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# The Role of Central Banks in Financial Inclusion and Sustainable Development: Comparative Analysis of Islamic and Conventional Banking Environments

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## Abstract
Several findings established the importance of Islamic finance through the removal of collateral and the payment of interest that are features of conventional banking in guaranteeing increased financial inclusion, economic growth and diversification, poverty alleviation, enhanced efficiency of intermediation and increase income per worker, among others. Financial exclusion is attributed to religion, economic inequality, culture, geography and structure of the economy, lack of access to loans, deposit services, insurance, pension, and financial illiteracy. Therefore, this paper examines the roles of central banks in creating financial inclusion in conventional and Islamic banking environments with a view to drawing important lessons for economies struggling with challenges of financial inclusion in multi religious states like Nigeria. The paper uses comparative contextualization and analyses trends of financial inclusion indicators as outcomes of central bank policy design and implementation strategies in these different paradigms to draw inferences of efficiency and effectiveness. The paper posits that Central Banks in Islamic banking environments which imbibe and actively implement financial inclusion strategies generate better outcomes relating to access to loans, deposit services, insurance, pension, and financial literacy.

**Keywords**: Central bank, financial inclusion, Islamic banking, conventional banking, sustainable development

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## Introduction

The roles of central banks are important to the stability of world economy. They work towards the stability of financial system; they foster development of the financial sector; and they promote financial inclusion. Their governance in some countries, comprises conventional financial and non-financial institutions such as commercial banks, finance companies, merchant banks, leasing companies and development finance institutions. In some other countries, their governance include, in addition to the above-mentioned institutions, Islamic banks and other Islamic financial institutions. The main difference between conventional and non-conventional (Islamic) financial institutions is the absolute prohibition of the payment and receipt of interest by the latter (Q2:275-279). The activities of the Islamic financial system are guided by the dictates of Islam. In some countries such as Kuwait, Qatar, Egypt and Saudi, both convention and non-conventional (Islamic) financial institutions are under the purview of their central banks, while only the conventional ones are managed by central banks in countries such as China and Brazil.

The apex of banking in all the countries of the world is central bank. It is known by different names in different countries. For instance, it is called central bank in countries such as Nigeria, Egypt and Ghana. In the United States of America, it is called the Federal Reserve. Bank Nagara Malaysia is the name given to central bank in Malaysia. The first central bank in the world is the Bank of England which was established in 1694.[3] In Nigeria, the Central Bank of Nigeria was established on July 1, 1959.[4] A central bank is usually government-owned, and thus advises government on monetary policy. It also implements the government's monetary policies on its behalf despite purported autonomy. The apex bank is saddled with many responsibilities. It is to see to the promotion and improvement of the existing financial institutions. This responsibility makes it very relevant in the area of including the excluded. The exclusion may be due to their inability to access interest-based loans because of their inability to provide required collateral securities. Other reason for the exclusion may be due to unavailability of sharīʻah compliant products. The people in this category who may not want to violate the dictates of their religion (Islam) may engage in self-exclusion from using the conventional financial products. Therefore, they would not be able to enhance their economic power. The resultant effect of their self-exclusion based on religious belief is an increase in their poverty level or economic status. Financial Inclusion or access to finance is one of the main stimulants of economic growth and development. Financial development and improved access to finance can accelerate economic growth and reduce income, inequality and poverty. The role of central banks in enhancing financial inclusion is too obvious to be emphasized. It is the CB that gives the guidelines for all the players such as micro-finance, small medium enterprises and other conventional financial and non-financial institutions.

[3]M.C. Vaish, Monetary Theory, New Delhi: Vikas Publishing house PVT Ltd, 2000, 393.
[4]The Central Bank of Nigeria. Bulletin www.cenbank.org/

While Risk-shifting is the focus of many conventional financial products, Islamic finance promotes risk-sharing contracts such as (mudarabah) profit and loss sharing arrangements and murabahah (cost plus mark-up). The Islamic products provide viable alternatives to conventional debt based financing. In addition, Islam emphasizes redistributive risk-sharing instruments such as Zakat and Qard-al-hasan (benevolent loan). They make the abler segments of the population share the risks being faced by the less able people. The two (risk-sharing instruments and redistributive instruments) provide a comprehensive approach to enhance financial inclusion, eradicate poverty and build a vibrant economy. The duties of the central banks to develop new financial institutions give people who would not naturally bank with interest-based financial system an opportunity to be financially included. In the world today, Islamic banks operate in countries where they coexist with interest-based banks. These include Nigeria, Egypt and Malaysia. There are some non-Muslim countries whose monetary authorities do recognize Islamic banks; and relevant guidelines were issued by their CBs so as not to make illegal the operations of such Islamic bank. This is because Islamic banks form part of the banking system where they are established.

Environment plays an important role in the operation of any financial system as it can make or mar it. This is because it helps in the identification of opportunities that can be seized and threats that can be avoided. Central bank, as the apex of banking system in Nigeria and an external factor in the operation of Islamic banks and conventional banks is saddled with responsibilities of conducting monetary policy for both systems. Islamic finance has created for itself a class in the global financial landscape. In 2009, the size and total number of Islamic financial institutions globally was estimated to be about 280 Islamic financial institutions with total assets of USD 729 billion according to the International Financial Services, London (IFSL 2009) research[5]. The total assets of the Islamic finance industry have surpassed USD 2 trillion in 2017. The industry's total worth as regards its three main sectors i.e. banking, capital markets and takāful is estimated at USD 2.05 trillion in 2017. In 2018, it was reported by the Islamic Financial Services Board(IFSB)that there were 185 members of the IFSB comprise 75 regulatory and supervisory authorities, 8 international inter-governmental organisations, and 102 market players such as financial institutions, professional firms, industry associations and stock exchanges that were operating in 57 jurisdictions[6]. In the literature, efforts have been made to discuss the issue of the roles of central bank particularly their monetary policy. But not much attention has been paid to the issue of comparing the role of central banks in creating financial inclusions in both environments. This study, therefore, tries to contribute to literature in this regard. As Islamic financial institutions have increased

[5]International Financial Services, London (IFSL 2009) IFSL Research: Islamic Finance 2009. https://www.scribd.com/document/21213777/IFSL-Research-Islamic-Finance-2009

[6]IFSB (Islamic Financial Services Board), Islamic Financial Services Industry Stability Report 2017, Islamic Financial Services Board, Kuala Lumpur. 2018. 5, 15, 21, 27, 159.

their presence around the globe. The question is to what extent have the central banks promoted financial inclusion in both environments i.e. countries where there are only conventional financial system and the ones with both conventional and Islamic financial institutions?

The study, therefore, examines the roles of central banks in creating financial inclusion in conventional and Islamic banking environment with a view to drawing important lessons for economies struggling with challenges of financial inclusion in multi-religious states like Nigeria. The paper uses comparative contextualization and analyses trends of financial inclusion indicators as outcomes of central banks. The rest of the paper is structured as follows. Section two gives a brief review of literature. The next section is on stylized facts wherein we discuss services of central bank under conventional banking, monetary operations under conventional banking and Islamic banking. Section four states the methodology used in carrying out the research work. Data analysis and its implications follow the methodology while the last part concludes the discussion and makes some recommendations.

**Significance of Study**

The importance of this paper is based on the topic with which it deals. By comparing the roles of the central banks in creating financial inclusion and comparing financial inclusion indicators in conventional and Islamic banking environments, the paper draws important lessons for economies yet to take advantage of Islamic finance to increase access to finance for less privileged people. A brief discussion on monetary policy under conventional and Islamic banking throws more light on the advantages that can be tapped by people in two environments particularly the Islamic banking. This also shows the significance of the present research work.

**A Brief Review of Literature**

Islamic banking has experienced rapid growth and has flourished worldwide during recent decades. In some countries where Islamic banking was established, there was no proper guidelines from their central banks to guide and supervise their operations. For instance, in Bangladesh where the growth of Islamic banks was driven for decades by a high demand without comprehensive support from the public sector, the country is deficient of having a specific legal and regulatory environment for Islamic banking. The same could not be said of Malaysia that started operating Islamic bank the same year with Bangladesh. Today, Malaysia has surpassed Bangladesh and many other countries that operate Islamic banking in terms of her legal and regulatory framework not only in Islamic banking but other Islamic financial institutions. They have legal, tax and regulatory system that pertains to the needs of Islamic finance. Since 1991, when the issue of Islamic banking was stated in Bank and Other Financial Institutions Act, the guidelines and regulatory only came 18 years later. It was in 2010 that Soludo brought out the first guidelines. An exposure draft on the operation of microfinance banks was released by the CBN in 2016. Many authors such as Siddique[7], Uzair[8], Mohammed Ariff[9], Kahf[10] Khan[11] Khan and Mirakhor[12], Khurshid Ahmad[13] and Chapra[14] have written extensively on the role and function of central banks in relation to Islamic finance. Concepts such as refinance ratio, qard-hasan ratio and central bank having equity stake in commercial banks in relation to the role of central bank and monetary policy based on Islamic financial institutions have been widely discussed. But the role of central banks in financial inclusion and sustainable development in Islamic and conventional banking environment has attracted relatively little discussion.

**Stylised Facts: Services of the Central Bank of Nigeria under Conventional Banking**

Central Bank performs a supervisory role over Islamic Commercial banks, Conventional Commercial banks and other financial institutions. It issues and controls currency notes in Nigeria. It is the only institution that has the responsibilities. The supply of money is therefore, regulated by it. In Nigeria, it was on July 1, 1959 that the Central Bank of Nigeria issued the first Nigerian currency after the withdrawal of the former currency notes called WACB notes[15]. Whenever any new currency notes are issued, they are distributed through CBN branches and currency centres to all the commercial banks in Nigeria. It is from the latter that people can obtain the currency notes.

The accounts of both the state and Federal Government are kept with the central bank. It is in charge of issuing treasury bill, treasury certificates and development stocks. The latter is for longer-term while the first two are short-term securities. It gives financial advice to the government particularly when government debt instruments are about to be issued. It contributes to the preparation of the Federal Government Budget. It manages both the internal and external public debt of the country. Another key area of its responsibilities is serving as banker to other banks such as commercial banks, merchant banks, development banks and other financial institutions. It ensures their activities are in line with the provisions of the relevant statutory Acts. The CBN does this function by sending its employees to all banks periodically in order to examine and scrutinize their books and their operations. This is done to prevent violation of banking regulations. It receives return from

[7] M.N. Siddiqi, "Islamic Approaches to Money, Banking and Monetary Policy: A Review," in M.Ariff (ed.), Monetary and Fiscal Economics of Islam, Jeddah: International Centre for Research in Islamic Economics, 1982.

[8] Uzair Mohammed, "Central Banking Operations in an Interest-Free Banking System," Monetary and Fiscal Economics of Islam, 1982.

[9] M. Mohamed Ariff, M. Monetary and Fiscal Economics of Islam, Selected Papers, Jeddah: King Abdulaziz University, Jeddah, Saudi Arabia, 1982.

[10] M. Kahf, "Fiscal and Monetary Policies in an Islamic Economy," in M. Ariff (ed.), Monetary andFiscal Economics of Islam. Jeddah: International Centre for Research in Islamic Economics,1982.

[11] M.S. Khan, "Islamic Interest-Free Banking: A Theoretical Analysis," IMF Staff Papers, Vol. 33, No. l, (March1986): 1-27.

[12] M.S. Khan, and A. Mirakho, Monetary Management in an Islamic Economy, J. KAU: Islamic Econ., Vol. 6, (1414 A.H./1994 A.D.): 3-21.

[13] Khurshid Ahmad, Towards the Monetary and Fiscal System of Islam, Islamabad: Institution forpolicy Studies, Islamabad, 1981.

[14] M.U. Chapra, Monetary Policy in an Islamic Economy. In Ziauddin Ahmad, et al, eds., Money and Banking in Islam, Islamabad: Institute of Policy Studies, 1983, 27-68.

[15] E.S. Ezekezie, The elements of banking. Onitsha: African FEP Publishers Limited. 2002.

them monthly, quarterly and annually. As regards the clearing and collection of cheques, the CBN makes sure reciprocal amounts of cheques are offset against one another, and the net differences are paid or collected as the case may be. Monetary policy is done solely by the CBN. This is usually done from time to time. The instruments used are discussed briefly in the following sections.

**Monetary Operations under Conventional banking**

Open Market Operations (OMO) refers to the purchase and sale of government securities (short-term and long-term)[16]. Both the buying and selling are done through dealers who represent investors' interest. This is done to increase or decrease bank lending. When a bank buys a treasury bill, its reserves are decreased. Selling a Treasury bill does the opposites. When the CBN sells securities - Treasury Bills and Treasury Certificates, investors issue their cheques which are debited to their accounts with commercial banks or merchant banks. This reduces the deposit base of the banks. Therefore, their lending will also be reduced because they don't have enough cash in their vaults. Buying the treasury bill from the holders does just the opposite. Commercial or merchant banks will have more money in their accounts. The banks will have more deposits to lend to their customers. This will increase money in circulation.

Discount Rate is the rate at which the central bank gives loans to the commercial banks as the lender of last resort[17]. When business firms or individuals have a shortage of funds, they approach commercial banks for loans. If the banks do not have enough cash to loan them, they, in turn, turn to the central bank for assistance. The central bank then credits the accounts of the commercial banks with the amount of the loans. The rate of interest that the central bank charges for loans is called discount rate. The central bank can increase or lower the rate with the approval of its board of governors. If the central bank increases the rate of interest on the loan given to commercial banks, the commercial banks in turn raise interest rates given to their customer. Lowering the rate of interest for commercial banks makes them in turn lower interest rate for their customers.

Both the deposits and the lending rates are fixed by the central bank and this is pasted at the wall of commercial banks. This is done to control inflation, enhance the performance of the financial market and reduce the impact of debt servicing on the economy. Central bank prescribes the minimum ratios of loan and advances to be given to persons and companies.

Where central banks are accepted as the financial leaders, they persuade and exert their influence on the commercial banks through moral suasion[18]. This is done by

[16] Layi Afolabi,Monetary economics. Ibadan: Heinemann Educational Books. (Nigeria) Plc. 1999.

[17] B. Bijan, M.S.B, Abul Hassan, Ali, M.S.B. and M. Allahyarifard, M. Interest-Free Bonds andCentral Banking Monetary Instruments, International Journal of Economics and Finance, Vol.3, No.3, August 2011.

[18] M.U.Chapra, M. U. Monetary Policy in an Islamic Economy. In Ziauddin Ahmad, et al, eds., Money and Banking in Islam, Islamabad: Institute of Policy Studies, 1983, 27-68.

asking commercial banks in a friendly manner either to increase or decrease their lending activities based on the prevailing circumstances. The efficacy of this instrument is attested to by Burgess when he said "the Reserve banks may at times exercise an important influence on the general credit situation through the informal suggestions which they may make to bankers and the informal influence which they may exercise in this way may at times prove more important than their formal actions under the law."[19]

Commercial banks are to keep a certain percentage of their cash deposits with the central bank. Increasing the cash reserve ratio reduces the ability of the commercial banks to give additional loans. In the same vein, decreasing the cash reserve ratio gives them the opportunity of extending more loans to their customers which in turn increases money in circulation.

Commercial banks in Nigeria are to keep a certain percentage of their deposit in cash or easily realizable form so as to meet unexpected demands by their customers. This will give them the opportunity of fulfilling their promises of paying their depositors as and when they demand for the repayment of their deposits. The central bank gives a list of items that are to be considered when calculating liquidity ratio. Cash reserve is a part of items used for calculating liquidity ratio.

**Monetary operations under Islamic banking**

Many conventional instruments, which are sharī'ah compliant, can be adopted by Islamic monetary policy to regulate Islamic banking businesses. Tools that central banks can use to solve or reduce liquidity problems of commercial banks are herein discussed.

The instruments, Open Market Operations (OMO), are used to control the expansion and contraction of money in circulation. This product contains interest (riba)[20]. Treasury bills, treasury certificates and development and government bonds that are used in OMO contain interest. Some attempts were made by some scholars to modify and find a close alternative to it. However, it does not win the favour of many scholars because of the bad effects it can have on economy. It can influence the market price of shares and also affect holders of commercial papers negatively. It must be mentioned that it is not all products that can have alternatives. Products should not be developed for the sake of it. If Islamic banks are facing liquidity problems, the CBN can purchase financial papers (Sukūk) from them. This act will relieve them of liquidity challenges they are facing. Central bank of Sudan does this for Islamic banks.[21] Malaysia also has many ways of assisting Islamic banks that are facing liquidity challenges. Some of the products developed for assisting any Islamic banks facing liquidity challenges are Interbank Mushārakah and Interbank Wakālah. It must be quickly mentioned that some of the instruments which contain interest

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[19]M.C. Vaish, Monetary Theory, New Delhi: Vikas Publishing house PVT Ltd, 2000,

[20]A. Ausaf, A. Instruments of Regulation and Control of Islamic Banks by the Islamic CentralBanks. Jeddah: Islamic Development Bank, 2000.

[21]B.E. Ada, On the Design and Effects of Monetary Policy in an Islamic Framework: The Experience of Sudan, Islamic Research and Training Institute, Research Paper, 2004.

or interest is charged from the backdoor such as sale and buy back must not be used as monetary measures for Islamic banks.

If an Islamic commercial bank is having a liquidity problem, the central bank can extend to it Muḍārabah funds[22]. The bank will scrutinize the feasibility reports of the projects to be financed by the CBN before giving the Islamic bank the funds so as to satisfy itself that the Islamic commercial bank has a viable project which it could not finance due to shortage of funds. Profits realized from the projects would be shared based on a pre-agreed ratio. If loss is incurred, and the commercial bank does not go ultra vire, the loss will be borne by the central bank. However, if the commercial bank violates the terms of the contract, the commercial bank will bear the total loss.

Islamic commercial banks keep a certain percentage, say 15 percent of their total deposits with the central bank in the form of minimum legal cash reserves[23]. The central bank will have an advantage of getting interest free funds through this reserve. However, the central bank pays the commercial banks the service charge. The government can have access to this fund by paying the central bank the service charge paid to the commercial banks. This statutory requirement is not part of the bank's equity. The central bank being the government bank provides the government interest-free loans to execute its socially beneficial projects and to develop its infrastructural facilities for the benefit of its citizens.

Commercial banks mobilise the public funds without paying any interest on the fund in an interest free economy[24]. Some infrastructural facilities which are badly needed by the public may not be advisable and feasible to finance them through any of the Islamic banking products such as Muḍārabah[25]. Therefore, if a percentage of the funds is given to government through the central bank, the government is able to get resources to finance its infrastructural facilities that are beneficial to the public. The deposits are fully insured by the central bank. This means the commercial banks will get their funds as and when needed. The government is able to get interest-free resources to finance the highly needed infrastructural facilities. The multiplier effect of this arrangement will be seen in the creation and conducive environment for people to create jobs and empower themselves.

Since Muḍārabah involves the combination of capital and entrepreneurship[26], the central bank may regulate the profit sharing ratio between commercial banks and the central bank. If the bank wants to reduce the money in circulation, it may make

[22] Al-Salem, Fouad H. Islamic Financial Product Innovation, International Journal of Islamic and Middle Eastern Finance and Management Volume: 2, Issue: 3, 2009.

[23] M.U Chapra, Towards a just monetary system. Leicester: The Islamic foundation, 1985.

[24] M.U. Chapra, Monetary Management in an Islamic Economy, Islamic Economic Studies, Vol. 4, No. 1, (December, 1996)

[25] M.U Chapra, Towards a just monetary system. Leicester: The Islamic foundation, 1985, 197.

[26] M.K. Kareem, "The Development Finance Institution in Nigeria and the Islamic Finance since1964," Journal of Oriental and African Studies Vol.19(2010), 161-190.

[27] M.N. Siddiqi, Banking without interest. Leicester: The Islamic foundation. 1983.

the ratio given to Islamic banking higher than the entrepreneur[27]. If the banks wish to pump money in to the economy, it may make the ratio given to the bank customer higher than that of the bank. The injustice in this arrangement is that if the efforts put in by the customer is higher than the capital provided by the bank, the entrepreneur is cheated. This is why Chapra suggested that the determination of the ratio should be left to the parties based on their perception of market conditions and profitability[28]. However, if the financial assistance is from the central bank to Islamic commercial banks and other financial institutions, the central may accept a lower rate of profit if the intention is to increase the supply of money because it is not established to maximize profit.

A certain percentage of demand deposits should be given to the government through the central bank. Chapra suggested a maximum of 25%. This is to finance infrastructural facilities that would benefit the public. The funds should be insured by the central bank. This gives the government interest-free resources to provide socially beneficial projects for the public whose resources are indirectly taken from the Islamic commercial banks. Chapra gives the following reasons for this product: "that commercial banks act as agent of the public for mobilizing the society's idle resources; the banks do not pay any return on demand deposits; and the public does not bear any risk on these deposits if these are fully insured"[29]. However, this product must be used with caution for it can lead to inflationary conditions.

Credit ceiling as a monetary instrument of the central bank is used to set separate ceilings for each Islamic commercial bank[30]. No one is allowed to exceed the ceiling. If an Islamic bank should give loans above it, it may be asked to deposit an amount equal to the excess amount with the central bank. It may also be fined. Penalty should not involve payment of interest because it is forbidden to pay or take interest in Islam.

Priority sectors of the economy are identified and valued. Islamic commercial banks are then asked to finance them. This is because the credit created is from the society. They should be able to give back to the society a share of what they obtain from it. Interest free loan or muḍārabah advances may be given to any Islamic bank facing liquidity problems. If the latter is given, central bank may take a lower rate of the profit since it is not established for the sake of profit maximization[31].

Islamic commercial banks can also be regulated and directed by the central bank by fixing different maximum and minimum profit sharing ratios for different deposits and investments.

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[28]M.U. Chapra, Towards a just monetary system. Leicester: The Islamic foundation, 1985. 203

[29]M.U. Chapra, Towards a just monetary system. Leicester: The Islamic foundation, 1985 ,197

[30]Bidabad, Bijan; Mahmoud Allahyarifard, Usury-Free Bonds and Islamic Central Banking Monetary Instruments, 2010, http://www.bidabad.com/doc/Islamic-banking-bond-en.pdf; Bidabad, Bijan, Interest-Free Treasury Bonds (IFTB), Islamic Finance and Legal Clarifications, 2011, http://www.bidabad.com/doc/interest-free-t-bond-feqhi-en.pdf

[31]A. Ausaf, Instruments of Regulation and Control of Islamic Banks by the Islamic Central Banks, Jeddah: Islamic Development Bank, 2010.

Employees of the central bank may have informal meeting with the operators of the Islamic commercial banks to explain the policies of central banks and its priority areas and urge them to focus their attention on them. Since Islamic banking products are many and different, the central bank may specify the proportion of bank finance that should be used in each of them.

## Empirical Analysis: Methodology

Using the data from the World Bank on financial inclusion, the paper uses comparative contextualization and analyses trends of financial inclusion indicators as outcomes of central bank policy design and implementation strategies in these different paradigms to draw inferences of efficiency and effectiveness. An accessible population of countries with Islamic banks and countries with conventional banks was used. From the population, a survey sample of five countries operating Islamic banks and six of the ones operating conventional banks was selected using purposive sampling technique. Those countries selected in the former case were chosen for this study because they have successful Islamic commercial banks. Apart from operating within a Muslim society and their rapid growth, Islamic banks in those countries enjoy support from their monetary authorities. The countries used in the latter case are those countries which give little or no recognition to Islamic banking.

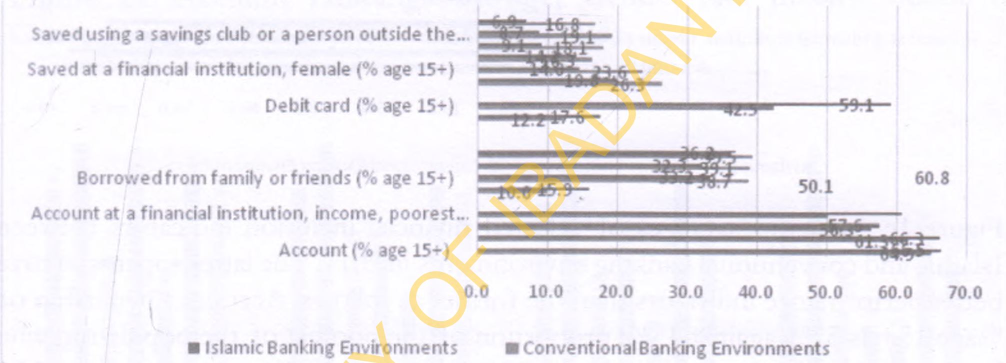
## Data Analysis and its Implications

### Performance of Financial Inclusion

While the literature review conducted above revealed certain role of the CB, data on most of these functions are not collected. To reiterate it, CBs are expected to, in their attempts at ensuring financial inclusion, educate stakeholders on regulatory provisions; promote pilots to demonstrate the business case for financial inclusion; create incentives for extending financial services to disadvantaged groups; and establish the MSME Development Fund; implement financial literacy programmes; create awareness among stakeholders on their roles and responsibilities and coordinate the implementation of the strategy; review and revise roles and responsibilities of stakeholders; gather or arrange to gather, and publish financial inclusion data as well as maintain the database; track and monitor progress on financial inclusion vis-à-vis the targets set; and address capacity building initiatives on financial inclusion issues. The CBs, aside fostering financial education and literacy, are expected to ensure consumer protection, supervise or oversee the activities of financial institutions and their services as well as promote universal access to payment systems.

In place of input data that will directly capture the work of CBs in relation to financial inclusion, the norm has been the creation of outcome database which is also still in its infancy. These data elements include those which measure number or proportion of people with access to the products and services offered by the banking system such as loans, deposit services, insurance, pension, and financial literacy, number of bank branches, offsite and onsite ATM usage of debit card and credit cards, sometimes in rural and semi-urban areas. Those indicators are the ones analysed subsequently in respect of Brazil, China, India, Kenya, Nigeria and South Africa. The data are trended and compared statistically where possible. The data provided by the World Bank on financial inclusion covers whether citizens from 15 years of age and above have account with financial institutions, whether they can borrow from them or from outside the financial system or whether they are able to make payments through their phones, among others. The figures below indicate the data available for countries running conventional banking and those running Islamic banks.

Figure 1a: Account Holdings by population aged 15+, Conventional Banking system countries (2011)




## *Conventional banking*

Figure 1(a) indicates that for the account holding by age 15+, China and Brazil are leaders at more than 50-60% and greater than group average of 46.9%. On account holding by female (%age 15+), China (63.8%) leads the group followed by Brazil and South Africa at 51%; and their performance is greater than group average of 42%. India, Kenya and Nigeria are all below average from the three indicators of account holding. Even a higher proportion of the poorest of the population in China has accounts with financial institutions (46%). Brazil is 39%, higher than group average of 30%. Given that the poor and the women are vulnerable population in any economy, countries which have higher percentages of these two groups holding bank accounts will tend to be more inclusive of the groups in sustainable economic development. In contrast, Islamic banking performance indicators regarding financial inclusion in Islamic countries appear better than those of conventional banking system (Figure 1b). For instance, account ownership by population aged 15+ in Kuwait and Iran range between 70% and above 80% which is greater than group average of 57%. Account ownership by female population aged 15+ in Kuwait is 79.6%, followed by Iran 62% and Qatar 61%; and these are greater than group average (45.3%). Egypt and Saudi are below average for the three indicators of account ownership. A higher proportion of the poorest of the population in Kuwait have accounts with financial institutions (i.e. 84.1%). Iran is 67%; and these are higher than group average (50%) in 2011.

Figure 1b: Account Holdings by population aged 15+, Islamic Banking system countries (2011)

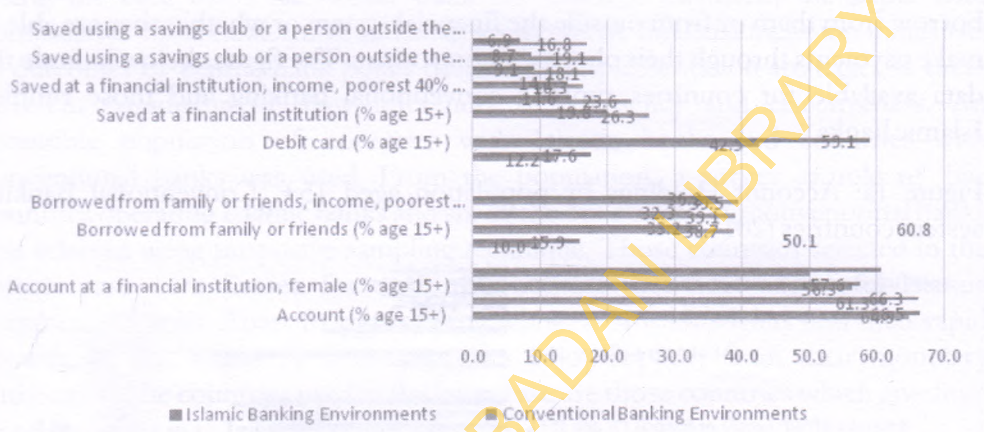



Figure 1c compares averages of selected financial inclusion indicators between Islamic and conventional banking environments in 2011. The latter appears to have better performance indicators than the former as follows: Account Ownership of %age 15+ is 57% against 45%; proportion of the poorest of the population who have accounts with financial institutions 50.4% against 30.2%; residents of age 15+ using debit cards 49.1 against 30.7%; and credit cards 27.1% against 9%. In addition, more ATMs are deployed in Islamic banking environments than in conventional banking environments.

**Figure 1c: Selected Financial Inclusion Indicators; Conventional and Islamic Banking Environments (2011 Averages)**

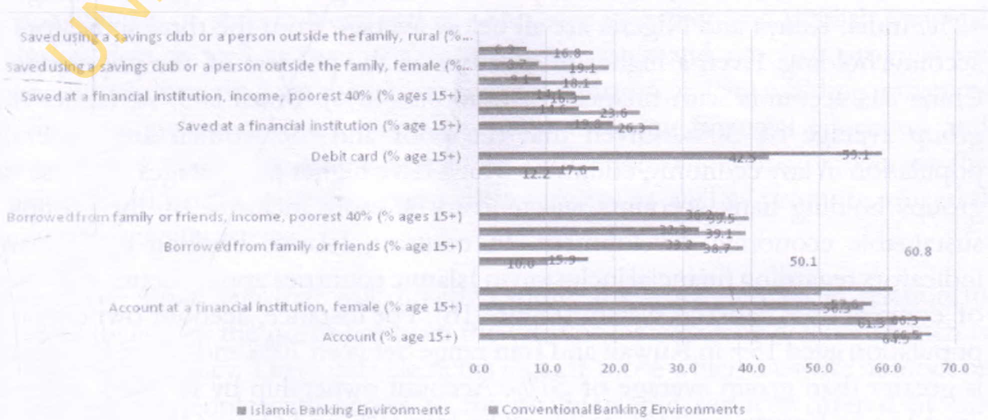


**Figure 2a: Account Holdings by population aged 15+,**

There have been marked improvements in the financial inclusion efforts of even the countries operating wholly conventional banking environments. For instance, Figure 2a shows that account ownership by percentage of population aged 15+ in China and Brazil are at >60-80% and greater than group average of about 60%, account ownership by female population aged 15+ in China (76%) leads the group followed by Brazil and South Africa at 65% and 69% respectively and greater than group average 56%. India, Kenya and Nigeria are all below average for the three indicators of account ownership; and higher proportion of the poorest of the population in China have accounts with financial institutions (72%) while Brazil is 59%. They are higher than group average (50%). Therefore, financial inclusion has improved in all the countries with conventional banking environments in 2014 compared to 2011.

**Figure 2a: Account Holdings by age, Gender and income Status in Conventional Banking system countries (2014)**

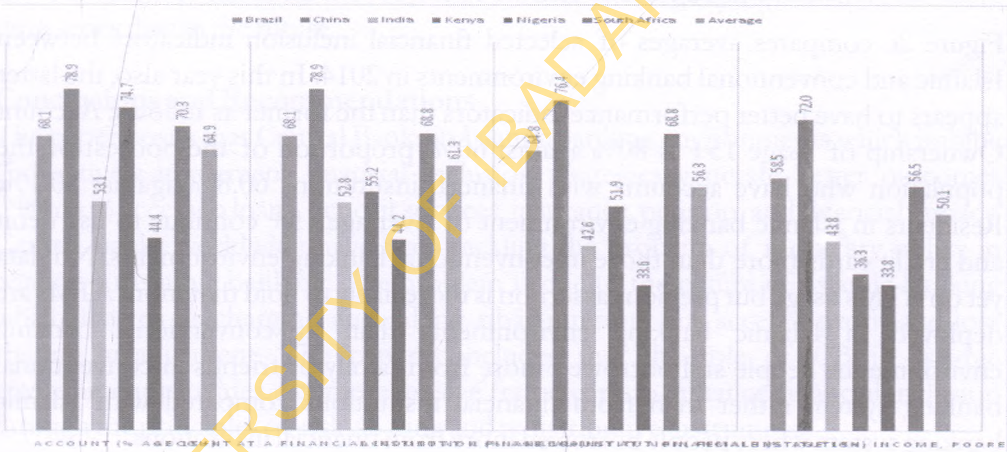



Figure 2b indicates account holdings by age, gender and income status in Islamic banking system countries in 2014. The percentage of account ownership by population aged 15+ was quite high in Iran and UAE which recorded 70% and above 80% respectively thereby performing better than the group average of 66%. In addition, account ownership by female (%age 15+) in Iran (87%) and UAE (66%) led the group of Islamic banking environment countries followed by Kuwait 64% and Saudi 61% and also outperformed the group average of 57.6%. Egypt is below average for the three indicators of account ownership. It is also noteworthy that a higher proportion of the poorest of the population in Iran has accounts with financial institutions (91.1%) while UAE is 78% which is higher than group average 61%. Therefore, financial inclusion has also improved in the countries with Islamic banking environment between 2011 and 2014. However, Kuwait has reduced performance relative to others compared to 2011.

*Figure 2b: Account Holdings by age, gender and income status in Islamic Banking system countries (2014)*

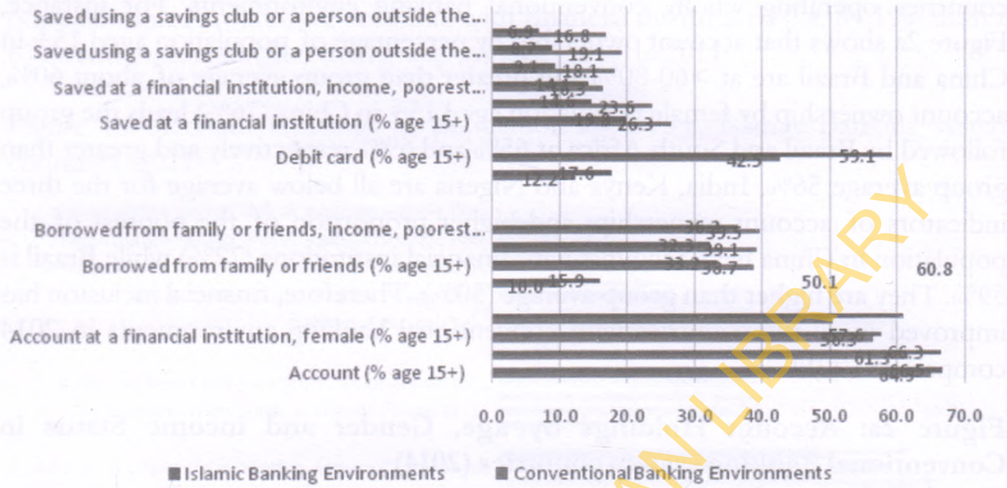
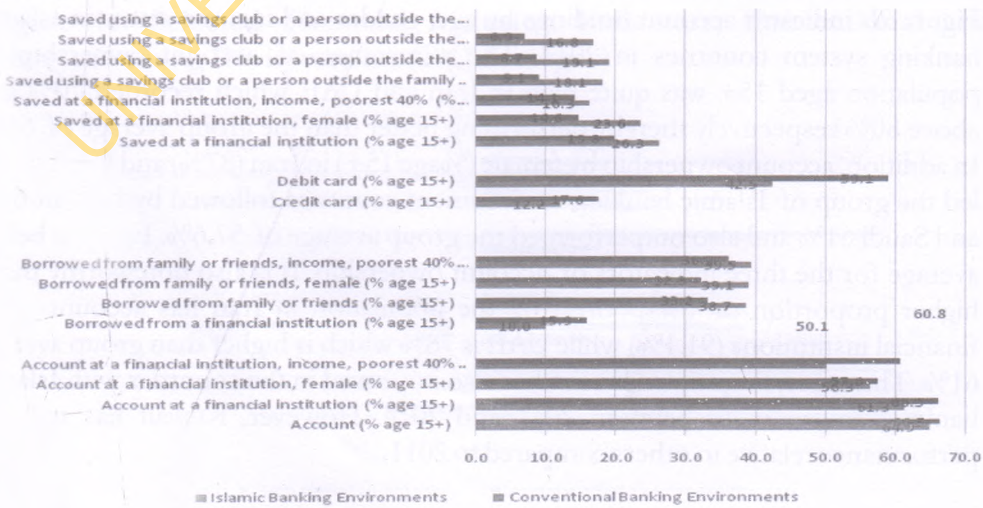



Figure 2c compares averages of selected financial inclusion indicators between Islamic and conventional banking environments in 2014. In this year also, the latter appears to have better performance indicators than the former as follows: Account Ownership of %age 15+ is 80% against 60%; proportion of the poorest of the population who have accounts with financial institutions 60.8% against 50.1%; Residents in Islamic banking environment of over age 15+ continue to use debit and credit cards more than those in conventional banking environments. No data yet on ATMs usage but previous assertion is more likely to hold that more ATMs are deployed in Islamic banking environments than in conventional banking environments. People still borrowed more from family or friends in conventional banking system rather than from financial institutions compared with Islamic banking system where people borrowed more from financial institutions.



**Implications of the data analysis**

Having analysed some selected financial inclusion data in conventional and Islamic banking environments, this paper reaches the conclusion that during 2011 and 2014, financial inclusion in Islamic banking environment appeared to show better performance than those of conventional banking environment particularly in terms of account ownership, proportion of population aged 15+, proportion of the poorest of the population who have accounts with financial institutions, residents of age 15+ using debit cards and credit cards, and ATMs deployment. In addition, borrowing from family or friends rather than from financial institutions is more rampant in conventional banking system compared with Islamic banking system where people borrowed more from financial institutions. Therefore, it appears CBs role in Islamic banking environment are better focused and channelled than in conventional banking environments. The reason for this may be the preoccupation of conventional banking environment CBs with issues relating to interests rates and interest-based monetary policy. However, a full analysis of the determinants of these differences can form the subject of further interrogation when there are more time series data in the future.

**Conclusions and Recommendations**

The paper posits that Central Banks in Islamic banking environments which imbibe and actively implement financial inclusion strategies generate better outcomes relating to access to loans, deposit services, insurance, pension, and financial literacy. Central banks worldwide have been tackling the problem of monetary policy in relation to Islamic banking. The problem is due to the nature of Islamic banking which frowns at charging and taking ribā (interest) but accepts profit-and-loss sharing arrangement. The paper concludes that the role of CB in Islamic environment provides a comprehensive framework to enhance financial inclusion through the principles of risk-sharing and redistributive instruments.

As dual banking system provides alternative for Muslims who had avoided using the conventional ribā-based banking system to make a choice to bank in a system that is in line with the dictates of the sharī'ah, non-Muslims continue banking with the conventional system. The resultant effect is that virtually all the people will be financially included. This will in turn affect economic growth and development positively because both Muslims and non-Muslims will be economically empowered and financially sound. The availability of a wider and diversified range of Islamic banking products and services will lead to economic growth and development. Being in this kind of a dual banking system will make Islamic banking operators to be innovative and creative with a view to remaining relevant and capturing a fair share of the banking system.

Islamic monetary instruments provide a better alternative to the conventional ones in the area of controlling inflation and creating real economic growth, employment, high savings and investments opportunities. It is acceptable in Islam to use any instrument that is sharī'ah compliant to control financial institutions under central banks. Data analysis suggests that CBs' roles in the Islamic banking environment are better focused and channelled than in conventional banking environments. This could be due to preoccupation of conventional banking environment CBs with issues relating to interest rates. Full analysis of determinants of these differences can form the subject of further interrogation when there are more time series data in the future. The instrument should not only devoid of interest but also must be lawful in the eyes of the Sharī'ah. Therefore, it means there is room for innovations that are sharī'ah compliant. Central bank in both conventional and Islamic economies needs to make sure price is stable, work towards a balance of payment equilibrium, promote the growth of the economy and be socially responsible. It is clear that there are many tools the central bank can use to regulate, control and manipulate the affairs of the Islamic commercial banks. They have to design products that will reflect the specificities of Islamic products. Central bank should make sure that the conventional banks that operate Islamic banking window do not mix or commingle the funds meant for Islamic banking products with those of non-Islamic investments. Precautions must be taken to ensure that Islamic funds do not mix with other funds used in non-shariah compliant activities. They should have separate capital funds, accounts and reporting systems different from the rest of the bank i.e. Islamic window as a separate entity.

Central banks can provide new laws for licensing and regulation of conventional and non-conventional Islamic financial institutions. They need to establish the Shariah Advisory Council (SAC) to ascertain, confirm and validate all Islamic financial products or any other businesses based on Shariah principle. The SAC should consist of prominent shariah scholars, jurists and market practitioners who are qualified and have vast experience in banking, finance, economic, law and the application of Shariah, especially in terms of Islamic economics and finance. Comparative analysis shows that Islamic monetary policy can adopt many conventional instruments which are Shariah compliant such as legal reserve ratio, credit rationing, selective credit control, issue of directive and moral suasion. They need to develop products that will comply not only with the legislation, guidelines and circulars of their countries but also with Shariah principles. They also need to create a medium to inform consumers on banking products and services and their benefits with a view to assisting them to make their choice on the bank that best meets their needs and demands. The ideals of Islam such as fairness, justice and transparency should be observed. CB can apply financial engineering to device innovative ways of developing hybrids of risk-sharing and redistributive instruments to enhance access to finance in order to promote economic development.

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