

# Costs and opportunities of the Islamic Finance in Italy

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## Abstract

The Arab world has always considered investment opportunities in Italy. Such interest is confirmed by a number of relevant investments already made in the country. The perception of attractiveness by Arabic investors, however, has not been stable, because of Italy's economy's well known structural rigidity (i.e. excessive bureaucracy, low quality infrastructures, ineffective distribution network, different dimensions of corporate ownership, intrusive tax system, powerful trade unions, low productivity of factors involved). Strong limitations to Italian attractiveness are also related to the financial-credit support, due to the scarce international dimension of the Italian system. In the future, Italian attractiveness to Arab capital might worsen, following the increasing request by Arab investors for technical peculiarities complying with Islamic religion.

In fact, in the Middle East and in countries with a large Islamic population, Islamic banking is now a growing phenomenon, spreading also outside the Muslim world, imposing new structural and ethical benchmarks to international finance. However, while extremely widespread abroad, in Italy shariah related financial activity is still a quite unknown phenomenon. At the moment, the Italian Banking Association (ABI) and the Union of Arab Banks (UAB) are devising the project of an Italian-Arab banking federation to favor the entry of Islamic financial contracts (i.e. contracts complying with the Shariah, the Islamic Law) into the Italian credit and banking system as a competitiveness factor for collecting and using retail and wholesale funds.

In 2007, "Standard & Poor's" estimated that Shariah-compliant financial assets all over the world hit approximately 500 billion dollars. The London-based "International Finance Services" made an in-depth estimate suggesting that in late 2006 worldwide Shariah compliant assets amounted to 531 billion dollars. "The Banker" has revealed that Iran is the leading country holding Shariah-compliant assets, followed by Saudi Arabia and Malaysia. The UK is the only European exception ranking among the first 10 countries in the world.

The spread of such financial tools in Italy should be considered as an opportunity for the competitiveness of Italy. The introduction of Islamic banking's instruments, however, requires an adequate capability in managing and supervising its religious, legal and financial complexities. The opening to Islamic finance introduces also a trade-off between competitiveness and economic security that requires the development of an "holistic institutional approach" (comprehensive of banking-financial supervising aspects, as well as economic and social ones). A Government intervention, in this regard, can provide a better coverage of the different issues involved.

A similar approach is adopted in UK through the creation of an Islamic Finance Expert Group, an institution within HM Treasury where different – even opposing – interests are balanced. The Group includes members of Parliament, state bodies, major investment banks, licensed Islamic banks, international consulting firms, specific research entities, representatives of the Muslim community and of the financial services industry.

Even considering the trade-off, the introduction of Islamic finance in Italy can boost the competitiveness of the Italian system through greater overall foreign investments, larger (and better detected) bank deposits and savings of funds (coming from the Italy-based Islamic community), a major (and better) use of these funds by the national banking system (towards direct Arab investments in Italy), potential synergies (referring to experiences, knowledge and instruments) with other experiences in Europe, major corporate internationalization capability, (notably towards Islamic countries, relying on the "expert" support provided by our national banking-financial system). Aspects related to economic security protection, (including typical risks such as Shariah risk, moral hazard), should also be considered: lack both of a Court of last resort and of a Shariah-compliant lender of last resort; concerns about asset requirements for obtaining the necessary license; high costs of learning programs; competition in bank deposits and savings in Europe; a close and continuous supervision by the relevant authorities.

A medium-run growth of the Shariah-compliant finance in Italy meets also the needs for investment and saving expressed by Italian Islamic community. In fact, the growth of the Islamic presence in the country has generated a growing of business firms and worship places, usually placed in locations intended for private and commercial use. After consolidating its presence in the country, the Islamic community started to purchase real estate using Muslim believers' funds, private or public donors (mostly from Islamic countries), Islamic religious organizations and

business activities associated with worship places (facilitated by extemporaneous solutions offered by Italian banks).

Such activity was carried out through conventional financial tools (bank accounts, deposits) as well as informal (hawala). Many Muslims have chosen the latter, looking for discretion, quickness, ethics and compliance with religious rules. This behavior was induced by the absence in the Italian banking-credit system of financial services that facilitates the use of liquidity and loans in accordance with the Koran. However, the hawala system has often proven to be vulnerable to illicit operations such as money laundering or terrorist funding. As a consequence, authorities have opted for a repression approach. This solution (stricter rules against illegal phenomena), however, does not address a phenomenon that is more complex and lasting and that can be better resolved by integrating such liquidity into the internal economic-financial system (so that to assure its monitoring).

The Muslim community's aversion for traditional banking channels and the suspects about the use of the hawala networks are contributing to launch new financial structures that comply to Islamic religious rules. A number of initiatives are currently ongoing within the European Union, notably France, Germany, Netherlands, Switzerland, Belgium and UK. Through the mechanism of the "European passport", these initiatives are likely to attract capital from other EU countries banking system, producing also an outward flow of the savings generated in Italy by the local Muslim community. Such capital flow can be seen as the effect of an "ethic arbitrage" (i.e an "asset allocation" strategy including Shariah-compliant financial services as one of the various proposed options).

To be Shariah-compliant, a financial activity must sets its economic objectives (profit maximization, balance between liquidity and profitability) in accordance to Islamic religion principles (compliance with Shariah norms, restrictions to options concerning legitimate assets by avoiding proscribed activities). The prohibition of interests (riba) poses a number of difficulties to Islamic banks. The two major ones are liquidity management - since there is no inter-banking Shariah-compliant market - and the impossibility to invest in short-term and low-risk conventional bonds. The solution for refunding Islamic banks is represented by "sukuks", defined as "Islamic bonds" and issued by state and other local governments according to a securitization scheme.

Italy should also follow the strategy applied by London, Berlin and Amsterdam, adopting the principle "better collection of liquidity by the Islamic community/powerful message of social integration". In order to develop an adequate strategy, economic and social aspects should also be taken into consideration. For instance, regarding "banking integration", a significant cultural problem needs to be taken into account. In fact, while in the case of Islamic customers, religious principles apply both to profit and loss, the situation is more complex for non-Muslim customers, who are accustomed to typical Western pattern. The risk is that when investments fail, non-muslim customers might find some difficulties in understanding and accept the peculiarities of the Islamic bank.

Uncertainties related to the introduction of Islamic financial contracts into the usual Italian banking system should be handled by safeguarding economic and financial aspects, as well as scientific and industrial ones. Should the Islamic contracts become a tool for financing the development of these sectors, a scarce knowledge of this topic would pave the way to distortions of the operators' "normal behavior". Therefore, a sensitive and perspective approach is needed not only as to the regulatory framework but mainly on a systemic and social level (by protecting the religious sphere from the effects of this approach), also through prevention-related means, namely intelligence, considered to be more appropriate .