THE DEVELOPMENT AND GROWTH OF ISLAMIC FINANCE IN EUROPEAN UNION

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ABSTRACT

This paper aims at capturing the latest developments and growth of Islamic finance (IF) in the European Union (EU). The study also aims at shedding light on the driving factors that have been attributed to the rise of this phenomenon in this region. Islamic finance is based on ethical principles in line with Islamic religious law. Despite its low share of the global financial market, Islamic finance has been one of this sector's fastest growing components over the last decades and has gained further momentum in the wake of the financial crisis. The paper examines the development of and possible prospects for Islamic finance, with a special focus on European Union. It compares Islamic and conventional finance, particularly as concerns risks associated with the operations of respective institutions, as well as corporate governance. Finally, to meet these objectives, the paper utilizes historical and SWOT TOWS methodology to draw some lessons and recommendations.

Keywords: *Development, growth, Islamic finance, European union*

INTRODUCTION

Islamic finance has become an important part of the international financial system and was, certainly, one of its fastest growing components over the last decades. In the wake of the financial crisis, there has been a renewed debate on the role that Islamic finance can play in the stabilization of our financial system, given its strong ethical principles and religious foundations (Kurochkina, 2021). Islamic finance is based on four main principles, which are all derived from the Quran and Sunna. The first dictates that paying interest (i.e. any predetermined payment over and above the principal) is prohibited. As a result, Islamic banks have to use contracts that create exposure to the real sector and must thus ensure efficient risk management. The second principle involves the profit and loss-sharing concept. Parties to a financial transaction must share both the risks and the rewards that may be attached to it; in this way, excessive losses and profits are minimized. The third principle is the prohibition of uncertainty or speculation. Uncertainty in contractual terms and conditions is forbidden. However, risk-taking is allowed when all terms and conditions are clearly stipulated and known to all parties. The fourth principle demands the use of asset-backing. Each financial transaction must relate to a tangible and/or identifiable underlying asset, ensuring that Islamic banks remain connected to the real economy.

From a historical point of view, the idea of an Islamic financial system began to emerge during the second half of the 20th century, when decolonization and the creation of new states with a majority Muslim population led to the foundation of the Islamic banking industry. An Islamic financial system was seen as a segment of the overall Islamic economy that would underpin an Islamic social order that could be an alternative to capitalist liberalism and socialist planning. It would offer the faithful the opportunity to reconcile their economic activity with their religious beliefs (GIFR, 2020).

The 1970s saw the industry experience its first major development and appear on the global stage, when a huge inflow of liquidity into the Gulf States was used to support the establishment of several institutions offering Islamic financial services (IIFSs). Since then, Islamic financial activity has grown significantly, both in terms of volume and scope.

The Islamic financial system and the way in which it is perceived by all the major players have changed profoundly since the 1970s: there has been a diversification of products and players and an intensification of the cross-border dimension. Islamic finance is no longer seen as opposed to a “secular”, global financial system, but as an integral part of it.

Today, an Islamic financial system exists to provide a variety of religiously acceptable financial services to Muslim communities and also as an alternative for non-Muslim clients seeking ethical investments and greater risk diversification. The on-going expansion of this financial market still tends to be confined to Muslim investors, as well as to the Gulf States and some Asian emerging countries (i.e. Malaysia and Indonesia). The industry, however, has started targeting non-Muslim clients and, in the 1990s, Islamic financial companies began operating in Western especially in European Union.

LITERATURE REVIEW

Islamic finance has developed significantly over the years to become a noticeable part of the international financial system. The value of Islamic financial assets worldwide increased from USD 150 billion in the mid-1990s to about USD 1.6 trillion by end-2012, led by the Islamic banking sector and the global sukuk market. And, in 2013, it is estimated to have reached the high figure of USD 1.9 trillion. Despite the formidable growth of the last few years, Islamic finance still accounts for a relatively small share of global finance, and remains mostly localized in selected areas of the world, particularly in the Middle East and Far Eastern. (https://www.islamicfinance.com/2014/12/)

'We have a strong network of professionals who are skills at creating innovative deals that are sharia-compliant' and The UK is ranked above other important centres on its overall Islamic finance offering. The latest ICD Thomson Reuters Islamic Finance Development Report gives the UK an index value of 16.2, above the global average of 10.3 and the highest ranking of any non-Muslim-majority country. (https://assets.publishing.service.gov.uk)

The UK welcomed Islamic banking and finance since its early emergence in the late 1970s and early 1980s. In 1976, soon after the First International Conference on Islamic Economics, organized by King Abdul Aziz University, Jeddah at Makkah Al-Mukarramah, Saudi Arabia, the Islamic Foundation (Winner of the 'Islamic Economics' prize of the Islamic Development Bank group in 1432H (2011)), Leicester, UK established its Islamic Economic Unit as the first ever research Centre on the subject. This Research Centre was followed by the International Centre for Research in Islamic Economics (CRIE) at the University of King Abdul Aziz University in 1977. The Islamic Foundation UK subsequently published the major works by pioneers of Islamic economics, banking and finance like Nejattullah Siddiqi, Umer Chapra, and others. It also organized conferences, seminars and workshops on these topics in collaboration with the IDB, IRTI and Loughborough University.

Nowadays, the UK is, as reported by Filippo et al. (2013:29) and UKIFS (2013:5), one of the most advanced and sophisticated Islamic financial markets in the western world and is quickly becoming a key destination for foreign Shariah-compliant institutions. It is the first western country to allow the establishment of the first fully-fledged Islamic bank, the Islamic Bank of Britain (IBB) and currently has six fully-fledged operating Islamic banks, that is more than in any other Western country.

In 2010, the former German Federal President Christian Wulf said that Islam belongs to Germany. Although the veracity of this statement is still discussed controversially today (http://www.zeit.de/2015/09), it cannot be ignored that Germany's Muslim population has risen rapidly ever since Turkish workers immigrated during the late 1960s. By the end of 2015, the federal Statistics Office Germany had registered the highest net immigration rate of foreigners in the history of the Federal Republic of Germany. Many of the 1.1 million counted immigrants were Muslims (https://www.destatis.de).

According to the latest statistical data, the number of Muslims present in Germany amounts to 4.7 million (5.9% of the total population) from http://www.bamf.de. This number is expected to increase as a result of the refugee crisis and further migration waves. A lot of these people are potential customers of Islamic Banks.

Over the years, France has established favorable trade flows with many neighbors with large Muslim populations, including North African countries (Morocco, Algeria and Tunisia). A significant proportion of the French population originates from North Africa (represent between 7-9% of French population -more than 5million-), and this has been driving domestic demand for Islamic finance. The potential target population in France is more than two times bigger than in Great Britain, where Islamic finance has been growing for many years. As well as, 41% of French Muslims are "practitioners" (actively practice their religion) which seem to be promising and presenting an opportunity to the domestic financial sector. Moreover, and as discussed in the previous section more than the half of French Muslims are potentially interested by bank Shariah-compliant loan to finance their homes, cars and businesses; and 45%potentially interested by Shariah compliant saving products (IFOP, 2011).

The development of Islamic finance in France has seen a strong political support in the beginning. Since December 2007, the French government started thinking seriously to develop Islamic finance in her market place (Bouslema, 2009).

In 2014, France's Alliance International Holding formed a Joint Venture with Bahrain's Gulf Finance House for the 3 million dollar Tunis Financial Harbour Project using Islamic finance and investment for the construction project in Tunisia. Furthermore, French Bank BPCE and Qatar Islamic Bank have signed an MOU to establish a partnership in France. French officials forecast that France may attract US$120 Billion in Islamic assets through lending and investments in French businesses, property, and financial markets by 2020. In order to remain competitive with other European nations and the world, the decision-makers in France have realized the necessity of entering the global Islamic finance markets (FAAFI, 2015).

Italy is one of the most rapidly developing markets in Europe. A number of initiatives have been taken by Italian authorities to study the issues related to an expanded presence of Islamic finance. The Banca d'Italia, for example, has hosted a number of conferences on the subject. ABI, the Italian Banking Association, is currently coordinating a working group related to the issuance of a corporate or sovereign sukuk.

Looking back to the Islamic finance-related events in 2016, a first step taken to make the Italian tax framework Islamic-friendly was the appointment of a working group of tax experts by Maurizio Bernardo, the president of the VI Finance Committee of the Chamber of Parliament, with the aim, inter alia, of implementing the so-called 'level playing field', therefore putting Islamic finance, from a taxation point of view, on the same level as conventional finance, in particular by removing the double taxation which may affect those contractual structures based on the purchase and subsequent resale by the lender of a specific asset like Murabahah. (https://www.islamicfinancenews.com/)

Luxembourg is the first European country being member of the International Islamic Liquidity Management (IILM). Luxembourg's Central Bank (BCL) is the first European central bank being member of the Islamic Financial Services Board (IFSB). The Grand-Duchy of Luxembourg is the leading non-Muslim domicile for Sharia-compliant investment funds and globally the fourth Islamic Fund Center, ranked by the number of Islamic funds established in the market. Luxembourg is also the first Eurozone country issuing a sovereign Sukuk.

Within the European Union (EU), Luxembourg serves as a hub for financial institutions seeking to expand their operations in the Eurozone. Luxembourg has long been known by institutional investors as an ideal center to manage an investment platform both within

Europe and beyond. Today it is estimated that approximately 80% of all global private equity transactions are structured through using Luxembourg investment vehicles.

A similar approach could certainly benefit premium Islamic financial institutions (i.e., banks and insurance companies) which would have as a strategy to tackle the hugely lucrative yet untapped market of Muslim residents in Western European countries. Luxembourg would be well positioned to welcome the first full-fledged Islamic bank aimed at offering Sharia-compliant retail, corporate and private banking services in Eurozone.(https://www.ey.com/Publication)

In 2008, the Dutch central bank (DCB) and the Dutch financial services regulatory authority (AFM) conducted a study on Islamic finance in the Netherlands. One of their conclusions was that the existing regulatory framework in the Netherlands can be applied to Islamic finance, but with respect to certain financial supervision-related matters (e.g., market entry, conduct of business, capital adequacy and provision of information) the Dutch regulatory framework may need amendments to specifically address Islamic finance products (Verhoef, S Azahaf and W Bijkerk,) However, no such legal amendments were introduced. Consequently, there is no legislative and regulatory regime that focuses exclusively on Islamic finance, but instead the existing legislative and regulatory regime for conventional finance also applies to Islamic finance.

Certain foreign Islamic banks have been looking with interest to the Dutch Islamic finance market for retail banking. The entrance of these foreign Islamic banks will be a game changer for the development of Islamic finance in the Netherlands. In addition, various small organization are currently assessing the possibility of offering the first shariah-compliant mortgage loans in the Netherlands. At the same time, discussions on abolishing mortgage interest relief have been ongoing for a while now. If mortgage interest relief is completely abolished, this will undoubtedly be regarded as a positive development for Islamic retail banking from a tax law perspective, as it will place Islamic retail banking products on a level playing field with their conventional counterparts. It will give the smaller Dutch organizations an incentive to continue their efforts for providing the first shariah-compliant mortgage loans in the Netherlands. (https://thelawreviews.co.uk/chapter/1150800/IslamicFunds)

Ireland is already a significant location for Islamic funds with an estimated 20% of the Islamic funds market outside the Middle East located in Ireland. The Financial Regulator can and does authorize Shari'a compliant investment funds under collective investment scheme legislation. The Revenue Commissioners issued an e-brief in October, 2009 that clarifies the tax treatment of Shari'a compliant funds, leasing and insurance services in Ireland. The technical changes provided in Finance Bill 2010 will give equality of treatment. (https://taxpolicy.gov.ie/wp-content/uploads/2011/03/)

Left Alliance chairman Paavo Arhinmäki wants "people's bank", which does not necessarily take the interest rate. Islamic banking is one that seems the closest equivalent to Arhinmäen thinking, even if the state owned Post Office Savings Bank in due course, for example a sample of the mentioned. Was the Postal Savings Bank a "people's bank" that I do not think the state monopoly on the transmission of money it was yes. "Public Bank" in Finland is likely to be a bank for politicians. Islamic banking in Finland, over time, will be set up, grow Muslims needs. Such Islamic banking is much more likely than the state "people's bank", perhaps the left-wing union directly to support the creation of a supporter. (https://ifinanceexpert.wordpress.com/2010/03/16)

So far Spain has largely failed to tap into this potentially lucrative market, despite high demand for such finance from the country's business sector. Guillermo Canalejo (2019), partner at Uría Menéndez in Madrid, says the use of Islamic finance in Spain has been very limited. He adds: "With the exception of the UK, the presence of Islamic investment in Europe has been of little significance, but countries such as France, the Netherlands and Luxembourg have taken the necessary steps to facilitate the arrival of such funds." Canalejo says that Spain's banking, regulatory and tax regulations are not suited to contracts and practices governed by the precepts of Sharia law. He adds the Islamic alternatives to traditional mortgage agreements, for example, would require modifications to Spanish laws, and there are regulatory obstacles and tax penalisations that hinder the use of such alternative financing. Canalejo says that a key advantage of Islamic finance is its abundance, while the SCIEF says that Islamic finance offers numerous advantages including ensuring greater social justice. (http://www.mondaq.com/x/619988/ slamic+finance). So far, the overall magnitude of Islamic finance is still limited in most of Europe Union countries because they still cannot adapt the Islamic finance way in their banking system or financial institution and overall the EU Islamic finance industry remains a niche segment in certain of EU countries.

RESEARCH METHODOLOGY

A method that being used in this study is Swot-Tows Matrix. This method to identify the advantages and disadvantages of establishing a "window" can be gleaned from Chart 1 below, which identifies the possible strengths, weaknesses, opportunities and threats (SWOT) of development and growth Islamic Finance and also how to fully fledged Islamic Banking in European Union (EU).

A fully fledged Islamic Banking would offer not only Shari'ah-compliant products and services, but also an inherent internal Shari'ah governance framework. Typically, a fully-fl edged IIFS will have its own Shari'ah committee/advisers who oversee Shari'ah-related issues from product development to execution. In addition, being a fully-fledged entity helps ensure that there is no "leakage" of Islamic funds to non Shari'ah-compliant activities and no commingling of Islamic and conventional funds.

Islamic windows have advantages in terms of sharing resources, such as office space and support services, IT systems, legal resources, personnel and marketing infrastructure, and other potential economies of scale. However, a fully-fledged Institutions Islamic Financial Services (IIFS) could have more resources devoted to Islamic products for example, as related to training, research and development and specialized Islamic portfolios.

European banks are currently being encouraged to provide Islamic investment solutions, not only for their overseas Arab/Muslim clients, but also for domestic populations showing increased demand for Shari'ah-compliant products.

Table 1: SWOT and tows analysis

	STRENGTHS 1. Regional acceptance 2.Sector,fortes-competitive advantage 3. Justice and fairness: The main feature of the Islamic Finance model based on a profit-loss sharing principle	WEAKNESSES 1. Political leadership will 2. Missing key skills of creative talent 3. Lack of trained management and staff 4. Insufficient knowledge, perception and awareness 5. Lack of strategies, methods or products offerings Tough competition among the Islamic Financial Institutions (IFIs) prompts the owners and the management to structure and market products that imitate their conventional products
OPPORTUNITIES 1. Untapped market with unfulfilled customer needs 2. Alliances 3.Synergy between other sectors. 4. Sector opportunities: Islamic banking appeal, expected growth in demand for ethical finance & business 5. Islamic capital markets are being enhanced and new ones established to capitalize on the appetite for raising funds through Sukuk both by corporates and governments.	(OS) 1.Use strengths to take advantage on untapped market, create and establish more alliances in long term and create more synergy between others sectors such as Islamic Finance and Tourism or Fashion. 2.Build incentive & support schemes to encourage investment in Islamic Finance sectors 3.Integrated marketing & awareness campaigns for all Islamic Finance sectors.	(OW) 1.Strategies overcome weaknesses by taking advantage of opportunities consistent framework & standards for all participants in Islamic banking 2.Develop a holistic project for marketing & education campaigns to both educate & build goodwill 3.Get use of many local start ups along with discovering local talents through setting up organized contests to discover talent 4.Integrated marketing & awareness campaigns for all Islamic Finance sectors.
THREATS 1.The technology, digital and virtual world is changing rapidly and disrupting not only	(TS) 1.Use strengths to avoid threats with use Fair and Justice in Islamic Finance to attract and convince	(TW) 1. Strategies Minimize weaknesses and avoid threats simplify regulations for cross

banking and and finance industry but everything 2.The giant conventional banks feel threaten by the presence of Islamic Finance 3 The heavy concentration on 'Murabaha and Tawarruq' made them to look like risk-averse and lose credibility	muslim and non muslim to participate in Islamic Finance 2.Regional integration & agreement for more empowerment against competitors	border expansion & larger, regional players support 2. Effective dialogue between relevant parties, to reach standardized benchmarks 3. Establishment of standardized framework. Applying management efficiency in Islamic banks

Currently, there are a large number of Islamic windows in the UK and other European markets that are run by conventional banks. At the same time, some large European banks have fully owned Islamic subsidiaries. Furthermore, there are a growing number of stand-alone Institutions Offering Islamic Financial Services (IIFS), both foreign and domestic, that have their offices in Europe.

In summary, Islamic windows and fully fledged Institutions Islamic Financial Services (IIFS) may offer alternative ways of conducting business as Islamic finance continues to grow across different jurisdictions.

CONCLUSION AND RECOMMENDATIONS

The discussion makes it clear that Islamic Finance in European Union (EU) is not merely temporary phenomenon. Islamic Finance are here to stay and there are signs that they will continue to grow and expand. Even if one does not subscribe to the Islamic injunction against the institutions of interest, one may find in Islamic Finance some innovative ideas which could add more variety to the existing financial network.

Is it sometimes suggested that Islamic Banks are rather complacent? They tend to behave as though they had a captive market in the Muslim masses who will come to them on religious grounds. This complacency seems more pronounced in countries with only one or two Islamic Bank. Many Muslims find it more convenient to deal with conventional banks and have no qualms about shifting their deposits between Islamic Banks and conventional ones depending on which bank offers a better return. This might suggest a case for more Islamic Banks in those countries as it would force the banks more innovative and competitive. It is perhaps that there is need for specialized Islamic Financial Institutions such as mudaraba Banks, muharaba banks and musharaka banks which could compete with one another to provide the best possible services.

Beside that, the lack of awareness of Islamic Finance among the residents in specific countries in European Union also make them hard to understand well about the products that being offered and also the lack of expertise and skill to deliver the knowledge about Islamic Finance and the products may well be the problem. So as suggested, the countries that willing to fully fledged in term of Islamic Finance need to consider to send their people to learn from Islamic countries or search more talents related to this matter so that they can develop and grow steadily in the way to promote the Islamic Banking in their respective country.

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