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PROGRAM ON DATA SCIENCE FOR PUBLIC POLICY

Islamic Finance: Needed, Wanted, but Unavailable

How Can Government Promote Islamic Finance in the Philippines?[1]

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Abstract

We overlaid sentiment analysis onto our ongoing project on Islamic finance and discovered that the sentiments toward Islamic finance are generally positive. However, there are a number of negative sentiments, such as concerns about "risks," which suggest that the literature perceives risks either in the design or implementation of Islamic financing. The preliminary findings of our project, combined with the results of the sentiment analysis, underscore the important role of government agencies in disseminating information and enhancing public knowledge on Islamic finance. Successful models of Islamic finance could be supported to scale up or expand. More importantly, the government, particularly the Bangsamoro Autonomous Region for Muslim Mindanao (BARMM), is encouraged to take a proactive role in developing industry plans and promoting investments and entrepreneurship. This would help attract Islamic financial institutions to set up operations in the region. With these measures in place, Islamic finance, which is much needed and highly sought after, may become more available and accessible.

[1] The sentiment analysis of this policy brief is an output of the Webinar on Spatial and Text Data Mining Analytics organized by the UP Center for Integrative and Development Studies (UP CIDS) Data Science for Public Policy (DSPPP) held on 29-31 July 2024. Prior to the conduct of sentiment analysis, the data, review of literature, and analysis on Islamic finance were outputs of the Islamic Finance Project of the UP CIDS Escaping the Middle-Income Trap: Chains for Change (EMIT C4C) Program and the Peace and Equity Foundation (PEF). This policy brief is part of a more comprehensive forthcoming publication of EMIT C4C and PEF. Funding for the Islamic Financing Project came from PEF and UP CIDS.

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Background

Of the 119 million Filipinos, Muslims account for 6-11 percent of the total population (World Bank n.d.).[4] Despite this demographic, there is a notable lack of Islamic financing products and institutions. This means that there are limited opportunities for Muslims and non-Muslims to engage in financing that operates outside the framework of interest. "Islamic finance" refers to financial activities that adhere to Shari'ah or Islamic Law. One of its core principles is the prohibition of *ribā* (interest), as money and money instruments, such as the use of repurchasing agreements, certificates of deposit, and treasury bills, are considered merely mediums of exchange. Earning from them is deemed *haram* (forbidden). Returns on financing must be tied to an asset, ensuring that both lender and borrower share in the profits or losses. This approach promotes shared risk-taking between lender/investor and borrower/entrepreneur. Islamic finance also prohibits the use of money to support businesses that are considered immoral or ethically problematic, such as arms manufacturing, gambling, and alcohol production.

Islamic finance is already well-established in the Middle East and North African (MENA) region, but it is gaining popularity in countries that are not predominantly Muslim. Saudi Arabia and Iran are the largest markets, each boasting asset exceeding USD 400 billion (Rasmal 2024). Various Islamic finance instruments, such as *musharaka*, *murabaha*, and *ijara*, are used worldwide.

In late 2023, the Philippine government launched its maiden *sukuk* bonds, which were oversubscribed, signaling a strong demand (Arcalas 2023). It is therefore puzzling why there are limited Islamic finance institutions and products in the Philippines, despite its growing popularity, the availability of a law enabling its rollout, the number of potential users, and the government's policy on financial inclusion in unbanked regions like BARMM. This policy brief contributes to the discourse on Islamic financing by analyzing the situation and offering suggestions to the government, emphasizing its pivotal roles in promoting, disseminating, and regulating.

On one hand, Islamic financing encourages the use of *Murabaha* or cost-plus financing, *Mudabarah* or profit-sharing, *Mushakarah* or joint venture, *Istisna* or contract for manufacturing, and *Ijirah* or leasing. On the other hand, Shari'ah financing is the subset of Islamic financing which connotes a stricter compliance to Shari'ah principles. All financial transactions that occur in this type of financing must meet ethical, moral, and legal standards set by Islamic Law, distinguishing it from other financial systems by ensuring that all capital movements are fair, transparent, and just.

Be that as it may, the rules and regulations for each Muslim country differs from one another with the Middle East being much stricter relative to Southeast Asia (Abaza 2007). In the case of the former, Shari'ah and Islamic financing are interchangeable but the case is not the same for the latter.

What We Know So Far

One of the projects of EMIT C4C and PEF, is an action research on Islamic finance. Our project aims to understand the landscape of Islamic finance in the Philippines and to recommend ways to promote it. We have reviewed relevant scientific literature on the topic, conducted fieldwork to interview Muslims from various ethnolinguistic groups (Maranao, Maguindanao, Yakan), and held brainstorming sessions with government officials, financial institutions, and experts in the field. Here are some of our key findings:

1. There is a clamor for Islamic finance products, and many Muslims prefer not to use conventional finance;

2. A number of cooperatives had good success when they pilot-tested Islamic microfinance among their members;

3. The Islamic microfinance pilot model experienced challenges on screening, business model, and enforcement of agreement, which are common problems in any credit transaction;

[4] The low end of the range (6%) is from the 2000 census of the Philippine Statistics Authority (https://psa.gov.ph/content/religious-affiliation-philippines-2020-census-population-and-housing) while the high end comes from the 2012 estimate of the National Commission on Muslim Filipinos. The World Bank (n.d.) states that the range is due to differences in methodology.

4. The Shar'iah Advisory Boards, which were set up in the cooperatives, provided not only policy guidance on lending but also helped enforce agreements using religious teachings, social capital, and reputation. This suggests that, in this set up, Islamic financing could help address conventional or typical credit challenges; and

5. Many Filipino Muslims do not have a clear understanding of Islamic finance, and the need to establish a Shar'iah Advisory Board in every financial institution contributes to limited agreements on acceptable products, services, and procedures (Iqbal 2007, 7).

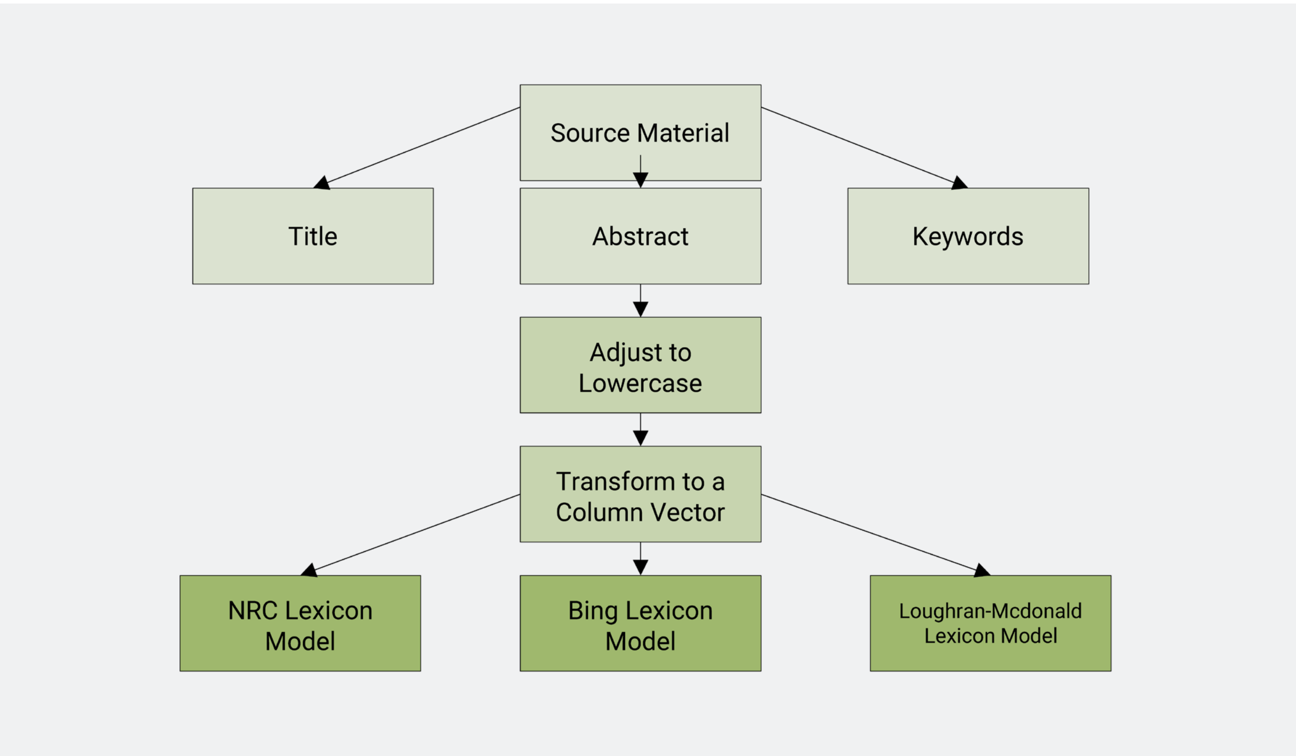
It was evident that information and education efforts, along with pilot testing of models and harvesting of lessons, could improve the appreciation for Islamic finance in the Philippines. For this policy brief, we conducted a sentiment analysis based on available literature. We wanted to understand the underlying emotions behind the tone and delivery of the texts. Our sentiment analysis complements the literature review conducted in our Islamic Finance Project, which focused on identifying themes from the literature.

Sentiment Analysis on Islamic Financing and Shari'ah Financing: Generally Positive but with A Mix of Negative Emotions Around Risks

We performed a sentiment analysis, a form of a data mining procedure, on the abstracts of scientific journals that looked into "Islamic financing" and "Shari'ah financing," both are used interchangeably, along with "Shari'ah-compliant financing" in the literature. This is why both were used to ensure that papers that use either term are included in the analysis.

We sourced our data from various journals, including the International Social Science Research and Economic Journal of Emerging Markets. With 100 observations, we used the R programming language to create three models of varying complexity: NRC Word-Emotion Association Lexicon, the Bing Lexicon, and the Loughran-McDonald Lexicon. Figure 1 outlines the methodology of our sentiment analysis.

In performing the sentiment analysis, the "textdata" and "tidytext" packages were installed in R Studio.



■ Figure 1. Operational Framework of the Sentiment Analysis

Data preprocessing methods were then applied, such as transforming all characters in the text to lowercase letters and placing them into a single vector. From this vector, the "syuzhet" package in R provided the first visualization and data sentiments of the dataset under the NRC Lexicon Model. The process was then repeated using the Bing and Loughran-Mcdonald Lexicons.

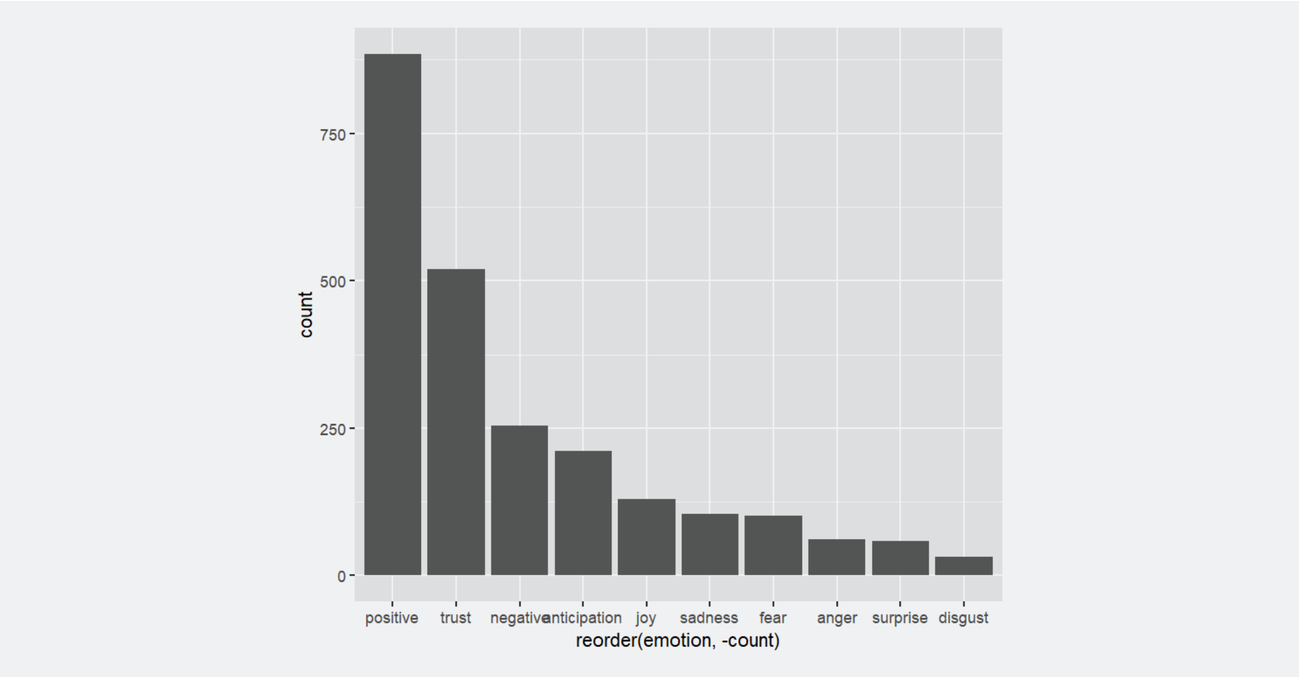
To mitigate sampling bias, we expanded and sourced our dataset from various journals. This approach ensures that perspectives on Islamic financing and Shari'ah financing whether positive or negative, are likely included in the data used in the study.

From the NRC Lexicon model, it appears that Islamic financing and Shar'iah financing have positive connotations, implying is effectiveness. In Figure 2, it can be seen that there is also a sense of trust, with around 500 counts, an important ingredient in banking and finance. However, despite the presence of good sentiments, there are doubts, as indicated by the ~250 counts of negative emotions. This suggests, among others, potential shortcomings in either the design or implementation of Islamic financing. Nevertheless, the positive sentiments outweigh the negative ones in this model.

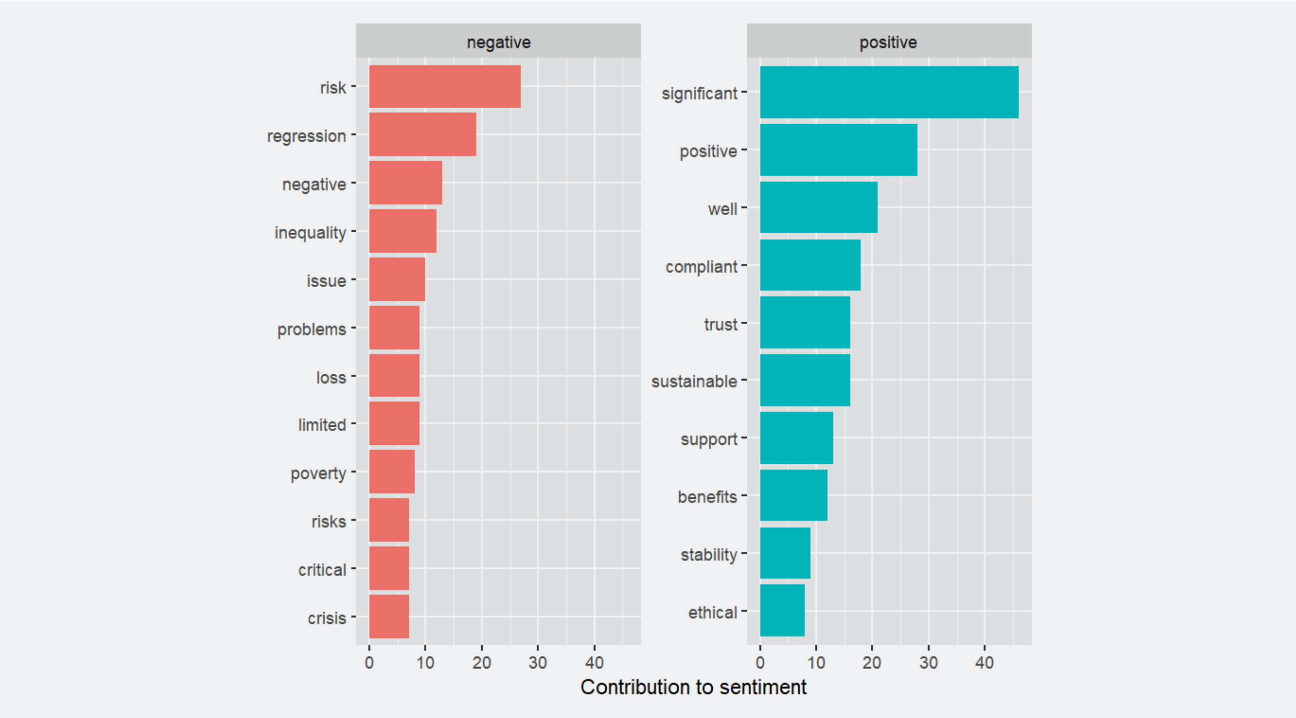
The Bing model dichotomizes positive and negative sentiments, then classifies other subcomponent emotions in their respective categories. Figure 3 shows the Bing Lexicon Model results in a horizontal bar chart. The terms "significant," "positive," "negative," and "regression" are ambiguous, suggesting that these may have originated from quantitative studies that reported statistically significant results. However, "compliant," "trust," and "sustainable," being at the top of positive sentiments, imply that these are strengths of Islamic financing. "Risk" stands on top of all the negative sentiments.

Lastly, the Loughran-McDonald model presents the sentiment analysis in a more granular way by including other forms of emotion, such as "litigious," "constraining," and "uncertainty." These emotions must have been significant in the literature reviewed but were not captured by the earlier models. In this model, uncertainty is led by risk, while negative sentiments are led by terms like "problems" and "loss." This suggests that, there are negative issues, such as loss and unemployment, that were not covered by the Bing Lexicon Model. Still, positive sentiments stand out the most, with "profitability," "satisfaction," "stability," and "opportunities" leading the category.

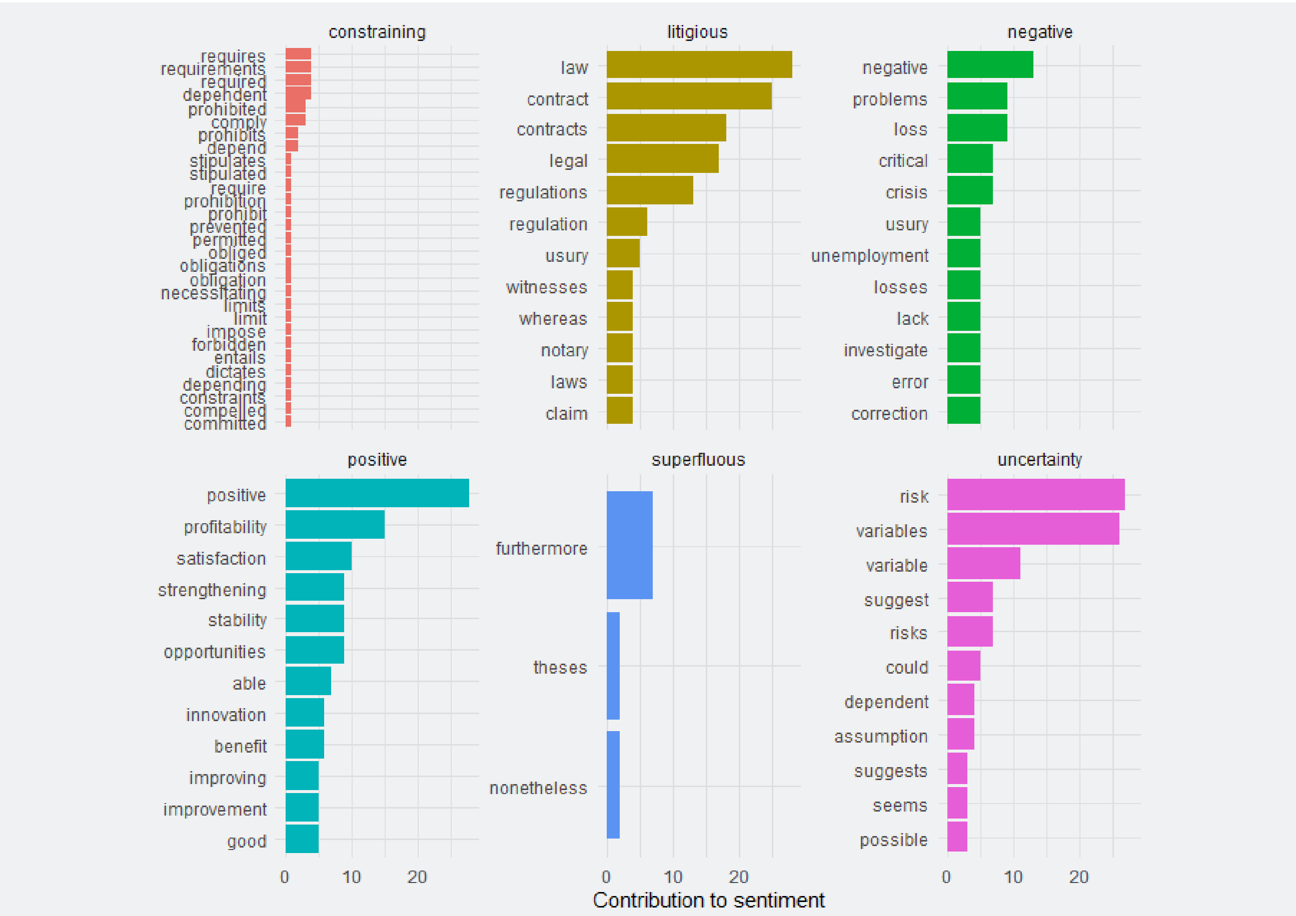
Overall, despite the existence of negative sentiments, there are positive emotions in the existing literature, suggesting that it is generally perceived as beneficial by those who studied it.



■ Figure 2. NRC Lexicon Model Results in a Vertical Bar Chart



■ Figure 3. Bing Lexicon Model Results in a Horizontal Bar Chart



■ Figure 4. Loughran-McDonald Lexicon Model Results in a Horizontal Bar Chart

Recommendations to Government

The government has played a pivotal role in encouraging the development of Islamic financing in the country and has made huge strides recently. In 2019, the passage of Republic Act No. (RA) 11439, or the Islamic Banking Law, removed the monopoly of Amanah Islamic Bank as the lone player in Islamic banking.[5] RA No. 11439 enabled the entry of CARD MRI and Maybank Philippines into the Islamic banking system in the country. In 2023, the Shari'ah Supervisory Board, composed of key government officials, was created. In the same year, the Bangko Sentral ng Pilipinas issued USD 1 billion of sukuk bonds, with demand nearly five times oversubscribed compared to the offer (Business Times 2023).

Nevertheless, government agencies, particularly Bangko Sentral and Pilipinas (BSP) and the BARMM Regional Government, could proactively address the need and demand for Islamic financing. These recommendations could help mitigate the negative sentiments regarding uncertainty and risks:

- **For the BSP and other agencies to pursue financial literacy on Islamic financing**

  Particularly in the BARMM, which is the most unbanked region in the Philippines, there is a need to disseminate information about Islamic finance. Culturally and religiously accepted models of Islamic microfinance that have been pilot-tested and proven successful could be used as illustrative examples. Models of contracts and contracting arrangements could be fine-tuned, discussed, and shared with various publics to demonstrate that these mechanisms have been tried and have worked under specific conditions. These conversations could build trust and lessen uncertainties about Islamic finance.

- **For the BSP and other institutions to build the capacity of key stakeholders**

  There is a need to train regulators on the principles, models, and operations of Islamic finance. Training should also be made available to industry professionals and religious leaders, such as ustadz and ulamas.

- **For the BARMM regional government to support successful pilot models**

  Formal and community-based models that have been proven effective could be supported through capacity building, public promotion, and other non-distorting incentives. Currently, these models are small and context specific (based on location, types of members/borrowers, and ethnicity). Eventually, they should aim to achieve the needed scale and diversify their offerings.

- **For the BARMM regional government to develop industry and related plans to entice Islamic finance**

  No amount of government incentives and regulations will stimulate Islamic finance if financial institutions do not find it attractive to operate in largely unbanked areas like Muslim Mindanao. Since the presence of economic activities is often a key factor establishing operations or branches, the BARMM government could encourage entrepreneurial activities by developing industry plans coupled with feasibility studies, assisting priority sectors, and streamlining business processes.

With Islamic finance, Muslims Filipinos would be able to access credit, engage in lease agreements, and pursue enterprises while being good Muslims.

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[5] Based on Presidential Decree No. 264 issued in 1973.

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