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EVIDENCE ON ISLAMIC BANKS AND ECONOMIC GROWTH: EXPERIENCE IN MALAYSIA

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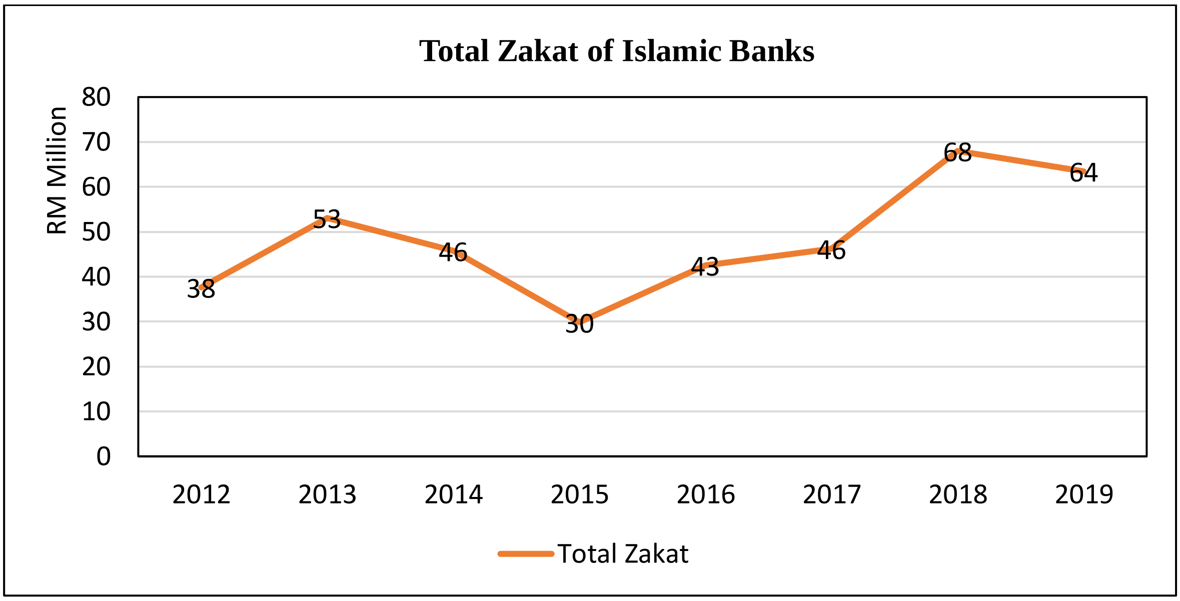
Abstract: *The purpose of this paper is to contribute to the empirical studies of Islamic banking literature by examining the effect of Islamic banks' factors on economic growth from the context in Malaysia. By using a panel regression, the secondary data of 11 local Islamic banks has been extracted from annual reports while the real gross domestic product (GDP) has been collected from an International Monetary Fund (IMF) within a period from 2012 until 2019. The paper presents a model which shows the relationship between the selections of seven variables in Islamic banks (total asset, total investment, total financing, total deposit, financing to deposit, non-performing financing, total zakat) to economic growth. Although it is insignificant, total zakat in Islamic banks appeared to be positively related to the Malaysian GDP representing economic growth based on the fixed effect regression result. Hence, this finding led to several interesting discussions, including the amount of zakat paid by Islamic banks which stimulates economic growth.*

Keywords: Local Islamic banks, Economic growth, Total zakat, Panel data

INTRODUCTION

Islamic banking and finance had been captured as an interesting topic across many countries particularly in the Gulf Cooperation Council (GCC) countries, followed by the Middle East and North Africa (MENA) countries, Asian countries and others and Islamic banking remain as the most popular products among the financial market according to the study (IFSB, 2019). This remarked the importance of developing Islamic banking around the world including Malaysia as for now, 16 Islamic banks had been established in Malaysia including local and foreign Islamic banks legally registered by Bank Negara Malaysia. Currently, Malaysia has introduced the Value Based Intermediation (VBI) to be instilled in the Islamic banking sector. This value highlights the importance of Islamic financial intermediaries for giving a valuable impact to the society through the three components of sustainability, the 3Ps concept: People (society), Profit (economic), and Planet (nature). This is to nurture value among Islamic banks not merely about making a profit, Islamic banks are also considering the valuable impact on society and nature instead (BNM, 2018).

Apart from that, Islamic banks in Malaysia have a noble function towards social corporate responsibility by introducing zakat business in their activities. According to Badarulzaman, Azhar, & Md Ismail (2016), a payment on zakat is not according to the IFSA or CBMA. Yet, it has been a concern by the Shariah Advisory Council (SAC) committee as zakat is part of shariah matter. Hence, Zakat on business is an obligatory role by 11 local Islamic banks to pay based on its shareholders only, not depositors. Based on figure 1, the amount of zakat is fluctuated from 2012 until 2019 as extracted from each annual report of 11 local Islamic banks.



Source: Annual report 2012-2019

Figure 1. Total zakat of Islamic banks in Malaysia

The highest amount of zakat paid in 2018 approximately $68 million with a significant increase remarking during Malaysia Building Society Berhad (MBSB) Bank entered as new local Islamic bank in 2018 (MBSB, 2018). Meanwhile, the amount experienced a sharp drop in 2015 due to a decrease at a huge amount of total zakat in Maybank Islamic and following by few other local Islamic banks as well. Up until now, Maybank Islamic signified as the highest contribution for total zakat, which is amounting to $64 million in 2019, following by Bank Islam Malaysia well along with the trend. Thus, it is observed that the higher the total asset of Islamic banks, the higher the total zakat can be paid by a bank. For instance, Maybank Islamic has the highest total amount of assets in 2019 compared to other Islamic banks which contributed to the huge amount of zakat payment in that year simultaneously.

LITERATURE REVIEW

Islamic banking and finance started during the year 1970 in which an oil boom occurred in the Middle East countries (Qudah, Badawi, & AboElsoud, 2016). This led to the development and modernization in all these countries particularly in the oil exporting countries for instance Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (UAE) or known as Gulf Cooperation Council (GCC) countries. It also triggered a rapid growth of Islamic financial institutions, due to the increasing oil price at large amounts that contributed to the development of economy in these regions (Abdalla & Abdelbaki, 2014). Therefore, previous studies were taking the data from those countries by collecting all the relevant factors in Islamic banks such as total asset, total investment, total financing, and total deposit to empirically tested on economic growth by using panel regression (Bahrini, 2017; Daly & Frikha, 2016; Nawaz et al., 2019; Zirek et al., 2016).

Meanwhile, previous work of literature based on experience in Malaysia were found using almost similar variables to represent Islamic banking sector in the respective studies. For instance total financing, total deposit, total investment, and total asset meanwhile gross domestic product is representing its economic performance (Furqani & Mulyany, 2009; Kassim, 2016; Khaliq & Thaker, 2017; Mohd. Yusof & Bahlous, 2013; Sapuan, 2018; Wahab et al., 2016). Thus, it had been identified the previous studies that were within the context of Malaysia are preferably employing time series data (Abd. Majid & H. Kassim, 2015; Furqani & Mulyany, 2009; Hachicha & Amar, 2015; Khaliq & Thaker, 2017).

Another finding within the Malaysian context also was consistent, although between the different year conducted. The result suggested that total deposit and total financing were statistically significant towards economic growth. Precisely, total financing showed a significant relationship in the long run and short run, while total deposit was significantly related in the long run only (Afidah & Yusof, 2020; Kassim, 2016). Besides, Abduh & Yameen (2013) confirmed that performance of Islamic banks was associated with the GDP which reflects the economic growth. Therefore, liquidity management is one of the determinants of banks' performance and commonly be measured in a form of financing to deposit (Samail, Zaidi, Mohamed, & Kamaruzaman, 2018). Meanwhile, non-performing financing had been selected in the previous study which was resulting in a significant result on growth (Khaliq & Thaker, 2017). It was suggested by Uda et al., (2018) that non-performing financing was among the factors that significantly contributed to the economic growth during 2008 to 2016 by using panel data.

Local Islamic banks in Malaysia are compulsory to pay zakat on business on behalf of shareholders only for 2.5% and it does not include the payment for depositors. Meanwhile, foreign Islamic banks are not obligated to pay as the zakat payments are already paid by the group in the oversea headquarters. According to Norazira & Hairunnizam (2019), Bank Islam Malaysia Berhad (BIMB) had been acting as payers on behalf of depositors for their savings account, since its establishment in 1983. However, this service ended in 2015 after being advised by the government body, encouraging the depositors to pay at the zakat authorities. Later, BIMB continues to pay zakat only on business up until today.

Furthermore, it had been determined that zakat distribution had a significant effect on the GDP of Malaysia by employing panel data from 2001 until 2008 (Suprayitno, 2013). However, this result was small and short run only within that period. In another study involved total zakat that had been collected in Malaysia considering as one of the determinants of the growth in the Muslim countries (Yusoff & Densumite, 2012). From the finding, it revealed that total zakat had a positive relationship on growth in the short and long run by using panel data between 2001 until 2006. This shows the uniqueness of Islamic banking compared to conventional banking as obligated to pay zakat.

DATA AND METHODOLOGY

The data for Islamic banks' factors used in this study is the secondary data collected from annual report of 11 local Islamic banks and the database from Fitch Connect whereby the real Gross Domestic Product (GDP) measured in local currency and at a constant price is obtained from the International Monetary Fund (IMF) between 2012 until 2019. As the panel data has been employed in this study, Stata version 12 software has been used to gain an empirical result based on the model below.

$$\text{Model} = \mathbf{LnGDP}_{it} = \beta_0 + \beta_1\mathbf{LnTA}_{it} + \beta_2\mathbf{LnTI}_{it} + \beta_3\mathbf{LnTF}_{it} + \beta_4\mathbf{LnTD}_{it} + \beta_5\mathbf{FD}_{it} + \beta_6\mathbf{NPF}_{it} + \beta_7\mathbf{LnTZ}_{it} + \varepsilon_{it}$$

Where, β_0 = constant
i = country
t = time period
ε_{it} = Error term of country i on time t

Dependent variable:
GDP = Economic growth

Independent variables:
TA = Total Asset
TI = Total Investment
TF = Total Financing
TD = Total Deposit
TZ = Total Zakat
FD = Financing to deposit
NPF = Non-Performing Financing

FINDING AND DISCUSSION

This analysis estimates the result based on the panel regression analysis, by including the Hausman Test. It has been recognized that a fixed effect model is appropriate in this model which rejects the null hypothesis. From table 1, the result indicates that this model had no heteroscedasticity issue as the result shown is higher than 0.05 ($p>0.05$). Thus, it has been identified that the researcher accepts null hypothesis of heteroscedasticity for this model.

Table 1. Summary on regression result

Variables	Result (Fixed Effect)	Variables	Result (Fixed Effect)
Constant (Coef.)	20.719**	LNTD	-0.370*
(Std. Error)	(0.656)		(0.205)
LNTA	-0.202	FD	-0.624***
	(0.175)		(0.143)
LNTI	0.047*	NPF	-0.648
	(0.026)		(1.157)
LNTF	0.849***	LNTZ	0.008
	(0.157)		(0.009)

R-Square	0.8910	Breusch-Pagan LM	chi2(1) = 1.88
F-Value	F (7,82) Prob>F 0.000		Prob > chi2 = 0.1469

Note:

1. Figures in the parentheses are coefficient and standard error values.

*2. *p<0.10, **p<0.05, ***p<0.01.*

3. LNGDP is a dependent variable to represent growth.

The result appeared four variables LNTI, LNTD, LNTF, FD are significant at 10% significance level for LNTI and LNTD, while LNTF and FD are significantly related to growth at 1% significance level. By coefficient of R square at 0.8910, it is indicated that independent variables explained by 89% in this model. Despite four variables only showing significant, LNTF in the local Islamic banks remain significant to the growth at 1% significance level.

It has been estimated that LNTA, LNTD, FD, and NPF have a negative relationship to the LNGDP as 1% increases of these variables will reduce the growth at 0.202, 0.370, 0.624 and 0.648 respectively. Although LNTZ is insignificant, it has a positive relationship to the LNGDP as growth will be increased by 0.008 when LNTZ increases by 1%. Additionally, LNTI and LNTF remain positively related to the LNGDP in this model. It is observed that with 1% increases in the LNTI and LNTF, the growth will increase at 0.047 and 0.849 units respectively.

Despite the insignificant result, total zakat has a positive relationship towards the economic development of Malaysia which indicates that the amount of zakat paid by Islamic banks has a small contribution to the growth. Accordingly, this finding will convey another view on the importance of zakat paid by Islamic banks as among the corporate entities. Although this study does not compare to conventional banks, it has been determined that Islamic bank has a significant impact on economic growth consistent with previous studies (Abd. Majid & H. Kassim, 2015; Abduh & Chowdhury, 2012; Furqani & Mulyany, 2009; Rawat & Mehdi, 2017; Wahab et al., 2016).

CONCLUSION

Based on the finding, it is suggested that total investment, total financing, total deposit, and financing to deposit are significantly related to economic growth consistent with the previous studies (Afidah & Yusof, 2020; Kassim, 2016; Sapuan, 2018). This study carried out panel data regression analysis by few factors collected within the local Islamic banks and tested empirically on growth. This selection is made due to the uniqueness of Islamic banks obliged by a zakat payment compared to the conventional banks.

Moreover, it is rare to empirically test the impact of total zakat paid by Islamic banks to the economic growth in Malaysia. Unremarkably, the study between an effect of total zakat on economic growth is collected from the data in the Religious Council authorized in Malaysia (Mohamed, Ibrahim, Zaidi, & Kamaruzaman, 2019; Suprayitno, 2013; Yusoff & Densumite, 2012). These previous studies also found that total zakat is significantly related to the development of the economy. Although total zakat in Islamic banks is insignificant to give an impact on the growth, it has been determined that total zakat has a positive relationship to the growth.

To conclude, the better the performance of Islamic banks in Malaysia, the greater the impact on the economic growth of Malaysia. Moreover, the greater the total amount of assets in Islamic banks, the higher contribution to the zakat on business by the local Islamic banks. Subsequently, it will improve the socioeconomic of the local communities particularly during these days due to the pandemic outbreak. Hence, the idea behind Islamic Finance Hub 2.0 must be empowered towards a resilient economic performance in the future.

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