Islamic finance in the national accounts

13th meeting of the Advisory Expert Group on National Accounts

1-3 October 2019
Washington D.C., USA
Outline of presentation

- Background
- Classification, sectorization and calculation of output
- Classification of return on Islamic loans, deposits and debt securities
- Comparison of FISIM using single and separate reference rates
- Questions for the AEG
Islamic finance follows Shari’ah (Islamic law)

Conventional finance
Background

Islamic finance

Does not permit
- Riba (interest)
- Gharar (excessive uncertainty)
- Maysir (gambling)
- Short sales/financing

- Parties must share risks/rewards
- Transactions should have real economic purpose without undue speculation
- No exploitation
Conventional Finance

Conventional finance

Monthly Installments (Principal + Interest)

Money

Client

Market

Price (spot)

Asset (spot)

Installment has interest component
Background

Islamic Finance

IFI = Islamic financial institution
Asset backed financing
Background

10th AEG meeting
- Noted differences between Islamic and conventional banking
- Agreed further research on statistical implications of Islamic banking in SNA is needed

ESCWA and UNSD formed ISWGNA task force on Islamic finance

11th and 12th AEG meetings
- Discussed progress of work of task force
- Provided guidance on way forward
- Requested updates at future AEG meetings
Classification, sectorization and calculation of output
Classification, sectorization and calculation of output

Working Group on Sectorization and Classification

- Classification of Islamic financial instruments and property income (Annex I)
- Diagrams showing flows between IFIs and clients (Annex II)
- Sectorization of IFIs and methods to calculate output (Annex III)
Workshop on Islamic Finance in the National Accounts

• Agreed on classification of Islamic financial instruments and corresponding property income, except for classification of property income for Islamic loans, deposits and debt securities
• Agreed on diagrams
• Agreed on sectorization of IFIs and methods to calculate output of Islamic financial services, except for output of IFIs which are allocated to deposit-taking corporations except central bank subsector (S122)

More work needed to
• Address the classification of property income for Islamic loans, deposits and debt securities as interest in SNA and prohibition of interest in Shari’ah
• Determine how property income for Islamic loans and deposits can be accommodated in FISIM formula
• Evaluate single vs. two reference rates (one for conventional FISIM and one for Islamic FISIM)
Classification of returns on Islamic loans, deposits and debt securities

Is it interest or not interest?
Classification of returns

- “Interest” applies to income for deposits, debt securities, loans and other accounts receivable
- “Interest” is a type of investment income
- Shari’ah prohibits interest but, not investment income

- General system with universal basic concepts, definitions, classifications and accounting rules
- Covers wide range of circumstances and should not apply differently to different segments of society

- Identical treatment of any two actions regardless of principled considerations
- If Islamic finance activity/flow has same characteristics as conventional one, it should be recorded similarly in SNA
- Studies show such similarities
## Classification of returns

<table>
<thead>
<tr>
<th>Returns of Islamic loans, deposits and debt securities</th>
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<tbody>
<tr>
<td>Seem functionally indistinguishable from interest payments for corresponding conventional instruments</td>
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<tr>
<td>Implies 2008 SNA does not need to be changed</td>
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<tr>
<td>But need to consider interpretation Islamic returns may represent broader concept than interest</td>
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</tbody>
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- Consider terms such as
  - “Interest and similar investment returns” or
  - “Financing and investment income”
- Report returns on Islamic financial instruments on “of which” basis
Comparison of FISIM

FISIM

- 2008 SNA states that a single reference rate should be used to calculate FISIM on loans and deposits for each currency type

- Indonesia, Malaysia and State of Palestine participated in empirical tests to calculate nominal FISIM using a single reference rate for the sum of Islamic and conventional loans and deposits as well as separate rates
  - One for Islamic loans and deposits
  - One for conventional loans and deposits

- Results appear quite different
  - However, there is a need to analyze more country examples
Questions for the AEG
Questions for the AEG

Questions

• Do you agree to consider the interpretation that returns on Islamic loans, deposits and debt securities have a broader concept than interest?
  • If yes, can terms such as “interest or similar investment returns” or “financing and investment income” be used?
  • If yes, which term is preferable?

• Do you agree that further work to assess the use of single versus separate reference rates in the calculation of FISIM in economies with conventional and Islamic finance needed?
Thank you