactions in goods and services. Islamic finance thus ensures synchronization of the real and financial spheres, which has the effect of controlling the evolution of debt and sparing the economies concerned from debt crises, which are always costly in terms of job losses and a drop in the standard of living of populations, particularly the most vulnerable strata.

The institutional framework in which conventional finance operates stimulates fundamentally destabilizing speculation and reduces the ability of financial markets to support investment and development effectively and in stability. The approach to the issue of risk in Islamic finance is fundamentally

different; it rejects speculation and does not allow the financing of speculators, thus reducing to a large extent the exposure of the economy to financial crises. Indeed, Islamic finance diffuses joint risk-taking to all market participants instead of entrusting risk-taking to a particular category of agents and speculators. The depositors, the banks and the beneficiaries of bank financing are all in the same chain of risk and jointly share the consequences. This leads to an economic system with a high degree of integrity and strong resilience to shocks.

Moreover, the mode of operation of Islamic finance prevents the excessive creation of credit and the constitution of debt pyramids at the origin of financial crises. Let us remember that speculation is fueled by unbacked credit to tangible assets and the possibility of selling without holding, both of which are foreign to the Islamic finance model. The operations that are securitized at the origin of the current crisis are also not possible in a framework governed by the principles of Islamic finance. It is obvious from the above that Islamic finance is repugnant to speculation and is more protected from financial crises.

Additionally, empirical studies relating to the banking sector suggest that the profit of participatory banks does not depend on the variation of short-term assets and liabilities, which allows us to deduce that short-term monetary and financial developments do not affect the investment decisions and financial operations of the participatory banking sector.

In the same order of ideas, if we assume that the profit of the participative banks remains independent of the evolution of the monetary and financial aggregates in the short term, this will lead us to retain that the participative finance can be a plausible solution: to promote the performance of the banking sector in developing countries, to preserve financial stability on an international scale and consequently to avoid financial crises and their heavy effects on the world economy in general.

b- Cooperation between Islamic and conventional finance: is it to be encouraged given the complementarity, or rather to be boycotted given the substitutability?

On the one hand, the conventional financial system has an interest in opening up to that of Islamic finance because of the capacity of the latter to mobilize massive financial resources. At the same time, Islamic finance will gain by opening up to conventional banks since they are the obligatory passage for a possible integration of the international financial system. Then, What is the blockage?

- On the macroeconomic side, the coexistence of Islamic finance and conventional finance offers the advantage of widening the range of financing possibilities for investment projects; it promotes to achieve the optimal resource allocation objectives.

- On the microeconomic side, the management and governance models are diametrically opposed:

* in conventional finance, cooperation can only be based on taking into account the time variable and the interest rate as a tool for evaluating the price of money for a unit of time; similarly, operations such as securitization, speculation, derivative products, etc., are legitimate or even a must for the progression of the sacrosanct Net Banking Product.

* Conversely, in Islamic finance, the remuneration of neither money nor time is not justified, only the remuneration of the risk taken is justified; likewise, speculation, uncertainty, etc., are prohibited, and no sharia committee can authorize them since it sanctifies the backing of any transaction on a real asset.

Nevertheless, points of intersection for possible cooperation either already exists in special niches such as venture capital financing, or to be invented through clever arrangements of financial engineering.

In the absence of such cooperation, perhaps we will converge towards a strictly compartmentalized dichotomous financial system.

Conclusion

In short, crowd funding is an alternative that enables the fair distribution of wealth and prosperity through morally acceptable business and investment activities in a participatory and ethical spirit.

While conventional finance seeks to defend the notion of first-rate performance, regardless of any moral or denominational considerations, something that is not economically tolerable. From here, we can deduce that participatory and conventional finance show an apparent rivalry in principle, and justify an economic complementarity that is difficult to refute. However, a complementarity between the two types of finance can further promote the positive impact on economic development.

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