Development, Globalization, and Islamic Finance in Contemporary Indonesia

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Existing Work (I): Political Economy of Islamic Finance

Studies of tend to be

- Very theoretical—“how can we use Islamic principles to synthesize variable rate home mortgages?”
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Observation: Little room for the diverse views of ordinary people who choose whether or not to consume Islamic financial products
Existing Work (II): The Bankers

Bankers’ Question: Who uses Islamic finance?
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**Bankers’ Question:** Who uses Islamic finance?

**Bankers’ Answer:** Muslims who care about Islamic finance use Islamic finance

⇒ *Implicit logic is orthopraxy*
Bankers’ Question: Who uses Islamic finance?
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⇒ Implicit logic is orthopraxy

Multiple Transformations: Religious revivalism, modernization, globalization, many others

⇒ All plausible explanations for observed patterns in consumers’ orientation towards Islamic finance
Existing Work (III): New Political Economy of Islam

Representative S.E. Asian examples: Khoo 2008, Khoo and Hadiz 2010; Hadiz 2011

Key analytical categories include class, capitalist transformation, elite contestation, political control

Open Questions:

1. Evidence?
2. Bottom-up processes?
3. Complementary with existing approaches?
The Origins of Islamic Revivalism

Islamization and Religious Change
As people become more pious, they do more pious-sounding things (sounds tautologous, but isn’t really)
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Modernization and Social Change
Modernization produces dislocations that individuals confront by relying on “deep” or “enduring” identities

Globalization and Identity Change
Global flows of goods, people, and information increase the local salience of transnational identities
Observing Islamic Revivalism

Claim: Everyday behavior reflects identity maintenance

- Muslim World: veiling, dress, prayer, language
- Elsewhere: “McWorld,” revivalism, “clinging to guns or religion”

A sociological, developmentalist, or political economy perspective suggests that these behaviors have plausibly non-religious motivations.
Islamic Finance

Three useful features

1. Everyday activity
2. Touches on multiple dimensions of identity
3. Binary opposition to "conventional" finance

Competition makes it functionally identical to conventional finance (see e.g. El-Gamal 2006; an assumption to revisit shortly...)
Parallel Case

The Origins of Islamic Economics

- The partition of India–Mawdudi and Islamic modernism
- The 1970s oil boom–Arab states awash with cash to sponsor institutions and research

Conclusion: the “supply side” of Islamic finance is related to global political-economic forces (Kuran 2004)
Data and Context

Original national survey in Indonesia ($N = 2,548$)

Large and growing Islamic financial market
- 10 “sharia banks” in 2010
- 23 “sharia units” in 2010
- wide local market presence
- compete directly on price and service
Sedangkan informasi Nisbah per Juli 2010 adalah sebagai berikut:

<table>
<thead>
<tr>
<th>Jenis Simpanan</th>
<th>Nisbah (Nasabah)</th>
<th>Porsi (Nasabah)</th>
<th>Ekuivalen Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>RUPIAH (Rp)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposito 1 bulan</td>
<td>50.00</td>
<td>5.01</td>
<td>5.95 %</td>
</tr>
<tr>
<td>Deposito 3 bulan</td>
<td>51.00</td>
<td>5.11</td>
<td>6.06 %</td>
</tr>
<tr>
<td>Deposito 6 bulan</td>
<td>53.00</td>
<td>5.31</td>
<td>6.30 %</td>
</tr>
<tr>
<td>Deposito 12 bulan</td>
<td>54.00</td>
<td>5.41</td>
<td>6.42 %</td>
</tr>
<tr>
<td>VALAS (USD)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposito 1 bulan</td>
<td>51.00</td>
<td>2.67</td>
<td>3.52 %</td>
</tr>
<tr>
<td>Deposito 3 bulan</td>
<td>51.25</td>
<td>2.69</td>
<td>3.52 %</td>
</tr>
<tr>
<td>Deposito 6 bulan</td>
<td>51.50</td>
<td>2.70</td>
<td>3.56 %</td>
</tr>
<tr>
<td>Deposito 12 bulan</td>
<td>51.75</td>
<td>2.71</td>
<td>3.58 %</td>
</tr>
</tbody>
</table>
Sample Frame

Standard Lembaga Survei Indonesia Survey

Step 1  District-level sampling frame (stratified by provincial population, urban/rural)

Step 2  Obtain lists of neighborhoods/populated places (rukun tetangga/rukun warga), select five per district at random

Step 3  Contact local heads (kepala RT/RW) to obtain list of households, select two per RT/RW at random

Step 4  Select R within household via Kish grid (stratified by age, gender)
Sources of Inference

Variation in reported frequency of use of “sharia financial products” among

1. bank users who
2. live where at least one person reports using sharia financial products

(results are robust to broader sample definition)

Exploit individual variation in piety, socioeconomic characteristics, and opinions about the global Muslim community.

Control for regency (*kabupaten*) specific effects, demographic covariates
Indicators of Piety

1. Religion is important to $R$
2. $R$ claims to be pious
3. $R$ thinks about religion
4. $R$ prays at obligatory daily times
5. $R$ fasts during Ramadan
6. $R$ studies or reads the Qur’an
7. $R$ attends Friday prayers
8. $R$ performs additional (non-obligatory) rituals (*shalat sunnah*)
9. $R$ attends communal religious meetings
10. $R$ participates in ritual prayers for the deceased (*tahlilan*)
11. $R$ pays *zakat* after Ramadan

Define *PIETY INDEX* as the first principal component of these 11 indicators
Unidimensionality of *PIETY*

Scree Plot of Eigenvalues after PCA
Unidimensionality of PIETY

Scatterplot of PIETY INDEX and PIETY MEAN
Measuring Class and Global Identity

Class:
- *INCOME*; interaction with *EDUCATION* yields similar results

Global Identity:
- *MUSLIM TIES* (importance of strong relations with the Muslim world)
- *PRO SAUDI* (personal views of Saudi people)
## Baseline Results

<table>
<thead>
<tr>
<th>Ind. Var.</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PIETY INDEX</strong></td>
<td>0.042</td>
<td>0.035***</td>
<td>0.032**</td>
<td>0.241***</td>
</tr>
<tr>
<td></td>
<td>(0.028)</td>
<td>(0.010)</td>
<td>(0.012)</td>
<td>(0.061)</td>
</tr>
<tr>
<td><strong>INCOME</strong></td>
<td></td>
<td>0.035***</td>
<td></td>
<td>0.241***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.010)</td>
<td></td>
<td>(0.061)</td>
</tr>
<tr>
<td><strong>MUSLIM TIES</strong></td>
<td>0.419***</td>
<td>0.184**</td>
<td>-0.441*</td>
<td>-0.535</td>
</tr>
<tr>
<td></td>
<td>(0.009)</td>
<td>(0.065)</td>
<td>(0.211)</td>
<td>(0.294)</td>
</tr>
</tbody>
</table>

Robust standard errors (clustered by regency) in parentheses.
Demographic controls suppressed. * p < .05, ** p < .01, *** p < .001

**Robustness**: conditional logit, ordered probit (with and without fixed effects)
Probability of Using Sharia Products, by Income

Probability of Using Sharia Banking Products, by INCOME

Cumulative Probability

INCOME

0 1 2 3 4 5 6 7 8 9 10 11 12 13 14

Always

Usually

Sometimes

Never
Probability of Using Sharia Products, by Int’l Orientation

Probability of Using Sharia Banking Products, by MUSLIM TIES

Cumulative Probability

MUSLIM TIES
Does *INCOME* Measure Price Sensitivity?

Dependent variable is *IMPORTANCE OF COST OR RETURN*

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<tr>
<td><em>INCOME</em></td>
<td>-0.003</td>
<td>-0.009</td>
<td>-0.016</td>
</tr>
<tr>
<td></td>
<td>(0.007)</td>
<td>(0.010)</td>
<td>(0.012)</td>
</tr>
<tr>
<td><em>Constant</em></td>
<td>2.999***</td>
<td>3.065***</td>
<td>3.098***</td>
</tr>
<tr>
<td></td>
<td>(0.033)</td>
<td>(0.060)</td>
<td>(0.075)</td>
</tr>
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</table>

OLS regression with regency-level fixed effects (suppressed for presentation). Robust standard errors (clustered by regency) in parentheses. *** p < .001
Beliefs about Islamic Finance

Dependent variable is *FORBID RIBA*

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<tr>
<td><strong>PIETY INDEX</strong></td>
<td>0.061</td>
<td>0.043</td>
<td>0.093*</td>
</tr>
<tr>
<td></td>
<td>(0.035)</td>
<td>(0.034)</td>
<td>(0.046)</td>
</tr>
<tr>
<td><strong>INCOME</strong></td>
<td>0.013</td>
<td>0.020</td>
<td>0.025</td>
</tr>
<tr>
<td></td>
<td>(0.014)</td>
<td>(0.015)</td>
<td>(0.018)</td>
</tr>
<tr>
<td><strong>MUSLIM TIES</strong></td>
<td>0.262**</td>
<td>0.274*</td>
<td>0.342**</td>
</tr>
<tr>
<td></td>
<td>(0.099)</td>
<td>(0.107)</td>
<td>(0.129)</td>
</tr>
</tbody>
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Method: OLS OProbit OProbit, FEs

Robust standard errors (clustered by regency) in parentheses.

Demographic controls suppressed. * p < .05, ** p < .01, *** p < .001
Beliefs about Islamic Finance and Bank Use

Dependent variable is USE ISLAMIC BANKS (BINARY for (2))

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<tr>
<td>FORBID RIBA</td>
<td>0.063</td>
<td>0.135</td>
<td>0.105</td>
<td>0.104</td>
</tr>
<tr>
<td>(0.047)</td>
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<td>(0.060)</td>
<td>(0.088)</td>
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<td>0.062</td>
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<tr>
<td>(0.026)</td>
<td>(0.077)</td>
<td>(0.041)</td>
<td>(0.049)</td>
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<tr>
<td>INCOME</td>
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<td>0.058***</td>
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<tr>
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<td>(0.017)</td>
<td>(0.025)</td>
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</tr>
<tr>
<td>MUSLIM TIES</td>
<td>0.228*</td>
<td>0.535*</td>
<td>0.370**</td>
<td>0.448**</td>
</tr>
<tr>
<td>(0.087)</td>
<td>(0.242)</td>
<td>(0.114)</td>
<td>(0.168)</td>
<td></td>
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</table>

Method          | OLS  | Clogit|  OProbit |  OProbit, FEs |

Robust standard errors (clustered by regency) in parentheses. Demographic controls suppressed. * p < .05, ** p < .01, *** p < .001
Conclusions

1. Support for political economy perspective on “commodified religion” and “aspirational piety” (Fealy 2008): consumption as identity.
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2. Surprisingly little evidence that piety or orthopraxy matter in the way that bankers think: against consumption as piety
Support for political economy perspective on “commodified religion” and “aspirational piety” (Fealy 2008): *consumption as identity*

Surprisingly little evidence that piety or orthopraxy matter in the way that bankers think: *against consumption as piety*

Results are nice parallels to the origins of Islamic finance and new political economy of Islam: *global political economy matters*
Future Research

1. Dynamic data for dynamic theories
2. Other countries, other periods, richer data
3. Mutual relationship between demand for and supply of Islamic finance in Indonesia