Islamic Finance in Indonesia: High Tide or New Mecca?[1]

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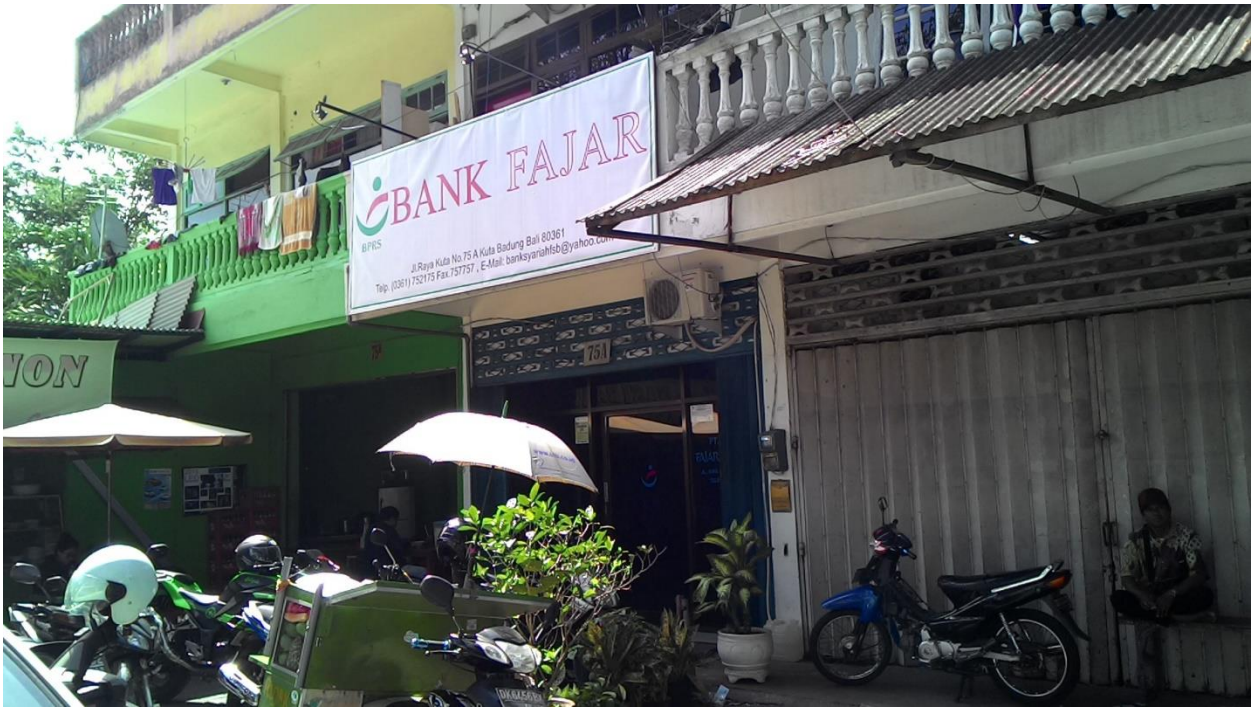

The oil-rich GCC countries have driven the demand for Islamic finance since its founding in the mid-1970s. Wealthy Gulf investors diversified their portfolios and seemed ready, on occasion, to invest not only in Islamic banks but also in sharia-compliant securities that were less profitable than comparable conventional securities. The question arises whether the novel enterprises of Islamic banking and capital markets will gain traction among the masses of Muslims who also believe, like the wealthy Gulf investors, that conventional bank interest is *haram* (against the teachings of Islam) but still either use the convenient services of conventional banks or avoid all banks. Indonesia is an important testing ground.

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Apart from the very wealthy Gulf states (along with Brunei), Islamic banking seems in much of the Muslim world to hit a natural plateau of some ten percent of the commercial bank market. To be sure, Iran and Sudan have imposed versions of Islamic law on their entire banking systems, but elsewhere the only countries to have moved much beyond the ten percent threshold are Bangladesh and Yemen, two of the very poorest of countries, and Malaysia. In Egypt and Jordan Saudi-owned Islamic banks entered in the late 1970s and eventually attracted 10.3 and 11.4 percent, respectively, of their commercial bank deposits. In Pakistan, too, Islamic banking deposits come to only 10.6 percent of the total. Turkey's "special finance houses" achieved a market share of only 6.3 percent by 2013, despite being governed by an Islamist party that promoted them and a leader and former prime minister and president, Dr. Abdullah Gül, who had begun his post-doctoral career as an economist at the Islamic Development Bank.

Table 1: Islamic Deposits and other Economic Indicators of Major Players[2]

Country Name	GDP (2013)	Population	M2/GDP	M2 ASSETS	Deposits /M2	Islamic %	Islamic deposits
Indonesia	$868,345,652,475	249,865,631	41.06%	$356,573,133,040	86.60%	5.01%	$15,470,495,893.94
Turkey	$822,135,183,160	74,932,641	60.72%	$499,213,345,791	91.76%	6.60%	$30,260,488,922.27
Saudi Arabia *	$748,449,600,000	28,828,870	55.90%	$418,352,956,149	90.73%	49.60%	$188,270,419,591.70
United Arab Emirates	$402,340,106,796	9,346,129	56.62%	$227,792,083,766	95.20%	24.70%	$53,591,360,580.70
Malaysia	$313,159,097,401	29,716,965	143.79%	$450,302,142,295	94.97%	22.70%	$97,272,836,780.22
Egypt, Arab Rep.	$271,972,822,883	82,056,378	79.15%	$215,258,961,392	80.91%	10.30%	$18,010,909,213.93
Pakistan	$232,286,781,111	182,142,594	40.91%	$95,029,226,183	75.98%	10.30%	$7,405,238,881.68
Qatar	$203,235,158,978	2,168,673	61.84%	$125,681,946,082	97.29%	26.00%	$31,792,427,444.58
Kuwait	$175,830,502,498	3,368,572	65.03%	$114,335,776,080	95.43%	47.30%	$51,595,799,219.57
Bangladesh	$149,990,454,541	156,594,962	61.34%	$91,997,965,804	87.50%	20.00%	$16,099,644,015.70
* TA not deposits							

The principal exception among middle income countries is Malaysia, where the government has systematically cultivated Islamic finance, lifting its market share above 20 percent and planning further expansion. As Table 1 indicates, Malaysia's Islamic deposit base comes second only to Saudi Arabia's. In capital markets Malaysia is dominant, with $164 million or 55.7 percent of the total outstanding *sukuk* (Islamic bonds) in 2015, compared to Saudi Arabia's $47.5 billion or 13.6 percent.[3] Next to these numbers, Indonesia appears insignificant, with only $15.4 billion of *sharia* compliant deposits and $18.9 billion or 6.2 percent of the *sukuk*. But its population and

[2] Sources: Indonesia Financial Services Authority (OJK), Islamic Financial Services Development 2013; EY, Islamic Financial Competitiveness report 2014; World Bank, World Development Indicators.
[3] Source: Sukuk Monitor http://www.zawya.com/sukuk/ (accessed April 15, 2015).

GDP, even in its present status as a lower middle rather than upper middle income country, are huge by comparison with the other Southeast Asian and Middle Eastern countries. With greater financial deepening its deposit base could surpass those of Islamic banking's major players. Indonesia, having already achieved its democratic transition, may be poised for substantial growth that is subject to less risk from volatile oil and gas markets. Indeed, any transition of Islamic finance from its current base in the wealthy GCC states into a sustainable financial movement may well depend on Indonesia's potential.

This paper examines the prospects for the "New Mecca"[4] of Islamic finance by analyzing data generously provided by the Bank of Indonesia and Indonesia's new banking regulatory arm, the Financial Services Authority (OJK), in the course of a nineteen-day field trip conducted in May-June 2015 in Jakarta, Denpasar (Bali), Mataram (Lombok), and Yogyakarta. Has the Islamic share of the commercial banking market reached high tide or, despite its current stagnation, is it really poised for new growth, even if not at the annual average rate of 35 percent experienced from 2010 to 2013?[5]

The official impetus from above

As one bank official recalls, only eight or ten of those working in the Bank of Indonesia in the late 1990s had any interest in Islamic finance. To the writer's surprise, given the strong sense of Indonesian exceptionalism he had been led to expect, this official and another of his colleagues on a different occasion spontaneously observed that Indonesia was ten years behind Malaysia and that it was time now for Indonesia to follow Malaysia's lead in providing top down support for Islamic finance, which had hitherto simply been given a relatively level playing field (as in Singapore). Indeed, Malaysia's originally enabling legislation for its dual supervisory system dated back to 1983, whereas it was only in 1992 that Indonesia permitted Islamic banking (act no. 7 -1992).

As in Malaysia, a *hajj* credit union had pioneered "Islamic" finance, and then in 1992 Indonesia officially licensed an Islamic bank, Muamalat, to open its doors for business. At that time Dr. Bacharuddin Jusuf Habibie was President Suharto's favorite technocrat, and he took the initiative to raise capital for the bank by

[4] As announced by Bank of Indonesia, November 6, 2014: http://www.bi.go.id/en/ruang-media/info-terbaru/Pages/Indonesia-Kiblat-Baru-Keuangan-Syariah-Dunia.aspx

[5] "Islamic Finance in Indonesia: Sharia Banking is Large Untapped Potential," Indonesian Investments, November 7, 2014: http://www.indonesia-investments.com/news/todays-headlines/islamic-finance-in-indonesia-sharia-banking-is-large-untapped-potential/item2592. Rifki Ismal (2013: 145) states that sharia assets grew at an annual average of 46.3 percent from 2004 to 2009 and then 47 percent in 2010.

mobilizing eighty-seven wealthy well connected businesspeople as private shareholders. Designed in cooperation with Indonesia's newly formed Indonesian Council of *Ulama* (MUI) and the Islamic Development Bank (IDB) in Jeddah of the Organization of the Islamic Conference (OIC), the new bank perhaps was expected to compensate in some Muslim circles for President Suharto's waning popularity (Otto 2010: 448; Hefner 2003: 154-156). When Habibie replaced Suharto, who fell victim to the financial crisis of 1997, the new president promoted new legislation to institutionalize Indonesia's dual supervisory system.[6] In 1999 MUI formed the National Sharia Board (NSB) consisting "of the Islamic law experts (*fuqaha'*) as well as practitioners and economists, particularly in the financial sector, both banks and non-banks."[7] The Board defines sharia-compliant financial instruments and has issued over 90 *fatwas* to date on every banking subject from current accounts (*Fatwa* No. 1) to hedging with currency swaps.[8] The three-member *sharia* boards of Islamic banks and windows include members of the NSB and must obey its regulations, unlike more free-wheeling *sharia* boards in Arab countries.

By the year 2000 there were two Islamic banks, three Islamic windows of conventional banks, and 83 Islamic "rural banks." The latter were essentially small, local savings banks that could also finance or lend funds but not engage in other banking services. The market shares of Islamic banks were minimal, well under one percent of the total commercial banking market. Further legislation in 2008 led to the two large state banks transforming their windows into stand-alone Islamic banks, and a number of privately owned commercial banks followed suit. Indonesia's parliament then established the Financial Services Authority (OJK) as an autonomous regulatory and supervisory body for all financial services (Act No. 21 Year 2011). In a first phase the Ministry of Finance transferred the regulation and supervision of capital markets and nonbank financial institutions to the OJK; then the Bank of Indonesia (BI) transferred the regulation and supervision of the banking sectors to the OJK in 2014, to be followed in 2015 by all microfinance institutions as well, implementing MFI Act No. 1 of 2013.

By 2015 twelve Islamic banks and 22 windows had accumulated 5.29 percent of commercial bank deposits, 4.85 percent of their total assets, and 5.42 percent of their

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[6] Banking Act No. 7 of 1992 was amended by No. 10 of 1998, leading to Central Bank Act No. 23 of 1999, amended by Act 3 of 2004 to be the cornerstone of the dual supervisory regime. Central Bank official Rifki Ismal (2013: 16) goes on to identify Banking Act No. 21 of 2008 and Sukuk Act No. 19 of 2008 as the first set of laws explicitly focused on Islamic banking and, for instance, limiting double taxation associated with certain Islamic forms of financing.

[7] National Sharia Board, Indonesian Council of Ulama, Fatwa, published in cooperation with the Central Bank of Indonesia, 2012, p. iv.

[8] Fatwa No. 88 or 89, issued more recently than the collection cited in note 5, which lists only 82 fatwas.

financing or loans. In the rural sector 163 sharia-based banks had about 8 percent of the deposits and did 6 percent of the financing. Islamic banking, however, was apparently stagnating. As one banker explained, in 2013 the growth of the Islamic sector was slowing but was still twice as fast as conventional banking; by 2014, however, each sector seemed to be growing at about the same diminished rate.[9] By April 2015 Islamic finance had made slight gains in its share of deposits but was actually losing market share in its use of funds and total assets, as reported in Table 2.

Within the Bank of Indonesia the Governor established a task force to devise a strategy for financially deepening, to bring its current M2/GDP ratio of 41 percent to higher levels associated with more advanced economies. One of its members was propelling Islamic financial development along several fronts. The strategic objective was to institute a National Islamic Finance Committee (KNKS) to be chaired either by President Joko Widodo or preferably by Vice President Jusuf Kalla, who was more experienced with the interplay of administrative politics across the various concerned ministries. The Ministry of National Planning included such a committee in its interim national economic plan of 2016-2019, and proponents of Islamic finance within the Bank Indonesia and OJK could also count on strong support from the Ministry of Finance, headed since October 2014 by Dr. Bambang P. S. Brodjonegoro, a professor of economics who had also directed General Islamic Research and Training Institute of the Islamic Development Bank in Jeddah until 2011.

[9] Interview, BNI, Yogyakarta, 11 June 2015.

Table 2: The Stagnation of Islamic Finance in 2014-2015

CONVENTIONAL AND ISLAMIC BANKING MARKET SHARES

Asset	2011	2012	2013	2014	Apr-15
Conventional	92.98%	92.05%	91.14%	91.26%	92.05%
Syaria	7.02%	7.95%	8.86%	8.74%	7.95%

Loans/Financing	2011	2012	2013	2014	Apr-15
Conventional	92.37%	91.51%	90.82%	90.99%	91.24%
Syaria	7.63%	8.49%	9.18%	9.01%	8.76%

Funding	2011	2012	2013	2014	Apr-15
Conventional	93.87%	93.05%	92.96%	92.82%	93.56%
Syaria	6.13%	6.95%	7.04%	7.18%	6.44%

STAGNANCY IN SYARIA MARKET SHARES'S GROWTH

OJK OTORITAS JASA KEUANGAN

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Proponents of KNKS cited as international precedents the Islamic Finance Task Force established in the UK in 2013 by Prime Minister David Cameron as well as the Malaysian International Islamic Finance Center, established in 2006 and chaired by the prime minister, including major regulatory and decision-making centers such as the Ministry of Finance and the Capital Markets Authority.[10] They expected it to begin operations in 2016.

Meanwhile the Bank Indonesia was adding pieces to the architecture of Islamic finance. In close association with the IDB plans were on track to establish the World Islamic Investment Bank (WIIF) with a paid up capital of $10 billion that will facilitate the financing of infrastructure for IDB member coutries and also play important role as an anchor bank for the Islamic liquidity market. The Government of Indonesia (GoI) will be expected to be the *lead investor* and provide initial paid up capital of US$ 300 million. Other IDB member coutries are to provide capital not exceed GoI share.

[10] According to its website, "The MIFC Community is a network of the country's financial sector regulators, including Bank Negara Malaysia (Central Bank of Malaysia), Securities Commission Malaysia, Labuan Financial Services Authority and Bursa Malaysia (Kuala Lumpur Stock Exchange), Government ministries and agencies, industry players from the Islamic banking, takaful, re-takaful and Islamic capital market industries, human capital development institutions as well as professional ancillary services companies ranging from legal firms and Shariah advisories to tax and audit firms and research companies." http://www.mifc.com/index.php?ch=ch_header_contact_us&pg=pg_header_aboutus (accessed 22 June 2015).

A second initiative concerned an international center for *zakat* (Islamic tax for charity). A MOU with the IDB in November 2014 led to a conference in Aceh in June 2015 to lay the foundations for an International Islamic Social Finance Services Board, a charity and social services financial center for all OIC members. Pending final approval from the IDB of a report concerning the core principles for effective *zakat* supervision, the international *zakat* center was expected to open in May 2016.

Once the KNKS was established, planners envisioned a number of initiatives for carrying out its mandate of promoting Islamic finance:

1. dissemination and campaigns on Islamic finance, led by the Committee.
2. encouraging the placement of government funds in the banking or Islamic financial institutions. It also encourages the government financial transactions through Islamic financial institutions,
3. encouraging the establishment of Sharia-compliant investment banking in Indonesia,
4. increasing investment in human resource development in the field of Islamic financial through education and training and encourage Islamic financial institutions to increase human resource development of Islamic financial investment,
5. encouraging innovation in Islamic finance (i.e. products and service),
6. increasing the Islamic financial information technology systems to improve the competitiveness and performance of Islamic finance, and
7. increasing interaction with international stakeholders to play more active role in Global Islamic finance industry.[11]

Development from the ground up

Meanwhile on the ground in Lombok, the OJK Regional Office arranged a meeting with bankers and presented the PowerPoint reported in Table 2 illustrating the stagnation of Islamic finance. One of the bankers at the meeting then showed me his most recent consolidated Mataram branch balance sheet. Despite an inflation rate that averaged about 6.8 percent in December through May, his deposit base diminished by 14.5 percent, while the non-performing financing percentage (NPF) of his relatively stationary financing (loan) portfolio rose from 5.22 percent in December to 9.76 percent on May 31. This was well above the already mounting NPF national average of 4.81 percent reported on March 31 for Islamic banks and windows.

[11] Email from Ministry of National Development and Planning (bappenas.go.id), 11 June 2015.

The bank exemplified a major dilemma these banks faced. In hard times they still needed to pay out returns on their time deposits equivalent to those of the conventional banks. The officials at the Bank of Indonesia tended to agree with the CEO of one Islamic bank who believes he can count only on a "traditional" 5 percent to keep their savings with him if they are not paid a share of the bank's profits equivalent to the interest paid by conventional banks.[12] Evidently the bank in Mataram was overloaded with non-performing financing operations because it was attempting to earn sufficient profits to retain its depositors. Possibly business was especially slow on the island of Lombok, but the bank's difficulties in finding good credit risks also pointed to another problem: saturated credit markets.

A study in 2014 of Indonesia's "rural" or local banks, the Bank Perkreditan Rakyat (BPR), discovered that the number of its debtors had actually declined after 2011, even as the average amount of their loans steadily rose, from an average of $900 in 2007 to $1550 in 2013.[13] These savings and loans cooperatives, institutionalized as "rural banks" (BPR) after 1988, were the junior partners of conventional commercial banks reaching into microfinance. If their markets were becoming saturated, they were perhaps exerting upward pressure on the conventional banks, as in Lombok, for instance. On this "island of one thousand mosques," 96 percent Muslim, the sharia-based rural banks (BPRS) had close to 15 percent of the ruralmarket and were competing with the bigger full-fledged Islamic banks for creditworthy customers. One of the OJK regulators pointed out in her presentation, however, that potential customers had difficulty understanding the complexities of Islamic financing instruments, such as their bread and butter murabaha or installment sales agreement.[14]

Ambiguities of microfinance

Indonesia has pioneered microfinance, but its definition remains a work in progress, the size of a microloan varying with financial opportunities. In most countries banks

[12] Interview at OJK, Jakarta, June 1, 2015. In one survey, conducted in 2009 among Islamic bank depositors, 35.5 percent of the 409 respondents said they would close their account if their returns were less than the prevailing interest rate of less than expected. In a more general market survey conducted in 2008 only 16.4 percent believed that conventional banks had to be avoided because interest was forbidden, whereas 33.8 percent preferred to conduct all their business with conventional banks. A number of surveys are summarized by Ismal, 2013, 30-41.

[13] Wolfran Hiemann, 2014, PowerPoint page 20.

[14] In a *murabaha* the bank authorizes the customer to buy, say, a motorbike. It costs 16 million IDR ($1200). A sharia-compliant bank then charges the customer a monthly payment that they have negotiated for a given time period. In the case of a good motorbike, some banks may extend the time period for up to five years, but this must be negotiated in advance. Most banks do not offer transparent options for buying out the debt in advance. Their calculation of profits differs from those of interest rates charged by conventional banks. The bank advertises its profit rates as a function of the installment total divided by the number of years, a rate that will be substantially less than the interest charged by a conventional bank for precisely the same set of payments. Understandably, consumers may be puzzled.

are allergic to microfinance because large numbers of small loans are more expensive to process and monitor than smaller numbers of larger loans, and, banks being banks, Indonesia is no exception. Until 2004 the Bank of Indonesia engaged in many programs that essentially subsidized the banks to deepen their networks to reach poor cultivators and other small entrepreneurs. In 2004 BI programs were farmed out to the largest state bank, Bank Mandiri, and its Islamic subsidiary, Bank Syariah Mandiri (BSM). The official OJK definition of a micro loan or financing defines the upper limit as IDR50 million Indonesian Rupiah(IDR), or roughly $3750. In Yogyakarta, however, BSM explained his division of labor with the parent bank, Bank Mandiri: BSM would take over the microloans of IDR2 million up to IDR100 million. The manager of the branch was hoping in future to raise its lower limit to IDR50 million and eventually increase it to IDR100 million, in other words to remove his bank from all "microfinance" as defined by the OJK. Meanwhile he planned to hand over some of the 10 percent of his financing portfolio allocated to 3000 micro clients to a Baitul Maal wa Tamwil (BMT, literally a "money and finance house"), an NGO specialized in microfinance.[15] The branch manager of one of his competitors, state-owned BNI Syariah, claims already to have left microfinance, although the bank still finances consumers for motorbikes and the like that fall below the technical 50 million ceiling for microfinance.[16]

In Lombok BSM had to eliminate microfinance at one of its outlets altogether because of NPF, although it constituted a very small portion of its total financing portfolio. In Jakarta the CEO of another Islamic bank opted to raise his lower limit to IDR100 million and understood microfinance to involve any financing under IDR500 million, ten times the BI definition. He thought the state-run Bank Mandiri could tap the lower end of market that it in turn was spinning off to rural banks or NGOs. The Islamic banks had accumulated over 18.5 million customers by 2013, and 163 BPRS banks an additional million. Despite having only 5 percent of deposits, they had over 30 percent of Indonesia's bank accounts.[17] However, they were constantly trying to upgrade the customer base so as to finance a leaner, wealthier clientele.

On the deposit side, the BPR and BPRS banks offered better rates of returns and, closer to the people, processed loans or financing operations more expeditiously than the full service banks and so could charge more for them. In Bali, for example, the leading BPR (with a market share approaching 30 percent of the island's total BPR assets) pays its depositors 10.25 percent whereas conventional banks pay only 7.5

[15] Interview, BSM, Yogyakarta, June 11, 2015.
[16] Interview, BNI Syariah, June 11, 2015.
[17] World Bank, Findex Database (accessed July 13, 2015) indicated that 36 percent of Indonesia's 175 million population at least 15 years old had bank accounts.

percent, little more than the prevailing rate of inflation. They also charge substantially more for loans, up to 22 percent, and earn a return on assets of 5 percent, higher than the norm.[18] Their non-performing loan ratio (NPL) was only 0.5 percent, substantially less than 2.37 percent registered for Bali BPR banks at the end of 2014.[19] However, this BPR was sufficiently upscale to escape the travails of microfinance by setting its lower loan limit at IDR100 million.

Among the other 137 rural banks on Bali only one, Al Fajar, the very smallest, was sharia-compliant on this predominantly Hindu island. With total assets of only IDR 7.5 billion (barely $500,000) this BPRS necessarily engages in microfinance, like a number of the other BPRS. Its commissioner, a Hindu representing a three Muslim owners from Java, including the representative of a foundation for IT training, also oversees Tata, a conventional BPR with total assets of IDR 100 billion that is supported by the foundation. As Tata grew, its three offices now servicing 3 to 4000 customers, its loan ceilings increased to IDR 1.5 billion whereas no Fajar customer can receive more than IDR 700 million in financing, barely enough for a small car. Enthusiastic about microfinance, whether Syariah or conventional, the commissioner may nevertheless aspire to revise upward the minimum for a microloan.[20] At Fajar Bank microfinance is defined as being below IDR5 million or $375, and its two managers claimed that 200 of its 600 customers were in this category. All of the financing took the form of a *murabaha*, 70 percent of the customers being Hindu, 2 percent Christian, and 28 percent Muslim. Financing charging were negotiable, averaging roughly 1.7 percent monthly, while their 300 savers received 0.6 to 0.8 percent monthly.[21] These rates were roughly equivalent to those of the big conventional interest-based BPR discussed above.

The only other formal sharia-compliant financing available on Bali was with the full service banks. BSM retained some hundreds of clients, but Islamic finance had a limited presence on the island despite a population that was 12 percent Muslim and increasing with immigrants including wealthy Muslim investors from Java. Just as there was only one small BPRS, so the nine full service banks had only 2 percent of the total commercial bank assets, compared to Lombok's 14.5 percent and Yogyakarta's 7 percent. Bali also had thousands of informal savings and loan associations, including village cooperatives, the Lembaga Perkreditan Desa (LPDs),

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[18] The survey of Hiemann (2014), PowerPoint 24, indicates an average ROA of 3.8 percent for BPR banks, well over the BI target of 1.5 percent, but saddled with 5.7 percent of non-performing loans, above the target of 5.0 percent set by the BI.

[19] Interview with Pribadi Budiono, BPR Lestari, Denpasar, June 10, 2015. The Bali data are published by the Bali office of OJK in SPB Statistik Perbankan Bali 2014.

[20] Interview with Marlowe Bandem, OJK Regional Office, Denpasar, Bali, June 10, 2015.

[21] Interview, Bank Fajar, June 9, 2015.

where savers could receive tax-free interest but microfinance was prohibited by law. To bring informal practices under control in the Muslim community, the OJK sought out the informal BMTs usually based in mosques, had already identified ten out of a possible fifty, and intended in 2016 formally to regulate them. Across Indonesia there were thousands of them.

Plunging deeper – the politics of inclusion

Islamic finance might expand from below, through further regulation of the thousands of informal BMTs that could recruit savers and petty entrepreneurs from the informal economy. And beyond the BMTs were various informal cooperatives and village associations. In Bali my driver had borrowed funds to buy a motorbike from a large LPD cooperative based in the upscale Sanur neighborhood of Denpasar. I calculated that he was paying an effective interest rate of 43.8 percent over 4 years,[22] and I wished to compare his loan shark's deal with the financing packages offered by other banks and nonbanks visited in the course of my fieldwork. One of the full service Islamic banks, claiming a profit rate of 7 percent, offered a package with an effective interest rate of 13.9 percent.[23] As expected, a BPRS offered a package with a somewhat higher profit rate of 8.7 percent, which translates into an effective interest rate of 15.9 percent.[24] Further down the line into a financially unregulated sector, one of the two largest BMTs in the Yogyakarta region offered a five year package with an effective interest rate of 22 percent.[25] When quizzed about possible early repayments, each bank and nonbank official hesitated, indicating that there might be some possibility of receiving some compensation for early repayment of the entire sum of contracted installments.

Inspired by a dense network of Muhammadiyyah business associations, Islamic finance was thriving at all levels in Yogyakarta. BMT Beringharjo was the city's largest of these Islamic non-banks facing possible regulation by the OJK. Dra. Mursida Rambe, its director and one of the three sisters who had founded their *baitul*

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[22] The driver, Amane, purchased a motorbike for 16 million. The Samur LPD required a down payment of 4 million followed by three monthly installments of 1 million each. The remaining 9 million was to be paid off in installments of 400,000 rupees per month over 4 years. Amane showed me his crumpled paper detailing the monthly repayments and principal remaining after each payment, indicating that his usurious LPD was well organized. There would be a penalty for paying off the loan in advance.

[23] Down payment of 6 million toward a bike costing 16 million, followed by monthly payments of 232,000 rupees for 5 years. The profit rate of the murabaha is calculated as the percentage of total payment "profits" divided by the number of years.

[24] Down payment of 30 percent on a bike costing 10 million, followed by 3 years of monthly payments of 245,667 rupees.

[25] Monthly payments of 442,666 for five years for a motorbike costing 16 million. The accountant calculated an annual profit rate of 13.2 percent or 66 percent for 5 years, to reach a total profit of 10,560 and installment payments of (10,560 + 16,000)/60.

maal wa tamwil in 1994, claimed that the ministry of cooperatives already regulated their association. Starting with 1 million rupiah raised from a *zakat* foundation to save the poor tradespeople from loan sharks in the Yogyakarta's historic Beringharjo market, she managed total assets in 2015 of IDR 104 billion, roughly double those of one of the city's largest and most publicized BPRS banks.[26] Housed in more sumptuous headquarters than any of the BPRS, it directed 15 branches in five provinces and managed an office in Hong Kong, financed by a *zakat* foundation, for some 20,000 Indonesian female expatriates. Dra. Mursida also had plans to set up similar facilities in Malaysia for some 400,000 potential female clients but no plans for more strictly regulated Singapore. Headquarters also housed a small training center to implement the Bering Campus plan of a one-year course for vocational high school graduates and one to two-week in-house training programs for BMT staff. The director is in touch with other BMTs across Indonesia. She actively represents Yogyakarta in the Indonesian Association of BMTs (Perhimpunan Baitul Maal wa Tamwil Indonesia) and seems poised to counter any possible plans to regulate the BMTs. No doubt vigorous debate between the Ministry of Cooperatives and the OJK will enliven the activities of KNKS, the proposed interministerial committee discussed above.

Other outstanding issues

The prospective committee may have to face a number of other outstanding issues, in addition to extending the reach of official Islamic finance to the BMTs. First on the agenda may well be to persuade ministries where to channel their payrolls, at least as an option for their employees. In places like Lombok, where the BPRS financing exceeded savings by over 60 percent, the provincial state bank was a useful source of funds, but other mechanisms might be developed whereby the employee salts away part of his or her paycheck into a variety of sharia compliant funds. The issue of deposit insurance, however, recently emerged. Presently all bank deposits are insured, whether they are in full service, conventional or sharia banks or in any rural bank, BPRS as well as BPR. In preparing for Basel III, however, a separate deposit insurance program for the Islamic sector is now required, highlighting an issue previously ignored.[27] Some, possibly a majority of Muslim scholars insist that such insurance would violate the risk sharing principle of *mudaraba* (venture capital investment), except in the case of sight deposits. A *fatwa* is currently under discussion.[28]

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[26] Interviews, Dra. Mursida Rambe, June 12, 2015; Edi Sunarto, BPR Syariah BDS, June 11, 2105.

[27] "Indonesia eyes Islamic repo rules, separate deposit insurance," Reuters, December 3, 2014; International Association of Deposit Insurers, Insurance from the Shariah Perspective, BIS, Basel, Switzerland, May 2010 http://www.iadi.org/docs/DP-DI_From_Shariah_Perspective_(Final)_Sep2011_to_IADI.pdf.

[28] Cecep Maskanul Hakim, OJK, Jakarta, email to me, June 19, 2015. Cecep is the OJK ex officio member of the National Shariah Board.

More generally, whether the issue is deposit insurance or developing sharia-compliant investment banking and varieties of Islamic financial products beyond the six or seven presently recognized one, new product development requires close collaboration between a large, possibly unwieldy National Sharia Board (NSB), the BI, OJK, other government agencies, the Supreme Court, and the accounting profession. Making new *fatwa* is a slow process involving the twenty members of the NSB's executive committee reporting to a plenary of 60. Cross country standardization is even more complex. Indonesians are, perhaps fortunately, not part of the "small world" of predominantly GCC-based *ulama* who effectively standardize practices through their cross-cutting membership in the sharia boards of Islamic banks (Small World).

Indonesia has moved away from exclusive reliance on variants of *murabaha* (mark-up sales) and *ijara* (leasing), both of which are debt based financing, to more equity like *mudaraba* (venture capital investment) and *musharaka* (shared ownership), but maturities are almost bound to be mismatched between term deposits in these banks and their predominantly short-term debt-based financing. They probably need to work harder to earn the profits needed to pay their investors than conventional banks, which enjoy good spreads between interest earned on long term loans and their interest expenses to depositors. Their operating costs also seem higher than those of conventional banks. One explanation given by an Islamic banker was that his bank must run a separate investment house to monitor the expenditure of *zakat*.[29] A bank regulator observes, however, that "a big bank like BSM and BMI has its own *zakat* specialized body because it will benefit to enhance its reputation as a caring intitution and also integrate the *zakat* fund with its 'unbanked-poor people credit program.' So I do not find any correlation between high operational costs and the existence of a *zakat* body in a bank."[30] Working familiarity even with the small number of Islamic financial instruments currently available in Indonesia may be an additional burden for inexperienced new staff.

Perhaps encouraging them to publicize Islamic finance will help them to learn while teaching. One striking example concerned the BPRS BDS in Yogyakarta. Pictures, newspaper clippings, even coffee mugs were good publicity. They promoted the idea of this BPRS as being one big happy family. So also did one of their competitors, a much smaller BPRS that was literally part of a big family of four rural banks with total assets of IDR600 billion, about 20 percent of the entire BPR market in Jogyakarta. The largest belonged to the father, the next two conventional BPR to two sons, and the newest,

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[29] The establishment of a wing of Zakat Disbursment Intitution by an Islamic bank, such as LAZ BSM (belonging to BSM) and Baitul Muamalat (belong to Bank Muamalat Indonesia), is a way to overcome the regulations in official Zakat and Islamic Banking legislation about disbursing zakat. They may only be disbursed through national zakat institutions or by a specialized body established by the bank with separate management and book keeping.

[30] Comment by Nasirwan Ilyas, OJK, July 27, 2015.

tiniest (with just 22 billion) BPRS to the daughter. Comparing notes, they could perhaps publicize the similarities and differences among their family of enterprises—maybe comparing the two vocabularies of finance for financing motorbikes so as to demystify some of brochures prepared by Islamic banks.[31]

The panacea often suggested for developing human resources by encouraging new Master's degree programs in Islamic finance may need rethinking. Bank managers I interviewed were indeed actively seeking new staff, but not from such programs. The consensus was to look either for experienced conventional bankers or for bright undergraduates, whatever their field of study, and train them on the job. Two of the brightest interlocutors in my fieldwork were graduates who had respectively studied international relations and agronomy. Combinations of legal and financial training at a top elite institution for prospective *ulama*, by contrast, could accelerate new product development. The OJK administered written examinations for prospective members of banks' Sharia supervisory boards and had occasionally rejected candidates or passed them only under extreme pressure, given their lack of understanding of the operations of modern banks. A carefully designed program at one of Indonesia's top universities, sponsored by the National Shariah Council, the Bank of Indonesia, and the OJK, could lead to careers as scholars and, for the less academically inclined, to thousands of positions as sharia supervisors of the various full service Islamic banks and bank windows, the BRPS's, and the BMT's.

A final challenge concerns regional competition in the face of the liberalization of financial services envisioned by the ASEAN Economic Community. A meeting of ASEAN finance ministers and central bank governors in Kuala Lumpur on March 15, 2015, reaffirmed the road map for financial integration spelled out in 2013.[32] The path implementation may be "a work in progress,"[33] but to meet expected regional competition, notably from the big Malaysian Islamic banks, the Indonesian authorities in charge of state-owned enterprises are beginning to consider a merger of state-owned Islamic banks. On the ground the reactions were understandably mixed. At BSM the branch manager was enthusiastic about the project whereas at BNI Syariah, also state-

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[31] A brochure issued by the BNI branch headquarters in Yogyakarta, for instance, has long columns with sums of money and monthly payments for each of a number of years, topped by percentages that refer to *murabaha* profit calculations rather than effective interest rates that a conventional bank might indicate.

[32] Joint Statement of the 1st ASEAN Finance Ministers' and Central Bank Governors' Meeting (AFMGM) Kuala Lumpur, Malaysia, 21 March 2015 Theme: Our People, Our Community, Our Vision: http://www.asean.org/news/asean-statement-communiques/item/joint-statement-of-the-1st-asean-finance-ministers-and-central-bank-governors-meeting-afmgm-kuala-lumpur-malaysia-21-march-2015-theme-our-people-our-community-our-vision. For the road map, see Asian Development Bank, The Road to ASEAN Financial Integration, Manila, 2013: http://adb.org/sites/default/files/pub/2013/road-to-asean-financial-integration.pdf

[33] Sanchita Basu Das, "The ASEAN Economic Community: a Work in Progress," *The Diplomat*, May 23, 2015: http://thediplomat.com/2015/05/the-asean-economic-community-a-work-in-progress/

owned and to be merged, the reaction was mixed. The two officials wondered about the consequences, as if they were targets of a take-over.

Conclusion

Like the ASEAN Economic Community in the region, Islamic finance is very much a work in progress in Indonesia. If plans for KNKS materialize, market shares will undoubtedly resume their steady growth past the present high tide. As BI and OJK authorities have argued, the growth is essentially a matter of political will. Perhaps the consideration raised by an Indonesian official at the beginnings of the Islamic finance movement in 1993 still holds, "If we don't do this, if we continue to push Muslims into the opposition, then our future will be like that of Algeria"(Hefner 2003: 163). Islamic finance remains a gentle identity marker to preempt more violent messages, whether in the form of *hudud* or an Islamic State, from the Middle East.

Before Jakarta becomes the new Mecca for Islamic finance, however, it will need a human cadre not only of experienced bankers but also of scholars who can catalyze new product development. Indonesia is fortunate to have a National Sharia Board that escapes the stranglehold of GCC-based jurists who control most sharia boards of banks across the Arab region and as far east as Singapore (Ünal 2011).[34] It may benefit from some consensus developed by those jurists but is also free to develop more progressive interpretations of medieval rules. But new generations of scholars are needed who are equally trained in the complexities of domestic and international banking and in medieval Islamic law. Furthermore, they need to apply their legal interpretations to a judicial landscape based on civil law rather than on more compatible common law traditions like Malaysia's.

Indonesia's Islamic finance may be off to a slow start, ten years "behind" Malaysia, but its institutions are set on the relatively stable foundations of democracy and a liberal economy managed by world class technocrats. Consensus is slowly but deliberately discovered to guide the further development of Islamic finance. As it is melded into the country's relatively well banked landscape, it may indeed further financial inclusion by expressing financial transactions in a vocabulary that is closer to popular traditions. The sharia component, however, is no excuse for poor service but rather a challenge for these new bankers facing competition from their experienced conventional colleagues to shape up and engage in better service. The

[34] The Islamic Bank of Asia, Singapore's only Islamic bank, has a sharia board consisting of the top four listed in Ünal's register of sharia board members. Syrian-born Abdul Satar Abdul Karim Abu Ghuddah topped the list with membership on 101 boards, while Bahrain's Nizam Yacoubi, displaced from the number one spot in 2010, had 95 memberships. From Malaysia in 4th place came Muhammad Daud Bakar with only 46 memberships.

government may take limited initiatives to increase Islamic market shares but it is also constrained by a pluralist ideology and prevailing economic doctrine requiring an even playing field.

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