Islamic Participative Financial Intermediation and Economic Growth

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Abstract

This paper shows the extent to which islamic participative financial intermediation can enhance economic growth. It underlines its role in resolving ex ante and ex post asymmetric information problems. Based on Profits and Losses principle, this intermediation reduces costs of information as well as transaction and permits risk sharing. Consequently, this leads to an optimization of the saving/investment process. Besides sharing risk, management stimulates financial transactions and helps promote technological innovation. Therefore, participative intermediation is effective and competitive in the growth and development agenda.

We will highlight the fact that participative intermediation leads to an equitable, stable and sustained economic development. It can help to resolve a variety of problems: poverty and unemployment. However, many difficulties at both macroeconomic and microeconomic levels are likely to hinder their contributions to economic development and need to be overcome by enhancing the relationships between islamic banks-sukuk markets and establishing suitable policy reforms.

Keywords: Asymmetric information-Economic growth- Risk sharing-Participative Financial intermediation-Profits and Losses Sharing.

JEL Classification :G 20, O 11, Z 12

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1.Introduction

The subprimes crisis of September 2008 has plunged the world economy into the deepest recession ever since the end of the Second World War (IMF, 2009)[1]. In this context, the moral and ethical aspect of finance began to be more emphasized. The financial crisis has increased the attention on islamic banking (Beck et al, 2010). This finance could avoid new crisis (Pastré and Jouiny, 2009; Saidane, 2010) and help to institute discipline, transparency and therefore the hoped stability (Hassan, 2009).

Then, facing measures for financial sphere stabilization, economic development strategies in developing countries must be reviewed. In addition, after Arab countries' revolutions, development strategies must be revised and focus on the poverty alleviation and the democratization of wealth. The growing islamic finance is increasingly recognized as an alternative financing mode for economic development.

Islamic financial system can play a vital role in the development of islamic countries thanks to the further saving mobilizing outside the conventional interest system (Iqbal, 1997). It is really adapted to «growth-enhancing functions » (Habib, 2005). Social justice and particularly the elimination of extreme poverty are among priority areas of islamic financing strategies (Khan and Khan, 2010).

However, as noted by Marvakis (2009), many authors suggest that islamic laws aren't able to stimulate economic development. Since 1965, Weber considered that Islamic values constitute an obstacle to development. Moreover, according to Kjetil (1998), the pragmatic and fruitful development strategy leads to a limited integration of this finance in traditional and rural sector only. Based on popular and limited financial instruments, the Islamic financial system may be weaker in delivering the needed financial services of growth as the monitoring of managers and risk reduction (Honohan, 2001). As a sample, the pure Islamic financial system in Sudan doesn't contribute to economic growth, it also fails to mobilize resources for investment (Al-Jarhi and Hussein, 2002).

Islamic banks constitute the core of islamic financial sphere, head the savings-investment process and thereby the economic growth process[2]. Islamic banks are invited to respect many principles such as : Riba prohibition, Interdiction of

[1] For sample, the economic growth of around 7% in 2007 in Western Europe falls to 1% in 2009.

[2] Islamic finance includes an increasingly range of institutions such as commercial banks, investment banks, takafuls, investment companies, all respecting Islamic religion. But, islamic commercial banks dominate the market of financial Islamic assets with 73% while takuful, sukuks issues represent respectively 1% and 11% (IFSL estimated based on The Banker, Ernst & Young at end 2008).

speculation and gharar, Interdiction of investment in illicit sector, Profits and Losses Sharing (PLS) principle and Asset Backing principle. So, islamic banks are different from conventional ones in both assets and liabilities sides. The Main islamic bank's financing characteristics are Musharaka and Mudaraba[3]. Investment accounts[4] constitute the Islamic bank deposits particularity. Then, compared to conventional financial intermediation, the specific islamic intermediation is *participative financial intermediation* : Mudharaba and Musharaka financing using funds of "investment accounts". So, in this article, we focus on the extent to which this distinctive financial intermediation can promote economic growth.

The remainder of the paper is organized as follows. Section 2 deals with the role of participative financial intermediation in stimulating economic growth. Section 3 specifies the merits and limits of this specific intermediation-growth nexus notably in countries where both islamic and conventional banks co-exist. Section 4 concludes the paper.

2.Role of participative financial intermediation in promoting economic growth

The relationship between financial development and economic growth is a controversial issue. Finance is a critical element of growth both theoretically and empirically (e.g. Schumpeter, 1911; Goldsmith, 1969; Grennwood and Jovanovic 1990; King and Levine, 1993; Rajan and Zingales, 1998; Abu-Bader and Abu-Qarn, 2008). Yet, finance is regarded as a minor factor of growth (Robinson, 1952; Lucas, 1988). Economic growth causes financial development and not the reverse (Robinson, 1952). Furthermore, the relationship between financial development and economic growth can be negative since financial deepening harms growth because of more financial crisis caused by development (Degregoria and Guidotti, 1995).

In an ideal Islamic world, contracts are free from gharar, opportunism, asymmetric information. So, financial markets can ensure direct optimal financial contracts excluding financial intermediation. However, in islamic countries, financial markets are "underdeveloped" despite the recent development of sukuks[5]. Henceforth, their

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3 Musharaka is equity participation (active participation) of islamic bank in the capital of a firm. Mudaraba is a passive participation where Islamic bank is an investor that provides the capital full amount while the client is responsible of business management. Profits are shared in agreed portion but potential losses are supported by the islamic bank only except in case of manager negligence. However, Islamic banks offer other particular financing such as Zakat financing and commercial financing based on Salam and Istisn'a.

4 Banks act as managers of these deposits and allow them to project financing.

capacity to drain funds is limited compared to that of islamic banks. Islamic countries lack a performing accountancy system and also the domestic character of firms. According to Rajan et Zingales (1998), legal system problems conduct to favour banking financing rather than market financing. Then, Islamic banks present comparative advantage on Islamic markets.

Since Shumpeter (1911), the banking sector is showed as a driver of economic growth thanks to its productive investment financing. In this spirit, economic growth is related to the extension of indirect finance (Gurley and Shaw, 1960). Furthermore, McKinnon (1973) and Shaw (1973) consider that financial liberalization constitutes an efficient instrument to accelerate economic growth in developing economies characterized by the weakness of capital markets. Banks play an important role in funds allocation if they overcome the « financial repression ». Later, when authors consider the microeconomics basis of financial intermediation, banks are shown as intermediaries that permit to alleviate market deficiencies and stimulate growth: they reduce informational costs (Greenwood and Jovanovic, 1990), mobilize savings and provide liquidity (Gorton and Pennacchi, 1990). Empirically, the positive relationship between financial intermediation and growth has been proved (e.g. King and Levine, 1993; Abu-Bader and Abu-Qarn, 2008).

Alternatively, the role of financial development in economy varies among countries due to differences in economic and institutional structures (Ang, 2008). Islamic banking presents a viable and efficient method of financial intermediation (Iqbal and Ahmed, 2005). We attempt to study the role of participative financial intermediation in promoting economic development.

2.1. Reduction of informational and transaction costs and efficiency of saving-investment process

According to conventional intermediation theory, transaction costs, asymmetric information and agency problems between savers and entrepreneurs give rise to financial intermediaries. Financial intermediaries can reduce costs of financial operations in terms of time and money thanks to economies of scale, economies of scope and expertise (Benston and Smith, 1976). But, the main concern of intermediation is the treatment of asymmetric information. *Ex ante* and *ex post* asymmetric information cause problems of adverse selection and hazard moral[6].

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[5] The recent study of Abdmoulah (2010) of 11 Arab financial markets until march 2009 using the method of GARCH-M (1,1) concludes to their "weak efficiency"

[6] Selection adverse is defined as the selection of bad characteristics leading to stray from good characteristics. Also, if the market is incapable to ensure a continuous and impersonal control

The intervention of financial intermediaries permits to signal information at lower costs than those of an individual which tends to signal the information alone (Leland and Pyle, 1977). Intermediaries are able to produce information by taking advantage of economies of scale (Ramakrishman and Thakor, 1984) and guarantee its credibility (Campell and Kracaw, 1980**)**. Furthermore, a financial intermediary offers a better monitoring (Diamond, 1984; Williamson, 1986). In addition, banks can solve market imperfections in case of shocks in consumers' consumption by producing liquidity (Diamond and Dybvig, 1993).

How can participative financial intermediation treat and resolve asymmetric information problems?

By PLS commitments (active or passive participation), islamic banks provide a more important signal of information than the short-run financing (Ben Jedidia, 2010) and permit to reinforce the confidence in firms financed by banks. Moreover, participative intermediation constitutes a source of important information related to the situation of firms. Also, the integration of business world helps islamic banks to provide a better collection of information at lower costs. This bank produces more accurate information about firms notably due to "the imperative of good evaluation" since the choice of projects influences not only bank's return but also those of its depositors-investors. Unlike "credit scoring" subject to an important standardization, PLS financing always requires complex and specific evaluations for each case.

Despite costs, monitoring is necessary in order to control contracts and reduce uncertainty. In PLS financing, monitoring is facilitated by « participation » in companies. It permits to reduce the average cost of supervision and avoids duplication of costs if every party carries out its monitoring. Islamic banks can control the performance of firms at lower cost than their conventional counterparts. The close relationship permits, at a variable degree, to improve monitoring of firms, information flows and share risks among group (McCauley and Zimmer, 1989). In Musharaka, a bank relies on the boards of directors of its business customer. This allows it to monitor the performance of the firm and the use of its funds at a lower cost. Then, the Islamic bank is exposed to lower levels of moral hazard and adverse selection. However, in Mudaraba, participation is passive and causes more monitoring costs. In addition, in long run relationship like PLS financing, reputation occurs and supervision may become self fulfilling (Kreps and Wilson, 1982).

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and to sanction at any deviation, the hazard moral raises. We distinguish *ex ante* moral risk if agent doesn't provide necessary effort to obtain results promised and *ex post* risk moral when agent manipulates results of project.

To summarize, thanks to participative intermediation, islamic bank is better equipped to deal with information asymmetry. We think that Musharaka constitutes the ideal solution for resolving *ex ante* and *ex post* asymmetric information problem[7] as it is in an optimal position to tackle these problems.

Consequently, as participative intermediation enables to resolve asymmetric information, it favors a better mobilization of savings and saving rates. The implication of islamic bank permits acquisition and allocation of resources at minimized costs and eliminates, in parallel, the mismatches inherent to the needs of surplus and deficit units of an economy. It increases the share of saving channeled to investments and then funds at disposition of firms and capital accumulation. In addition, PLS intermediation improves the marginal social productivity of investments and orientates investments toward productive sectors.

So, participative financial intermediation guarantees an efficient process of saving-investment that stimulates economic development and generates productive economic activity. Furqani and Mulyany (2009) conclude to a bidirectional relation between Islamic banking development and investment: an increase of Islamic bank financing "stimulates an entrepreneurial response in the productive sectors" and leads to more investments. Again, an increase in investment facilitates further development of Islamic banking. In this context, the investment is determined by real savings and not by credit multiplier as in conventional banking (Mirakhor, 1988).

2.2.Risk management and stimulation of technological innovation

Since the end of 90's, asymmetric information and transaction costs are not in front of the financial intermediation theory basis (Allen and Santomero, 1998, 2001). In fact, cost transactions and asymmetric information have been reduced thanks to "computerized" information and data. In this context, new intermediation theory insists on the role of intermediaries in reducing participation costs[8] and risk management (Allen and Gale, 1995; Allen and Santomero 1998, 2001).

By its interposition, islamic bank manages, redistributes and faces many risks. Risk management is in the heart of its activity. It provides a strategic position for the bank and guarantees its stability and minimizes its exposition to bankruptcy.

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[7] However, according to Khaldi and Hamdouni (2011) the model based on Mudarabah (deposit, investment funds) is more efficient and suitable to Islamic bank than other modes since it guarantees equity and efficiency for the whole banking system.

[8] Participation costs are related to the waste of time, difficulties of analysis of complex information, density of information, difficulties of placement management,... Financial intermediaries intervene by the creation of products with a more stable revenues of assets and lower costs for bank customers.

Participative intermediation conducts an explicit risk management and discourages excessive risks exposures. In PLS intermediation, risk management is based on risk sharing between funds suppliers, banks and funds beneficiaries. In other words, there is a pass-through risk between depositors, banks and investors. However, classical intermediation based on debts vehicles a « risk transfer»[9].

The risk-sharing arrangements constitute a risk reducing factor (Beck et al, 2010). PLS financing is riskier since it is mainly based on the confidence in entrepreneurs. Nevertheless, islamic risks are entangled since it is difficult to dissociate each class of risks in the same financing contract. Moreover, the limited eligible class of financial products creates an important risk of concentration by sectors, by products. Among particular risks of PLS activities: displaced commercial risk, equity position risk.

In order to minimize the risks they face, islamic banks can constitute a judicious diversified portfolio of participation in order to reduce the global risk related to their balance sheet (Matthews et al, 2002). Besides, islamic banks can benefit from their better appreciation of clients so as to reduce risks (Ben Jedidia, 2010). When islamic banks have the best visibility of funds allocation, this improves their risk management. However, Hassoune (2010) recommends a better comprehension of Shari'a and integration of modern and innovative techniques of risk mitigation in order to overcome the lack of their convertibility or subordination and securitisation.

Consequently, risk sharing vehicled by PLS encourages new projects to integrate production, helps increase capital risk and stimulates technological innovation. In fact, if risks are collectively supported, this strengthens and accelerates the pace of new business growth and innovative firms. Participative intermediation reduces risks incurred thanks to the appropriate choice of profitable projects, a better risk evaluation, the creation of customer loyalty and adequate risk management. In return, this boosts technological innovation and economic growth. Strategies which minimize and manage risk under PLS principle involve integrating the risks associated with the real activities and real activities are expected to generate sufficient wealth in order to compensate for the risks (Zeti, 2010). PLS financing and particularly the Musharaka can be pertinent for sustaining «capital risk investment» and increasing the supply of venture capital thanks to a sound intervention of banks. Banks choose, manage, finance and ensure a continuous accompaniment to projects. Islamic finance is a finance of proximity (Saidane, 2010).

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[9] Credit risk is only supported by the bank while depositors have a fixed return. Risk management is based on *intertemporal smoothing* (Allen and Gale, 1995) where banks keep on short-run and liquid instruments if conditions are better and use them if conditions are worse. However, the new current risk management is based on derivative markets.

We conclude that participative financial intermediation is effective and competitive in the growth and development agenda. At microeconomic level, islamic bank can efficiently coordinate financing and investment activities across firms and better allocate funds to highly profitable firms. Whereas on the macroeconomic level, it allows the development of economic activity and permits to reconcile socioeconomic objectives like sustainability, human welfare and share values with profitability.

There are only few empirical studies on the relationships between islamic finance-economic growth due to lack of data. For example, Goaied and Sassi (2011) have studied the impact of development of islamic financing on economic growth in 16 MENA countries from 1962 to 2006 using the method of Panel system GMM procedure. They concluded that islamic banks show a « weak relation » with economic growth but this relation tends to be positive as it is theoretically supported. Also, empirical funding of Furqani and Mulyany (2009), related to dynamic interactions between Islamic banking and economic growth[10] of Malaysia concludes that in the long-run, islamic bank financing is positively and significantly correlated with economic growth and capital accumulation. Their result seems to support *demand following* hypothesis: Malaysian islamic bank financing is dependant on growth of GDP.

However, there are less or no empirical research dedicated to PLS intermediation-economic development nexus. We plan to conduct this empirical study in later papers.

3. Merits and limits of Islamic participative intermediation in economic development

Islamic intermediation specificities are likely to lead to a specific approach of intermediation-growth nexus. We try to check the specific strengths of participative (and social) financial intermediation in stimulating new horizons for development. Besides, we deal with limits of this specific intermediation that might hinder its ability to contribute ideally to economic development.

3.1. Merits : In a mixed system, the development of participative intermediation contributes differently to development compared to conventional intermediation. It is likely to finance sectors abandoned by conventional banks and represents a notable

[10] This paper uses Cointegration test and Vector Error Model (VECM), using time series data (from 1997:1-2005:4) of total Islamic bank financing (IB Financing) and real GDP per capita (RGDP), fixed investment (GFCF), and trade activities (TRADE) to represent real economic sectors.

and additional effort to realize macroeconomic objectives. In addition, PLS intermediation presents many advantages for economic development :

3.1.1.More stable and less inflationary growth : All financial transactions must be based on a cycle of B&S since money is at the service of wealth and interests are forbidden. Therefore, the strong relationships between real and financial sphere avoids problem of "discordance" between their developments. Notably, in PLS financing, banks do not create money *ex nihilo* causing an excessive inflation. Thus, monetary expansion would be in step with the growth of the real sphere. In reality, islamic finance deposits are reinvested directly by banks in production and commerce creating a flow of B&S. So, new monetary flows are generated by sale of B&S. Consequently, these connections guarantee stability and avoid speculative bubble[11]. Iqbal and Ahmed (2005) note that the islamic concept of financial intermediation is "interwoven" with real sphere.

PLS finance engenders a macroeconomic stability (Chapra, 2000; Iqbal, 1997). Islamic financial intermediation is an « anti-crisis» intermediation (Saidane, 2010) while the interest rate based system is subject to losses and repetitive crisis[12]. A sound and less vulnerable financial system is important to ensure the sustainability of financial intermediation boosting economic growth. This avoids growth-inhibiting financial crisis that occurs in case of excessive growth of credit as suggested by Rousseau and Wachtel (2011) in conventional system.

3.1.2.A Sustained economic growth : Participative intermediation is more apt to enhance growth of revenues and employment. Compared to other financing modes, more funds are oriented towards productive system since financial transactions are accompanied by an underlying productive economic activity[13]. At macroeconomic level, long-run financing permits to reduce under-investments (Berkovitch and Greenbaum, 1990). Moreover, PLS financing are more focused on projects profitability than on creditworthiness like in the conventional system. Then, the process of capital accumulation is accelerated; this fact reinforces the process of real wealth creation and strengthens growth.

In addition, this "Associative finance" might be in the heart of development strategies: it encourages entrepreneurship. PLS financing can be oriented to Small

[11] But, Islamic finance has faced many serious financial crisis such as « Dubaï Islamic Bank » in 1998 and « Ihlas Finans » in Turkey.

[12] However, studies such as this of Yosuf and Wilson (2005) do not support the evidence of the superiority and stability of interest-free banking system compared to conventional banking system.

[13] Since 1969, Friedman demonstrated that zero nominal interest rate is a necessary condition for optimal allocation of resources.

and Medium size Enterprises (SME) which do not get sufficient finances even for their best projects. Islamic finance gives more chance to dynamic but not rich entrepreneurs while conventional finance favors capital holders or those who can be mortgaged (large firms, multinationals).

3.1.3. Social responsible growth : PLS financing is socially responsible since it selects projects with high social benefits and forbids unethical use of funds causing high social costs and presenting harmful effects on the long run such as alcohol, tobacco, and casino. So, it involves many filters in research of brotherhood value and social harmony.

As for social responsibility, PLS financing (by *Mouzaraa, moussakate and mougharassa*) can be oriented to promote the development of rural sectors in countries facing a lack of food. A study of Alam (2000) has shown that Islamic Bank Bangladesh Limited (IBBL) has succeeded in financing SME and rural sector in Bangladesh. Kjetil (1998) recommends to establish islamic banks as rural development banks in developing countries. The author explains that islamic banks increase the revenue distribution that might be high in rural areas[14]. This is particularly opportune in agriculture through participatory products in exploitations of agricultural ground.

3.1.4.Equitable and moral growth : In parallel to the stimulation of economic growth, participative intermediation permits to promote economic justice. The principle of justice highlighted by islamic finance is notably assured by risk sharing and absence of interest rate. PLS principle carries out a more equitable distribution of resources without hindering individual liberty. In the USA, during 40 years, development of disparity in revenue and wealth is attributed to finance (Askari and Krichene, 2010). In addition, social justice is granted by avoiding inflation that impoverishes creditors and profits to debtors.

To sum up, economic development consecutive to participative financial intermediation development is relatively stable, more reliable, equitable and less inflationary than the conventional system based on interest rate. Also, it is socially responsible and more conducive to poverty alleviation. Therefore, the three dimensions of sustainable development: economic, social and environmental (preserving the quality of life and environment for future generations) are respected by the participative intermediation.

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[14] In islamic finance, Salam is more practical in agriculture. It permits to generate working capital. In this case, bank and the buyer can be covered against price inflation and speculation. The farmer can benefit from funds in early season and might produce more.

3.2. Limits : In order to increase the competitiveness of participative financial intermediation and enhance its role in the growth and development agenda, many problems should be resolved at both micro and macroeconomic levels:

3.2.1.Macroeconomic level

- In order to have a critical and distinctive impact on growth, islamic finance and particularly PLS intermediation need to have an important share in the whole banking system. But, for sample, in North Africa islamic countries, islamic banks are less developed due to the religious interpretation of interests which is less conservative than in the Gulf's countries.
- Islamic banks need to overtake the lack of institutional and regulatory framework that guarantees more enforcement and transparency especially those involving profit and loss sharing financing scheme. Therefore, the authorities must establish a comprehensive set of operational institutions as compared to conventional systems and notably induce special laws for the introduction and practice of Islamic banking[15]. In this context, Ben Khediri and Ben-Khedhiri (2009) demonstrate that islamic bank profitability in MENA region is higher in countries with better socio-economic conditions and better legal systems.

3.2.2.Microeconomic level

-PLS intermediation causes important costs to banks that aim at reducing risks and improving information collection. Such costs make heavy financing notably through Mudaraba due to lack of standardization and competences and constitute a "manque à gagner".

-PLS intermediation is a slow procedure because it needs to conduct a special study for each project. As a result, further time is needed between the date of the demand of financing and the date of the effective PLS financing compared to conventional system.

-PLS intermediation chooses projects at low risks and strays from risky projects that might be more profitable. In fact, while in Musharaka, problem of hazard moral is resolved, market risk and insolvability risk remaine (see Khaldi and Hamdouni (2011) for further details). Therefore, islamic banks try to limit financing risky projects which are likely to provide more revenues to the whole country and that might reduce significantly underemployment.

-The equity based instruments (mudarabah and musharakah) pose operational problems (Ahmed, 2005).

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[15] The recent significant regulatory changes related to islamic financial services such as Qatar Central Bank in Feb 2011 and Oman Central Bank in May 2011 are in this way

-The limited liquidity function of participative intermediation would affect investment and growth at different stages of development. Islamic banks are constrained to keep a higher liquidity. Islamic bank have 40% more liquidity than conventional banks (Khan and Bhatti, 2008). This causes a decrease or a sacrifice of banks' potential profitability.

- PLS financing can conduct to a high concentration on many sectors causing « pro-cyclicity » of asset return such as real estate. This is explained by the fact that banks focus on sector in which they have the higher competences. Islamic financial bank activity is dominated by the retail banking (Hassoune, 2010).

-PLS intermediation is affected by the small size of Islamic banks. For sample, the lower efficiency of Malaysian Islamic banking in comparison to conventional banking may be explained by the lack of economies of scale due to the smaller size of Islamic banks (Mokhtar et al, 2006).

Because of these problems, Islamic bank favours like-debt and short-run financing which are less risky than PLS[16]. Therefore, the development of PLS intermediation-growth needs to overcome these problems and suggests incentive-compatible profit-sharing finance and further research and innovation in this area. We think that most of these problems can be overcome by the development of relationships between islamic banks and islamic financial market (notably Sukuk markets). Such relationships can develop the corporate Islamic financial intermediation; reinforce the development of risk mitigating instruments and the development of product innovation, convey an access to liquidity for Islamic bank….

4. Conclusion

The aim of this paper is to study the relationships between participative financial intermediation and economic growth. The principle of PLS on asset and liability side of a bank's balance sheet constitutes the main specificity of islamic intermediation. Free from interest, gharar, speculation and investment in harmful sectors, and respecting PLS and asset backing, participative intermediation (PLS-intermediation) is notably based on investment deposits on the one hand and Musharaka and Mudaraba on the other hand.

In the absence of efficient financial capital markets, participative financial intermediation provides a better solution to asymmetric information problems. It reduces costs of information and transaction and permits risk sharing. So, it allows a better saving mobilization, increases the part of saving canalized toward investment,

[16] Chong and Liu (2009) note that only a negligible portion of Islamic Malaysian bank comply with PLS principle.

favors capital accumulation and the growth of wealth. Consequently, this leads to an optimization of the process saving/investment. Besides, bank reduces risks thanks to a better risk evaluation and diversification of investments. The management of risks based on risk sharing helps toward technological innovation.

PLS intermediation constitutes the best conductive of economic development by promoting productive projects through the efficient use of funds and improving the efficiency of resources allowance. Then, it can sustain economic growth, eliminate poverty, expand employment and self-employment opportunities. It leads to equitable, stable and high growth economic development. So, the integration of islamic banks in development strategy is pleaded. But many reforms are necessary in the institutional and economic organization of islamic countries. Policy reforms in muslim countries are invited to enhance PLS financing, develop new products of risk management and develop the relationships between islamic banks and islamic financial market (notably Sukuk markets).

Finally, in this paper, we have focused on participative intermediation; however, the social financial intermediation is important to resolve problems of poverty and unemployment and boost growth. On the one hand, *Quard hassan* permits poor people to become more productive and reduce unemployment. On the other hand, the distribution of Zakat related to many aspects of wealth helps to insert people which are more in need in the sphere of production, stimulates aggregate demand and influences the level of production. These ideas need further researches.

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