Abdul Rasheed Ghaffour: Islamic finance – building solutions for a sustainable future

Speech by Mr Abdul Rasheed Ghaffour, Deputy Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the 3rd Annual Symposium on Islamic Finance "Islamic Finance - Building Solutions for a Sustainable Future", Kuala Lumpur, 12 December 2017.

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It is an honour for me to be here today at this 3rd Annual Symposium on Islamic Finance. We are gathered here to engage and affirm our vision towards realising the potential of Islamic finance in supporting the Sustainable Development Goals that form the new global development blueprint. Time is of the essence in meeting the goals and targets by 2030. We have to collectively strategise our actions to bring them to life. How we balance economic prosperity, social equity and environmental responsibility matters greatly to the world. It is without a doubt that we cannot have continued prosperity without sustainability.

In my remarks this morning, I will touch on the current global economic environment and challenges facing the world that point to the need for us to promote fiscal, social and environmental sustainability. I will also discuss the imperatives that can strengthen the role of Islamic finance in promoting inclusive growth, reducing inequality and accelerating poverty reduction.

The past 50 years has been a period of extraordinary global economic expansion. The world economy expanded sixfold and average per capita income nearly tripled. Considerable progress was made in elevating living standards in many corners of the world, with hundreds of millions of people lifted out of poverty. The world economy has also gone through great transformation. We now have a truly global village. Closer ties have been formed between countries with the help of rapid technological progress and increased international integration. Stronger trade and financial linkages follow suit, at a rigour, more than could have been imagined, half a century ago.

Yet, against these gains, the world faces daunting challenges affecting sustainability that could dramatically alter the overall growth outlook in the next 50 years. Today, I would like to name three challenges that confront us. The first is climate change. What was once a theoretical discussion in lecture halls, today, climate change has impacted us more frequently and in more visible ways than ever before. The increasingly complex needs and demands of modern civilisation have indeed exerted a significant toll on the environment. Over the past two decades, carbon dioxide emissions have risen significantly, leading to a wide range of problems such as rising sea levels; melting glaciers; and more extreme weather events. It is alarming that the number of reported weather-related natural disasters has increased threefold since the 1960s. The effects of these events have been devastating – economic activities have been disrupted; large resources have been rechannelled; and vulnerable segments of societies have been the most affected. The El Niño phenomenon for example, affected many developing countries that are dependent upon agriculture and fishing, particularly those bordering the Pacific Ocean. Last year, it left millions of people hungry and in need of food aid; water shortages across Southeast Asia; and higher food prices globally. Closer to home, thousands have been displaced after the northern state of Penang was hit by the worst flood in more than 20 years. These are indications that despite progress made in regulating global emissions of greenhouse gases over the past decades, we need to do more to mitigate the adverse effects of climate change.

Moving on to the second challenge – growing inequality. Globally, the benefits of economic growth have been uneven. In reality, not all members of society have fully benefitted from the growth. While some have gained, many have been dislocated – feeling that they have been left behind. Today, global inequality is at its highest since the 19th century. Recent studies show that the richest 1% now owns half of the world's wealth combined. In stark comparison, 70% of the world's adult population holds only 3% of the global wealth. Globally, continued widening of the inequality gap would be detrimental to economic growth and social progress in the long-run. Inequality is a threat to growth if it leads to those in the low income segment suffering poor health and low productivity; and to struggle in obtaining quality education. Governments worldwide are already taking steps to address this concern – but more collective effort is needed to make any significant progress – in closing the gap between the rich and the poor.

The third challenge is the retreat in globalisation. Increasingly inward-looking political sentiment poses serious threat to trade liberalisation – which has formed the global economy's growth engine since the 1980s. Two decades ago, trade liberalisation enabled developing countries such as China and India to achieve exceptional growth, and in the process, unshackling millions from deep poverty. The calls for trade protectionism that are rife in the advanced economies today is therefore a major concern. If left unaddressed, the upsurge in protectionism and insular policies may lead to a reverse in globalisation, which would be detrimental to living standards.

I have painted a rather bleak picture that depicts the fragile state of today's world. Various forces at play have led us to where we are now – finance being one of them. While finance has lifted the lives of many, some argue that it has derailed from its intended objectives, leading to many economic, environmental and social problems that we face today. They argue that the global economy is very much driven by global financial capital, with most of it managed by financial entities that are attuned to financial risk and return considerations. Beyond these considerations, the non-financial impacts of an investment or 'externalities', such as rain forest destruction; water and air pollution are rarely considered and often simply ignored. I believe that the truth is more complicated than that, and that these views disregard the progress that has been made in making finance more "ethical" in recent years. Regardless, I believe that it is timely to recalibrate our moral compass – and to explore innovative ways and solutions that finance can offer to build a more sustainable future. If I may say, to discover humanity within the world of finance.

As we embark on this quest, we can consider the role that Islamic finance can play in contributing towards sustainable development. With positive values and ethical considerations ingrained within Islamic finance, it provides a ready and workable blueprint for finance that best works for the people and the planet. In supporting economic growth that is both inclusive and environmentally sound, Islamic finance can potentially realise the promise of sustainable development – that is to not leave anyone behind. Ultimately, it can help to build shared prosperity for not only the generation of today, but also the generations to come. There is already large acceptance of Islamic finance in the global economy, with global assets amounting to USD1.9 trillion in 2016. But the success of Islamic finance cannot, and must not be measured solely on headline numbers such as this. In our move towards a sustainable future, the way forward for Islamic finance, in my view, lies in four imperatives.

First, Islamic finance must prove its capacity to innovate. In these rapidly changing times, innovation has to be far from static and to continuously keep ahead of time. Just as the needs of the economy and society change, Islamic finance also needs to evolve to keep pace in being part of the solutions. To achieve quality growth, innovation has to focus on amplifying the positive value and impact of Islamic finance to the economy and society. This necessitates Islamic finance moving beyond being perceived as mere imitations of conventional finance. A step up is to have distinct modifications made to the products, services, business practice and operations of Islamic finance. The desired level of innovation is however – to significantly improve the offerings of Islamic finance and to build a sustainable business model to meet the unfulfilled 'real' needs of the economy and customers. The delivery of products and services to SMEs for example, can be remodelled to reflect deep understanding of their needs and circumstances. This paves the way for tailor made financial services solutions that can better assist aspiring entrepreneurs. To illustrate, the financing model of Islamic banks for SMEs can be more holistic – to include provision of entrepreneurship training and consulting services, as well as infrastructure support. This model not only leads to greater sustainability, but also provides more meaningful customer experience.

Within the Islamic capital market, we already see good examples of innovation in the form of green sukuk, an innovative financing vehicle to combat climate change. The recent issuances of the world's first green sukuk by two energy companies in Malaysia have kicked start the growth of green sukuk market and will significantly boost the "cleantech" movement. Fundamentally, Islamic finance is well positioned to advance the green agenda, as environmental protection and sustainable growth objectives are already embedded within its principles. The structures of sukuk make it well-suited to channel global Shariah-compliant capital to fund renewable energy and climate change projects. Socially responsible investment (SRI) sukuk has also made its debut with the unique vaccine sukuk programme launched in 2014 that raised funds worth USD500 million for children's immunisation in a number of poor countries. These are proofs of new ways of mobilising resources to increase sustainable humanitarian financing to reach non-traditional donors and responsible investors.

Innovation within the Islamic social finance space can also assist to address a number of issues facing the ummah and society at large. Waqf, sadaqah and zakat have large potential to become important additional sources of financing for people in need of aid. Each year, Muslims worldwide generously donate through these channels. The global volume of zakat itself, collected each year through formal mechanisms is estimated to be in the tens of billions of dollars. A conservative estimate by Islamic Development Bank indicated that there is at least USD600 billion of zakat collected are available to meet humanitarian needs. I believe that if collected and channeled in the right way, the funds can be of great value in fighting poverty, leading to long-term social improvements and long-term resilience of communities. Islamic banks can play a greater role and participate more actively in this area, particularly in developing innovative ways to enhance access to and outreach of zakat. Positive partnerships between Islamic banks and zakat institutions is a means to explore in this regard, to provide greater convenience to customers, while strengthening public trust and confidence in the system.

Second, Islamic finance must embrace the tech revolution to power up innovation. Fintech is rapidly changing the facets of the global financial industry, reshaping the expectations of consumers and businesses on financial services. For Islamic finance, there are large opportunities in fintech to develop financial solutions that can help drive Islamic finance to deliver even greater, wider and deeper positive impact – particularly in realising its promise in risk-sharing and providing support for genuine and productive economic activities. An example is the Investment Account Platform in Malaysia, which is a multi-bank online platform that connects investors to viable economic ventures, mainly SMEs. Technology can also widen access to and increase outreach of social financing instruments through digitisation of collection and disbursement of its proceeds. Fintech startups such as LaunchGood and SkolaFund are already making their name in social impact initiatives, which is a promising start.

The reality however is that Islamic fintech is still in its infancy and growing – and there is plenty of catching up with conventional peers to do. What is required in making this leap is for leaders to think far across and beyond the industry that we are familiar with today. The transition can be accelerated by challenging conventional wisdom on competition to create new value curve and market spaces. Through this, the Islamic finance industry can strategically leverage on technology to deliver innovative solutions that can create sustainability, including financial inclusion solutions that can help bridge the "digital divide". The industry can certainly take inspiration from the agility of the non-financial services industry to adopt, adapt and collaborate with fintech players – a strategy proven to be far superior. A good example is the partnerships formed between over 11,000 post offices in the U.K with a couple of fintech startups that have enabled these challengers to extend their simple, transparent online services to in-branch facilities.

The third imperative – Islamic finance must invest in capacity for the future, in particular in talent – for long term sustainable value creation. The journey ahead is one that is long and complex. This calls for the industry to fight the war for talent relentlessly. The industry can go far if it broadens its talent sphere, by providing top talent careers that are not just financially rewarding but also intellectually stimulating and socially meaningful. This is a win-win strategy. For the industry, attracting quality talent with a passion in creating greater good through Islamic finance helps in building a more sustainable business model. Such top-notch talent is essential in driving and executing innovative business strategies that will realise the full potential of Islamic finance. For the talent themselves – such career opportunities will increase their engagement and commitment – hence driving their productivity to achieve tangible results. With a more demanding future ahead of us, greater talent preparation is also required to effectively provide and implement solutions to real world problems. A much broader set of competencies that go beyond knowledge in the application of Islamic finance principles provides a stronger foundation to achieve this aim. This includes wider skills and knowledge ranging from green financing to conducting holistic assessments of credit linked to value-based intermediation. Knowledge of behavioural finance can also be used to "nudge" customers into making good financial decisions. Only with constant renewal and transformation of Islamic finance professionals that we can remain ahead of the curve.

Fourth, which is my final point, is that the march towards globalisation of Islamic finance must continue. A reflection on the past traces us to the origins of Islamic finance, with its roots in supporting international trade and commerce. An overview of modern day Islamic finance however – with the exception of sukuk – appears to be more domestic centric. It is timely for Islamic finance to play a more prominent role in mobilising capital to strengthen global trade and investment linkages. After all, it is in line with the aspiration for Islamic finance to support real and productive economic sectors. The need is more compelling as international trade has a key role in promoting economic growth. Greater participation in trade can also ultimately alleviate poverty in developing countries. This mission is particularly important now, given recent setbacks in the march towards globalisation. Globally, we see that prospects in trade are improving, with trade between emerging economies, particularly Asia is expected to increase by USD5.3 trillion by 2030. Access to conventional trade finance is however a continuous challenge faced by many developing countries. Said differently, this is a window of opportunity for Islamic finance to offer new solutions, and to prove itself as a viable channel to complement conventional financing solutions.

Shariah-compliant trade finance solutions can also provide the much needed support for the multi-billion dollar halal export industry that has increasing participation of SMEs. This can assist businesses to meet the strong demand for halal products and services globally. Islamic finance already has a good head-start in the trade finance scene, with a wide range of Islamic financial products that are now available to importers and exporters. More can be explored to widen the spectrum of Shariah-compliant trade finance offerings and enhance trade finance facilitation by Islamic finance players to spur greater cross-border trade, particularly by SMEs. To cite an example, enhancing the availability of trade credit takaful as a risk mitigant can help spur greater cross-border trade. I also believe that more can be done to deploy technology to untap the large business opportunities in trade, which includes the integration and digitalisation of trade finance as well as e-commerce.

Let me now conclude. The issue of sustainability is a matter of grave concern for the global community. If sustainable development takes a backseat, the global landscape in the future will look very different. We might see the gains that we have built and enjoyed over the decades erased. The clock is ticking, and the world has to act now. On its part, Islamic finance must contribute towards generating solutions to this challenge. In this endeavour, steadfast commitment from the Islamic finance industry to innovate; to embrace fintech; to invest in talent; and to play a greater role in international trade is crucial. Islamic finance must be a force for global good, proving that the sustainability agenda isn't just good for the world, but is good for business. It must prove the dictum “doing well by doing good”. This is what Shariah calls us to do – to benefit the people and planet; and bringing greater prosperity to the ummah.