

Macroeconomic, Legal and Cultural determinants of Islamic banking development

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This paper provides new evidence on the influence of macroeconomic, legal and cultural factors on the Islamic banking development, using data from 29 OIC countries over the period of 2005-2011. Using both OLS and GLS method of estimations we have find that as with conventional finance, international trade and economic development appears an important drivers of Islamic banking development. However, macroeconomic stability does not appear a significant determinant of Islamic banking development. Our results also highlight how legal and cultural factors play an important role in explaining the cross-country diversity in the level of Islamic finance development. In fact, Islamic financial system is more developed in countries where their first language is Arabic and their first religion is Islam. Shari'a law also has a positive effect on Islamic finance development. However, Civil and Common law have a negative effect on Islamic banking development.

Keywords: Islamic banking development, OIC Countries, OLS, GLS
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Introduction

Financial development, has received over the last decade much attention as a source of economic growth. The frontier of the literature in this field is, therefore, shifting towards providing answers to the question of why some countries are more financially developed than others.

A growing body of literatures demonstrates that a cross-country difference in the degree of trade openness, the legal origin and the cultural factors (religion and Language) are among the most causes that explain the cross-country differences in financial development (Laporta, Lopez-de-Silanes, Shleifer and Vinshny, 1998; Graff, 2006; Beck, Demirguc-Kunt and Levine, 2000, Stulz and Williamson 2003, Baltagi, Demetriades and Hook Law (2006)). These findings are true for conventional finance, but what about Islamic finance?

In fact, Islamic financial system has evolved as viable and competitive component of the overall financial system and as a driver of economic growth and development specifically in some OIC countries¹. Therefore this paper examines the determinants of Islamic finance development with special attention to the country's natural trade openness, legal and cultural factors.

In the first step we tried to examine the macroeconomic determinants of Islamic banking development. More specifically we have considered indicators of economic development and macroeconomic stability.

¹As a specific example in term of economic growth, GCC region has a remarkable record of consistently high growth in the past three decades. The growth of GDP accelerated in GCC region countries to more than 6% in 2010.