

SHARED RISK & REWARD

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My Reading List

- Islamic finance industry needs government support ([link](#))
- Are tax incentives good for Islamic finance? ([Sharing Risk blog](#))
- Should hajj funds be invested in government project-based sukuk or deposited in Islamic banks in Indonesia? ([Sharing Risk blog](#))

Blog Posts This Week

- [The paradox of Indonesia's sovereign sukuk](#)
- [Goals for Islamic microfinance institutions](#)

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Incentives for Islamic Finance

The Director of Islamic Banking at Bank Indonesia, Eddy Setiadi, [described](#) some of the ways in which government support can help the Indonesian Islamic finance industry “in the form of regulation, issuance of sukuk to finance, as well as placement of funds in the Islamic financial institutions.”

In a blog post a couple of weeks ago, I [contrasted](#) the supportive role that governments can play in facilitating Islamic finance by putting it on equal footing with conventional finance with the tax breaks that can benefit in the short term but risk becoming entrenched (like the tax breaks on sukuk), which were absent from the article where I found his quotes.

It is good to hear support coming from Bank Indonesia for ways of stimulating the growth of Islamic finance in the country that do less to distort incentives, particularly in terms of rewarding political connections. However, even avoiding the types of incentives which could become entrenched, there are a few points where care is merited in implementing his suggestions.

Governments should focus on creating an appropriate set of regulations for

Islamic banks, but shouldn't Islamic over conventional banks. Islamic finance is at an early stage in its development in Indonesia so allowing conventional banks with Islamic windows to operate can add competitive pressures for good pricing and service. Allowing only wholly Islamic banks (like Qatar) right now will slow the growth of Islamic finance.

Issuance of government sukuk (and facilitating a liquid secondary market) will provide safe assets for Islamic banks' balance sheets. Placement of government funds with Islamic banks can also help Islamic banks expand the asset side of their balance sheet, as long as the distribution of these deposits are not subject to political whim (perhaps by making deposits on a pro rata share to the total assets of each Islamic bank as a percentage of the total Islamic bank assets).

Government support for Islamic finance can help, but it should always be designed so as to avoid favoring political connections over competence, and to avoid letting the incentives become entrenched.

Until next week,
Blake Goud