Keynote Speech

"Integrating Islamic Commercial and Social Finance to Strengthen Financial System Stability"

Agus D.W. Martowardojo
Governor of Bank Indonesia

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Distinguished Speakers, Seminar Participants, Ladies and Gentlemen,

Assalamualaikum Warahmatullahi Wabarakatuh,

And very good morning to all of you.

[Introduction]

1. It is a great honour for me to be here today and to have this opportunity to welcome you in this International Seminar on Islamic and Finance, which also facilitate the 2nd Call for Paper Conference for the Journal of Islamic Monetary Economics and Finance in 2016.

2. As we have already seen across the globe, many people are in a search for a comprehensive formulation of Islamic economics and finance which can be developed not only conceptually, but also implementable to support the economic development in complement to the existing one.

3. The financial turbulence that has deeply impacted to the global economy is still waiting for a momentum to regain its strength and stability. The economic challenges that we are facing today has proven that even for the long standing conventional economics, new approaches and formulations are required to address and to overcome the challenges, such as sustainability of the economic growth and inclusive economic development.

4. The new approach in economic development concept, including the development of Islamic economic concept, should be able to address current issues and to provide credible solutions to the government. This conference serves as one of effective vehicles to facilitate exchange of thoughts and to formulate possible new approach that are worth-considering to complement the existing economic policy to come up with greater inclusiveness and sustainability.

Distinguished ladies and gentlemen,

5. The development of Islamic economic and finance has been promising. The three sectors covering Islamic banking, Islamic capital market and also takaful could serve as additional pillars to foster the Islamic economic development. Those three elements have shown tremendous progress in terms of business volume, financial products and also the wider networks to entertain the customers.

6. The Global Islamic commercial finance still dominated by Islamic banking sector, which is accounted for 80% of the whole system. While Islamic banking sector has demonstrated its resilience aftermath the global financial crises by delivering a strong average growth of 17.1% in 2008 to 2011, the latest development showed a moderation pace of growth with an average of 13.8% during 2011 to 2014, or in particular 10% for 2013 and 2014. Nevertheless, the first half of 2015 has posted a non-annualized upswing growth of 7.96% and therefore, global Islamic banking assets growth in 2015 is expected to once again sustain its double-digit rate.

7. However, subdue global macroeconomic outlook poses considerable risks to global banking sector performance in general. Similar with the performance of Islamic banking sector, the global Sukuk market also experience a slowdown after reached record years for global Sukuk issuances in 2012 and 2013. In 2014 the Sukuk market slowed down to

just over USD100 billion issuances, and the downward trend continue to 2015 where the issuance slides 43% to just around USD60 billion.

8. The development of Islamic commercial finance in Indonesia has similar down trend as the development of global Islamic commercial, especially in 2012-2015, where the growth of Islamic banking reached its lowest of 8.8% annually in 2015, compare to 9.2% annually of its conventional counterpart. However, by July 2016, the growth of Islamic banking has rebounded to reach 12.0% y.o.y, while its conventional counterpart still showed down trend to reach 7.2% y.o.y. Meanwhile, the share of Islamic banking has been stagnant at 4.8%.

9. Nevertheless, Islamic banking in Indonesia is claimed to be the biggest retail Islamic banking in the world with more than 18 million customers and more than 4.500 branches in 2015.

10. The development of Sukuk in Indonesia showed a slight down trend for corporate sukuk in 2009-2014 and for government sukuk in 2011-2014. However, the growth of sukuk has rebounded to 39.4% in 2015 and 29.8% by July 2016 for corporate sukuk, as well as 39.7% in 2015 and 36.28% by July 2016 for government sukuk. The share of sukuk by July 2016 has reached 3.8% for corporate sukuk and 15.6% for government sukuk.

11. The Islamic social finance sector comprises zakat, awqaf and non-profit microfinance institutions. Although development around Islamic social finance sector is not globally well documented, countries data indicates promising potential. Research by the Islamic Research and Training Institute of IDB (IRTI-IDB) shed some light for the development of global Islamic social finance.

12. It is estimated that the potential zakat collection in South Asian and South East Asian countries is around USD30 billion in 2011, while in Sub-Saharan Africa countries it could reach around USD24 billion in 2013. On the other hand, the process of estimation of potential

resources from awqaf is more challenging due to gross absence of data in most countries.

13. The Islamic social finance allows the government to reach wider segment to entertain, particularly the low income society that have been neglected due to inability to provide low cost funds. Henceforth, it becomes our real challenge to better formulate and define the concept of Islamic economics to reach compatibility in both concept and implementation, so that it can be integrated in to the mainstream economic policy. In this international seminar, the Islamic social sector becomes the center point of discussion after considering its potential to further equip the government in delivering prosperity to the society.

Distinguished guests, ladies and gentlemen,

14. Zakat enables those who are considered poor and extremely poor to fulfill their basic needs. Zakat can also be a mean of empowering the poor capable of doing work for producing goods and/or services, but have no or little access to the formal financing. so that the self-employed poor will be empowered to take care for himself and his family. Hence, poverty could be alleviated.

15. Similar to zakat, the management of awqaf also contributes to socio-economic wellbeing. Traditionally, the charitable purpose of awqaf includes educational institutions, orphanages, roads, graveyards, and religious establishment such as mosques. However, in the modern days, the institution of awqaf is encouraged to make awqaf either cash or estates more productive.

16. Through awqaf, charitable clinics, medical centers, shopping complex and commercial centers can be established. This large social-commercial projects finance by the raising awqaf in a planned manner

are considered as an important instruments to improve socio-economic wellbeing in a sustainable way.

17. Unlike the other commercial sources of funds, the zakat funds would never cause unnecessary burden to the economy since the type of the funds is not commercially claimable, and hence, no excessive social costs will occur. The same also goes to the awqaf sector, where, as a matter of fact, more people are endowed with low cost assets. With this huge potential of zakat and awqaf land, we can expect Islamic social finance a significant drive to economic development.

18. Both zakat and awqaf as Islamic social finance can become a buffer as well as an economic stabilizer. Zakat funds provide a transfer payment to the hardest hit poor and needy people caused by recession. Since zakat is a levy on both income and wealth, the redistribution of wealth will always be functional and operative in an Islamic economy due to wealth zakat irrespective of the phase of business cycle.

19. Transfer payments to needy people will continue when the economy faces further recession. Due to its simple and certain collection and also religious obligations than just an involuntary tool of fetching wealth, zakat is always available in good time (peak) and bad time (recession).

20. On the macroeconomic level, proportional zakat linked with income acts as an automatic stabilizer. When personal disposable income decreases due to recession, obligatory zakat also decreases. They do not have to pay the same proportional amount as before, thereby providing an automatic relief for income earners.

21. On the contrary, when aggregate personal disposable income increases (boom period), more zakat is collected and more amount remains at the disposal of government to allocate as transfer payments. Thus zakat enables the distributive allocation works independently and help stabilize the extreme business cycles. As for

awqaf, since the principal of awqaf will always increase from time to time, due to return of productive activities and new awqaf collection, awqaf could act as shock absorber of economic shocks.

Distinguished guests, ladies and gentlemen,

22. Despite the potential, we also realize that in order to manage zakat and awqaf efficiently and prudently so that poverty alleviation and socio-economic wellbeing can be materialized, the regulatory framework of this sector has to be improved. To this end, Bank Indonesia jointly together with Islamic Research and Training Institute-Islamic Development Bank (IRTI-IDB) and Baznas has established International Working Group on Zakat Core Principles in 2014.

23. Alhamdulillah, the Core Principles initiative has been finalized and launched in the World Humanitarian Summit of United Nations in Istanbul on May 23rd, 2016. The Core Principles serve as the main reference to further elaboration of Zakat regulations. Meanwhile, the development of Awqaf Core Principles has also been underway, following the success of Zakat Core Principles.

24. Realizing the potential of this Islamic social sector, Bank Indonesia puts greater attention to enhance zakat and awqaf system nationally and internationally. The Islamic economic and finance development program has put as one of the strategic objectives of Bank Indonesia Strategic Function 2024 and enhance inter-institutions cooperation and coordination programs including the development of inclusive finance and MSME, as well as Islamic economics and finance. Bank Indonesia has set a vision of Indonesia to become a center of Islamic Finance Center in the region.

Distinguished Guests, Ladies and Gentlemen,

[Closing]

25. Relating to the Journal that we are trying to develop, this conference serves as the platform to communicate and to elaborate the topics compiled in the Journal. We wish the journal can play a role as one of main compiler of repository knowledge in the area of Islamic economics and finance.

26. Up to this point, Alhamdulillah, we have an honor to facilitate important discussion attended by prominent scholars, representatives of several embassies, colleagues from governmental insitutions, researchers, and academicians on integrating Islamic commercial and social finance to strengthen financial system stability, which is a timely topic nowadays.

27. In this special moment, I am pleased to inform you that this Conference is conducted concurrently with "Indonesia Sharia Economic Festival (ISEF) 2016" which choose "Leading Roles in the Development of Islamic Economic and Finance to Achieve the Prosperity of the Nations" as the theme of the conference. This Festival will be held here in Surabaya, 25-30 October, 2016.

28. Allow me to conclude my speech by expressing my appreciation and sincere gratitude to all speakers and participants for the willingness to join this special event. I also would like to wish you all a productive discussion and deliberation in this important event. I am confident that supported by all participants in this room, we can achieve significant outcomes that are beneficial to promote development in the area of Islamic commercial and social finance.

29. Finally, I am delighted to officially open "**International Seminar and the 2nd Journal of Islamic Monetary Economics and Finance Call for Papers**", please enjoy the discussion and the rest of the session at this second biggest Metropolitan city in Indonesia and also known as "City

of Heroes", due to the importance of the Battle of Surabaya in galvanizing Indonesian and international support for Indonesian independence during the Indonesian national revolution.

Thank you very much.

Wassalamu'alaikum warahmatullahi wabarakatuh.

Surabaya, 27 October 2016

Agus D.W. Martowardojo

Governor of Bank Indonesia