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"Legal Origin and Islamic Finance Development: Why Does Sharia Matter?"

Rihab Grassa[*]

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[*] Ph.D.; Higher Colleges of Technology, Dubai- UAE; ISCAE University of Manouba, Tunisia

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Rihab Grassa, Ph.D.

Higher Colleges of Technology, Dubai- UAE

ISCAE, University of Manouba, Tunisia

rihab_grassa@hotmail.fr

Abstract:

Previous studies on financial development have shown that differences in legal origin explain differences in financial development. Using historical comparisons and cross-country regressions for 40 countries observed for the period from 2005 to 2018, our research try to assess how different legal origins affected the development of Islamic finance worldwide. More particularly, our research assess empirically why and how Sharia adopted wholly or partially (combined with Common or Civil Law) could explain the level of development of Islamic finance in different jurisdictions. Our primary results, shown that countries adopting a Sharia legal system had a very well developed Islamic financial system. Moreover, countries, adopting a mixed legal system based on Common Law and Sharia Law, were characterized by the flexibility of their legal systems to make changes to their laws in response to the changing socioeconomic conditions and that these helped the development of the Islamic financial industry. However, countries, adopting a mixed legal system based on both Civil Law and Sharia Law, were less flexible in making changes to their old laws and this thwarted the development of the Islamic financial industry in these countries. Furthermore, we found that the concentration of Muslim population (the percentage of Muslim population) had a positive effect on the development of the Islamic banking assets. Also, the level of income had a positive and significant effect on the development of Islamic.

Keywords

Legal origin, Islamic financial development, Sharia Law, Institutional quality

1. Introduction

A considerably body of research on law and finance has emerged suggesting that cross-country differences in legal origin can explain cross-country differences in financial development. One of the important factors that can explain the financial development is the flexibility of laws to evolve following the emergence of the news socioeconomic circumstances (Beck and all, 2003). Flexibility of law emphasizes the formalism of laws and the ability of legal traditions to change. Particularly, legal systems that adapt effectiveness to the contracting needs of economy promote the development of the financial system. While considerable research examines the effect of legal system on financial development are concentrated on the effect of the Civil and Common law origins, few research has attempt to study the effect of the legal system and especially the Shari'a law on the development of the Islamic financial system. Even if these researches exist, these studies still theoretical and no empirical research has attempted to test empirically the *Theory of Law and Finance* on the Islamic finance context.

Today, Islamic financial institution operates all over the world. Differently from conventional finance, Islamic finance and the activities of Islamic financial institutions must be based on Sharia law. That's why the legal environment on which Islamic financial institutions operate can have a direct effect on the level of development of the Islamic finance industry.
The development of the Islamic finance at different stage across the world draws our attention to investigate on the effect of the legal origin on the Islamic financial development. In fact, a legal environment that effectively accommodates the intricacies of the Islamic financial industry and facilitates its development is crucial not only to bring the industry forward, but more importantly to ensure its soundness and stability.

This paper is an extension of previous works of Grassa and Gazdar (2014 and 2016). In this study, we assess empirically the theory of law and finance in the Islamic finance context. More particularly, this research discusses why and how differences in legal system can influence the stage of development of the Islamic finance and how institutional quality affect this relation. This study is not only based on make comparison between the effect of common and Civil law, we will extend our investigation on how Sharia legal system origin adopted wholly or combined

with other legal origin (specially the Civil Law and Common Law) affect the development of the Islamic finance in the concerned jurisdictions.

We employ a cross-country regression on a sample of 30 countries observed over the period 2005-2018. We examine whether cross-country differences in Islamic financial institutions are accounted for by cross-country differences in legal tradition, and how institutional quality strengthen or weaken this relation.

Our paper finding provide evidences that: First Sharia Law has a positive and a significant effect on Islamic banking growth. As the evidence of countries adopting a legal system based on Sharia law and not influenced by western the legal tradition (common law and civil law) like Iran, Brunei and Sudan may have little impact because of institutional hysteresis. Hence, Islamic culture can be powerful force that leads to changes in institutions and consequently the development of Islamic finance in these countries

Second, mixed Civil Law/Sharia law has a positive effect on Islamic banking growth. However, the growth rate is relatively weak. This outcome could be explained by the fact that civil law adversely affects the positive effect of Sharia Law on Islamic banking development. In other world, countries adopting a mixed legal system based on both civil law and Sharia law are less flexible to make changes in their laws and to replace old laws with news laws more flexible with contractual need of Islamic finance, which promote the development of the Islamic financial industry.

Third, Common Law/Shari'a law looks as a significant determinant the Islamic finance growth, the positive sign confirm the theoretical expectation that Common Law affect favorably the positive effect of Sharia Law on Islamic banking development. Hence, countries adopting a mixed legal system based on common law and Sharia law are characterized by the flexibility of their legal system to make change in their laws to evolve in response to the changing socioeconomic conditions and therefore to develop the Islamic financial industry.

Fourth, countries adopting a combined legal system based on Civil Law/ Common Law have a non-development Islamic financial industry and characterized by a weak infrastructure for Islamic financial system.

Fifth, we find that the concentration of Muslim population (the percentage of Muslim population) has a positive effect on Islamic banking development. As well as, the level of income also has a

positive and a significant effect on Islamic banking development. As with conventional banking, rising income per capita tends to raise the number of Islamic banks in a country.

Sixth. Institutional quality affect positively the development of Islamic finance industry and strength the ef

This paper is organized as follows. Section 2 discusses the literature review on the effect of legal origin on finance development and how Sharia law can matter for the development of the Islamic finance industry. Section 3 describes the data and methodology. Section 4 discusses the regression results. Section 5 concludes.

2. Literature review:

The last decade have observe the emergence of large body of research discussing the role of legal origin on financial development and how the adaptability of Legal system in changing condition can explain the financial development. Adaptability of law means the aptitude of legal system to change on the way to satisfy the contracting needs of the new economic conditions which support the development of the financial system (Ahmed, 2006).

The law and finance theory argues that, over the time, the legal origin of different countries had influenced the evolution of their legal systems which became a crucial determinant to analysis of economic growth of these countries. In another hand, financial development is observed as a main driving force of economic growth (Graff, 2006). Hence, the legal system is recognized as one principal determinant of economic development. The causal chain proposed by this law and finance theory is accordingly:

Legal origin ➔ Legal system ➔ financial development ➔ economic growth

Many researches attempt to assess empirically the link between the legal origin and financial development. Levine (1998, 1999) explains the effect of legal origin on financial development through the long-run economic growth, and suggests that legal origin have an impact on the national financial systems which influence the economic growth. Moreover, La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1998, henceforth LLSV) demonstrate that whether a country

commercial's law have a British, French, German, or Scandinavian legal origins is critical to explain the country's laws on creditor rights, shareholder rights, and private property rights which explain the country's level of bank and stock market development.

Becks et al (2004) argue that one of the important factors that could explain the development of the financial sector is the legal system and the adaptability of laws to evolve following the emergence of the news circumstances. Adaptability concerns the 'process of law making' and implies the ability of the laws to evolve in response to the changing socioeconomic conditions (Beck et al. 2004). Nevertheless, make a changes in laws are usually slow and costly which make gap between financial needs of an economy to assure an efficient financing and financial development.

Moreover, Beck and Levine (2003) shown that cross- country difference in legal origin can explain cross- country differences in financial development and clarify how the theory of law and finance can explain why: "some countries have well-developed growth-enhancing financial systems, while others do not", and why "some countries developed the necessary investor protection laws and contract-enforcement mechanisms to support financial institutions and markets, while others have not". According to them, the ability of laws to changes depends on the legal origin of the legal system of each country, As well as, depends on the flexibility of the legal system to accept the replacement of an inefficient law by an efficient law through litigation and jurisprudence.

North (1988) argues that Britain institutions are better than France institutions. Hence, British colonies are expected to have better institutions than French colonies which can affect the financial development of these previous colonies. Hence, legal origin can be a proxy for institutions that can be related to the legal system. In addition, Stulz and Williamson (2003) explain that legal origin can be proxies for religious and cultural differences which influence financial development and differences in legal tradition, per se, are not help to explain the levels of financial development of countries. In the other side, Beck, Demirguc-Kunt and Levine (2003) show that legal origin is linked with financial development when controlling religious composition and other national characteristics.

La Porta (1997) argue that legal systems based on common law seems to be more flexible to evolve and to respond to changing financial conditions because rules can be replaced by new rules from time to time according to the doctrine of *stare decisis*. This change cannot be easy to happen when law is based on statutes and codes promulgated by the legislature under the civil law system in which laws and statutes can only be adjusted by the legislature, imposed on courts and introduced by a procedural formalism. Hence, the change of statutory law will be slow and costly in civil legal systems.

2.1 How Shari'a Legal origin can matter for Islamic finance development?

The issue of the flexibility of the legal system and the adaptability of the law to changing circumstances is crucial to the development of the Islamic financial system. The questions relating to dynamism, legal formalism, and the efficiency with which laws can adapt to changing circumstances will be a crucial factor determining the level of developing and growth of how Islamic financial sectors (Ahmed, 2006).

After the colonization, most of the Muslim countries have adopted the legal system of the colonizing countries (Common law or Civil law) with keeping some legislative instructions from the Shari'a law. Generally, these adopted legal systems don't reflect the Islamic culture and the Islamic ideology. That's why, for a long time, the lack of strong legal infrastructure institutions in Muslim countries is considered as a big challenge for the development and the growth of Islamic finance.

In fact, with the beginning of Islamic finance, Islamic financial contracts are being used, but this is being to be done in an unfamiliar legal environment. Even if there is a general agree to use Islamic contracts, the laws and courts may not be there to interpret and impose the form of these contracts (Ahmed, 2006). The development of Islamic finance with the contemporary financial transactions requires a strong support by the legal system.

3. Data and methodology:

    3.1 Sample:

We study a sample of 40 countries with different legal origins: Civil Law; Common Law; Sharia Law; mixed Civil Law/Sharia Law; mixed Common Law/Sharia Law; and mixed Sharia Law/Civil Law/Common Law origins (see Table 1). Due to the data limitations on Islamic finance data and institutional indicators, the sample is reduced to 30 countries. Table 1 describe our sample.

Table 1: Countries characteristics

Country	Primary Language	Primary Religion	Muslim	others	Legal Origin
Algeria	Arabic	Islam	0.99	0.01	Mixed Civil Law/Islamic law
Bahrain	Arabic	Islam	0.82	0.18	Mixed Common law/ Islamic law
Egypt	Arabic	Islam	0.9	0.1	Mixed Civil Law/Islamic law
Iran	Persian	Islam	0.98	0.02	Shari'a law
Jordan	Arabic	Islam	0.92	0.08	Mixed Civil Law/Islamic law
Kuwait	Arabic	Islam	0.85	0.15	Mixed Common law/ Islamic law
Morocco	Arabic	Islam	0.99	0.01	Mixed Civil Law/Islamic law
Qatar	Arabic	Islam	0.775	0.099	Mixed Civil Law/Islamic law
Saudi Arabia	Arabic	Islam	1	0	Shari'a law
Syrian	Arabic	Islam	0.74	0.26	Mixed Civil Law/Islamic law
Tunisia	Arabic	Islam	0.98	0.02	Mixed Civil Law/Islamic law
UAE	Arabic	Islam	0.96	0.04	Mixed Civil Law/Islamic law
Yemen	Arabic	Islam	0.99	0.01	Mixed Common Law/ Islamic law
Brunei	Malay	Islam	0.67	0.33	Mixed Civil Law/Islamic law
Indonesia	Bahasa	Islam	0.86	0.109	Mixed Civil Law/Islamic law
Iraq	Arabic	Islam	0.97	0.03	Mixed Civil Law/Islamic law
Kazakhstan	Kazakh	Islam	0.47	0.43	Civil Law

Country	Language	Religion			Legal System
Malaysia	Bahasa	Islam	0.604	0.395	Mixed Common Law/ Islamic law
Pakistan	Urdu	Islam	0.95	0.05	Mixed Common Law/ Islamic law
South Africa	Many languages	Christian	0.015	0.985	Mixed Common Law/Civil Law
Sri Lanka	Sinhala	Buddhist	0.067	0.924	Mixed Common Law/Civil Law
Sudan	Arabic	Islam	0.99	0.01	Mixed Common Law/ Islamic law
Tanzania	Kiswahili or Swahili		0.35	0.65	Common Law
Thailand	Thai	Buddhist	0.046	0.954	Civil Law
Turkey	Turkish	Islam	0.998	0.02	Civil Law
UK	English	Christian	0.027	0.966	Common Law
Bangladesh	Bangla	Islam	0.89	0.11	Mixed Common Law/ Islamic law
Lebanon	Arabic	Muslim	0.6	0.4	Mixed Civil Law/religious law
Oman	Arabic	Muslim	0.89	0.11	Mixed Common Law/ Islamic law

The primary language , primary religion, and the origin of the legal system for each country in the sample.

The primary religion (language) of country is religion practiced (language spoken) by the largest fraction of the population. The data on religion and language are obtained from 2011 CIA World Factbook. The percentage values for religion are from Pew Research Center[1] (2011). The Legal Origin variables are obtained from CIA World Factbook (2011).

3.2 Variables:

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[1] Data from " The Future of the global Muslim population" (2011), Pew Research center.

3.2.1 Islamic finance development indicators:

In order to measure the development of Islamic finance, we used indicators of financial intermediary development. The objective of this paper is to proxy for the degree of national financial system to facilitate the development of the Islamic financial industry and to help to mobilize saving effectively in this industry. Because we did not have a direct measure to allow us to compare the ability of national financial systems to help the broad cross-section of countries to have these benefits, we used a variety of indicators of financial growth to assess the relationships between law and the development and the worldwide growth of Islamic finance.

i.   ISLAMIC FINANCE GROWTH: to measure Islamic finance growth, we use two variables:

    a.   ISLAMIC FINANCE CREDIT GROWTH (IFCG): equal to Islamic finance credits to the private sector (financial intermediary credit to the private sector) divided by Gross Domestic Product (GDP) and measured over the period from 2005 to 2018. For most countries, this variable was unavailable. That is why we used hand collected data for this variable.

    b.   ISLAMIC FINANCE DEPOSIT GROWTH (IFDG): equal to Islamic deposits from the private sector divided by Gross Domestic Product (GDP) and calculated for the period 2005-2018. This variable was collected and calculated by the author.

ii.   ISLAMIC FINANCE CONCENTRATION: to assess the level of Islamic finance concentration, we used two proxies: Islamic Financial assets concentration and Islamic deposits concentration.

    a.   ISLAMIC FINANCIAL ASSETS CONCENTRATION (IFAC): equaled Islamic banking assets divided by the total banking assets and averaged over the period from 2005 to 2018. For our study of most countries, we hand collected this data.

    b.   ISLAMIC DEPOSITS CONCENTRATION (IDC): equaled Islamic private deposits divided by the total banking sector deposits in every country over the period from 2005 to 2018. Also, due to the non-availability of data, this variable was collected and calculated by the author.

3.2.2 Legal origin

In our analysis, we considered six legal families. Firstly, we considered the traditional families defined by La Porta et al., 1997, La Porta et al., 1998. In fact, La Porta et al., 1997, La Porta et al., 1998 classified the countries' legal origins in Common Law derived from British origin and Civil Law derived from French, German or Scandinavian countries. (i) The CIVIL LAW dummy variable equaled one if the country adopted its company/commercial law from the French, German or Scandinavian Civil Law and zero otherwise. (ii) The COMMON LAW dummy variable equaled one if the country adopted its company/commercial law from the British Common Law and zero otherwise.

Besides, and as an extension to La Porta et al., 1998, La Porta et al., 1999study, we used other data from the CIA FACTBOOK. (iii) The SHARI'A LAW dummy variable equaled one if the country adopted a pure Law from the Shari'a Law and zero otherwise. (iv)The MIXED CIVIL LAW/SHARI'A LAW dummy variable equaled one if the country adopted a mixed Law from the French Civil Law and Shari'a Law and zero otherwise. (v)The MIXED COMMON LAW/SHARIA LAW dummy variable equaled one if the country adopted a mixed Law from the French Civil Law and Shari'a Law and zero otherwise. (vi) CIVIL LAW/COMMON LAW, dummy variable equaled one if the country adopted Civil and Common Laws together and zero otherwise.

Map 1 legal system across the world (data adapted from CIA Factbook).

🟥	Common Law	🟨	Mixed Civil Law/Shari'a Law
🟦	Civil Law	🟧	Mixed Common Law/Sharia Law
⬛	Shari'a Law	🟪	Mixed Common Law/Civil law
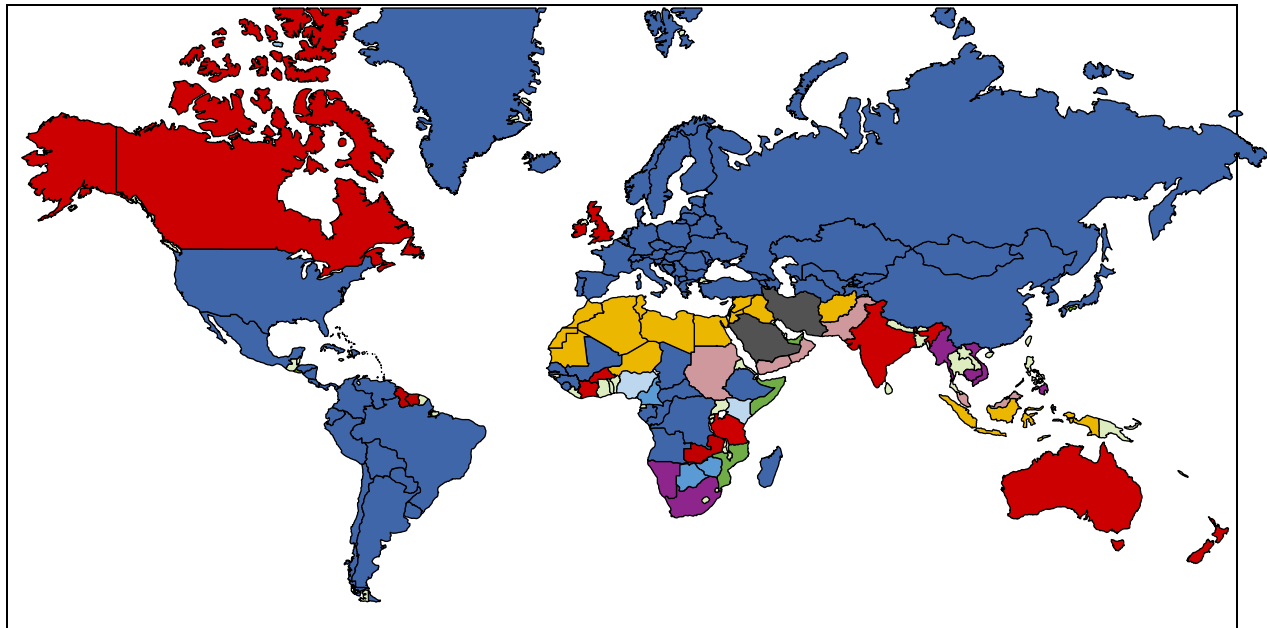
3.2.3 Institutional Quality:

We will use three variables to measure the institutional environment: (i) rules of law (ii) control of corruption and (iii) regulation quality.

a. RULE OF LAW: The extent to which agents have confidence in and abide by the rules of society, including the quality of contract enforcement and property rights, the police and the course, as well as the likelihood of crime and violence. The law subcomponent is an assessment of strength and impartiality of the legal system while order assesses popular observance of the law.

b. CONTROL OF CORRUPTION: The extent to which public power is exercised for private again, including both petty and grand forms of corruptions, as well as 'capture' of the state by elites and private interests. A high level of corruption that undermines law enforcement will be negatively related to Islamic finance development.

c. REGULATORY QUALITY: The ability of the government to provide sound policies and regulations that enables and promotes private sector development.

d. POLITICAL STABILITY: Political Stability and Absence of Violence/Terrorism measures perceptions of the likelihood of political instability and/or politically motivated violence, including terrorism. The variable ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance

These variables have been rescaled to assume values between zero and one. In all cases, larger values indicate better institutions. We expected a positive relationship between Islamic finance development and indicators of institutional quality.

3.2.4 Control variables:

To assess the robustness of our results, several other potential social and economic determinants of Islamic financial development will be involved in our model:

a. INCOME LEVEL: previous studies demonstrated that real income is strongly correlated to the development of Islamic banking (Grassa and Gazdar, 2014). We use the logarithm of the real GDP per capita in US dollars to measure the income level.

b. RELIGION: dummy variable equaled one if Islam was the country's primary religion and zero otherwise. We expect that Islamic finance is more developed in countries with higher concentration of Muslim community.

c. ETHNIC FRACTIONALIZATION is an indicator of ethnic diversity, it measures the probability that two randomly selected individuals from a given country will not belong to the some ethnic group. La Porta et al.(1999)argued that ethnic diversity led to corruption and low efficiency in governments that expropriated the ethnic losers. When we applied this view to the financial sector, the implication was that greater ethnic diversity implied

the adoption of policies and institutions focused on maintaining power and control, rather than on creating an open and competitive financial system.

d. INDEPENDENCE equaled the fraction of years since 1776 that a country was independent. We included this variable since a longer period of independence might provide greater opportunities for countries to develop institutions, policies, and regulations independent of their colonial heritage.

3.3. Model:

The model to be estimated is following:

$$Y_i = \alpha_i + \beta_1 X_i + \beta_2 Z_i + \mu_i$$

for i = 1, 2…N,

where Yi the dependent variable, is defined referring to: (i) Islamic finance credit growth (IFCG) (ii) Islamic finance deposit growth (IFDG),(iii) Islamic financial assets concentration (IFAC)and (iv) Islamic deposits concentration (IDC). X_i is a matrix of legal origin variables made up Shari'a Law, Civil Law, Common Law, Civil Law/Shari'a Law, Common Law/Shari'a Law, Civil Law/Common Law. X_i includes also institutional variables: RULE OF LAW, CONTROL OF CORRUPTION, REGULATORY QUALITY and POLITICAL STABILITY. Z_i is a matrix of control variables (INCOME LEVEL, RELIGION, ETHNIC FRACTIONALIZATION, and INDEPENDENECE). α_i is the unobserved country specific fixed effect, μ_i is the error term for each observation. Regressions are estimated using General Least Squares (GLS).

4. RESULTS

This section presents the results from regressions to assess the importance of legal families and institutional quality in explaining cross-country variance in Islamic finance development.

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Insert Tables 3 and 4

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4.1 Legal origin and Islamic finance development:

Tables 3 and 4 shows how the Islamic Assets to GDP ratio and Islamic deposits to GDP ratio differ according to legal families. In the first column of Tables 3 and 4 we present results when we introduce Shari'a Law as indicator of legal families. Our findings confirm the theoretical expectations. In fact, Shari'a Law has a positive and a significant effect on Islamic banking development. This outcome can be explained by the fact that Shari'a Law is the principles source of Islamic finance, hence government adopting Shari'a legal system are more interested to develop the Islamic finance industry.

To investigate the effect of the traditional legal families on Islamic banking, the Civil law and Common law variables are introduced respectively in the second and third columns respectively in both Tables 3 and 4. As with the conventional banking, the results indicate that, while there is a strong negative relation between civil legal origin and Islamic deposits growth. Common law variable has a positive and a significant effect on Islamic deposits growth. These outcomes are consistent with the LLSV (1998) view that countries where legal rules originate in the Common-law tradition tend to protect investors, considerably better than the Civil law countries, and especially the French civil law tradition. Law enforcement is also strong in Common law countries, whereas it is the weakest in the French Civil law countries. Therefore, the civil legal origin countries, on average have substantially lower level of financial development than the common law countries.

Our study is not only based on make comparison between the effect of common, civil and Shari'a Law, we extend our investigation on how mixed law (civil law/ Islamic law, common law/Islamic law, Civil Law/ Common Law can affect the development of the Islamic finance in these jurisdictions. Therefore in the column (4) of Tables 3 and 4, we introduce our first mixed legal family which is Civil Law/Shari'a Law. The results indicate that Civil Law/Shari'a law has a weak effect on Islamic banking development. This outcome can be explained by the fact that civil law adversely affects the strong effect of Shari'a Law on Islamic banking development. In column (5) the Common Law/Shari'a Law is introduced as indicator of mixed legal families. Our findings show that while the Common Law/Shari'a law appears a significant determinant the Islamic Assets to GDP ratio, the positive sign confirm the theoretical expectation that Common Law affect favorably the positive effect of Shari'a Law on Islamic banking development.

Finally, in column (6) the mixed Civil Law/ Common Law variable is introduced. Our findings indicate that the Civil Law/ Common Law variable has a negative effect on Islamic banking development. This result indicates in countries with mixed law (civil law/Common law) the negative effect of civil law on Islamic banking development dominates the positive one of common law. In fact, civil law hampers the positive effect of common law on Islamic banking development.

For the robustness of our results, we have considered the ratio of Islamic assets to total assets ratio as indicator of Islamic banking development. Tables 5 and 6 presents the results of estimation using Islamic assets to total assets and Islamic deposits to total deposits as dependent variables. In terms of significance the six legal families display qualitatively the same results as those of the regressions with Islamic assets to GDP ratio. In fact, while Shari'a Law, Common Law and mixed Shari'a Law/Common Law have a strong positive effect on Islamic assets to total assets ratio, Civil law, and both the mixed Civil Law/Shari'a Law, Civil Law/Common Law have a negative effect on Islamic assets to total assets ratio.

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Insert Tables 5 and 6

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4.2 Institutional quality and Islamic finance development:

Tables 7 and 8 reports the results of the impact of institutional quality on Islamic banking growth. We employed four institutional indicators to our baseline regression.

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Insert Tables 7 and 8

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Column (1) (Tables 4 and 5) we looked at the effect of rule of law on the growth of Islamic banking. Our results show that rule of law has a significant positive effect on Islamic banking assets and deposit growth. Column (2) (Tables 4 and 5) report the effect of control of corruption. Our findings show that corruption index is significant with the positive expected sign in both regressions. In regression (3) (Tables 4 and 5), regulation quality is introduced in our model. As with other institutional quality, regulation quality have a positive effect on

Islamic banking assets and deposits growth. Column (4) (Tables 4 and 5) report that political stability is an important determinants of Islamic banking assets growth.

In summary, we conclude that institutional quality are important determinant to promote the growth of the Islamic finance industry.

4.3 The effect of the interaction between legal origin and Institutional quality on Islamic finance development:

As robustness check test, we studied the effect of the interaction between the legal origin and institution quality on Islamic finance development. Table 9 reports the results of the interaction effect of the Civil Law/Sharia Law origin and quality of institution on Islamic finance development; and table 10 reports the interaction effect of the Common Law/Sharia Law origin and institutional quality on Islamic finance development.

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Insert Tables 9 and 10

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The outcomes of these two tables report that institutional quality strength the effect of legal origin on Islamic finance development.

Looking to our control variables our mains findings show that the variable Islam has a positive effect on Islamic banking development. The level of income also has a positive and a significant effect on Islamic banking development. Rising income per capita tends to raise the number of Islamic banks in a country. The effects of Ethnic fractionalization and independence are ambiguous. In fact, while they appear to have a positive and a significants effect on Islamic banking development in some regressions, they have a negative significant effect on Islamic banking in other regressions.

5. Conclusion:

The Law and Finance theory argues that that cross-country differences in legal origin help to explain differences in financial development (Beck, Demirguc-Kunt and Levine, 2002). In this paper, we tried to revise the law and finance theory by assessing the impact of the Sharia Law adopted wholly as a legal system or partially (combined with Common or Civil Law) and institutional quality on the development of the Islamic financial industry. This paper is an extension of the previous studies done by Grassa and Gazdar (2014 and 2016).

Using a cross-country analysis for 30 countries observed over the period 2005-2018 our research revealed several evidences.

First Sharia Law has a positive and a significant effect on Islamic banking growth. As the evidence of countries adopting a legal system based on Sharia law and not influenced by western the legal tradition (common law and civil law) like Iran, Brunei and Sudan may have little impact because of institutional hysteresis. Hence, Islamic culture can be powerful force that leads to changes in institutions and consequently the development of Islamic finance in these countries

Second, mixed Civil Law/Sharia law has a positive effect on Islamic banking growth. However, the growth rate is relatively weak. This outcome could be explained by the fact that civil law adversely affects the positive effect of Sharia Law on Islamic banking development. In other world, countries adopting a mixed legal system based on both civil law and Sharia law are less flexible to make changes in their laws and to replace old laws with news laws more flexible with contractual need of Islamic finance, which promote the development of the Islamic financial industry.

Third, Common Law/Shari'a law looks as a significant determinant the Islamic finance growth, the positive sign confirm the theoretical expectation that Common Law affect favorably the positive effect of Sharia Law on Islamic banking development. Hence, countries adopting a mixed legal system based on common law and Sharia law are characterized by the flexibility of their legal system to make change in their laws to evolve in response to the changing socioeconomic conditions and therefore to develop the Islamic financial industry.

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Sixth. Institutional quality affect positively the development of Islamic finance industry and strength the effect of legal origin on Islamic finance growth.

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APPENDIX

Table 3: Correlation Matrix

		A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P
IFCG	A	1.000															
IFDG	B	0.515	1.000														
IFAC	C	0.760	0.605	1.000													
IDC	D	0.613	0.961	0.669	1.000												
CIVIL LAW	E	-0.337	-0.245	-0.235	-0.266	1.000											
Common Law	F	0.386	0.279	0.279	0.305	-0.930	1.000										
Shari'a Law	G	0.008	0.475	-0.197	0.344	-0.266	0.295	1.000									
Civil Law/Shari'a Law	H	-0.472	-0.414	-0.355	-0.491	0.287	-0.241	-0.245	1.000								
Common Law/Shari'a Law	I	0.349	0.098	0.348	0.179	0.082	-0.103	-0.241	-0.515	1.000							
Religion (Islam)	J	-0.359	-0.158	-0.432	-0.209	-0.127	0.130	0.350	0.160	-0.289	1.000						
Ethnic	K	0.337	0.230	0.352	0.348	0.054	0.027	-0.120	-0.821	0.631	-0.281	1.000					
Income Level	L	0.384	0.245	0.384	0.282	0.190	-0.185	-0.042	-0.564	0.700	-0.190	0.587	1.000				
RULE OF LAW	M	0.489	0.119	0.335	0.164	0.141	-0.197	-0.068	-0.455	0.485	-0.250	0.346	0.655	1.000			
CONTROL OF CORRUPTION	N	0.381	0.269	0.396	0.318	0.197	-0.233	-0.080	-0.454	0.479	-0.114	0.386	0.760	0.846	1.000		
REGULATORY QUALITY	O	0.562	0.233	0.490	0.313	-0.032	-0.021	-0.160	-0.521	0.446	-0.468	0.407	0.584	0.828	0.796	1.000	
POLITICAL STABILITY	P	0.362	0.372	0.458	0.371	0.252	-0.338	-0.045	-0.419	0.430	-0.255	0.307	0.742	0.796	0.874	0.731	1.000

Islamic Finance Growth: equals Islamic financial assets divided by Gross Domestic product (GDP), Islamic Finance Concentration: equals to Islamic banking assets divided by total banking assets, CIVIL LAW: dummy variable equals one if the country adopted its company/ commercial law from the French, German or Scandinavian Civil law and zero otherwise; COMMON LAW: dummy variable equals one if the country adopted its company/ commercial law from the British Common law and zero otherwise; SHARI'A LAW: dummy variable equals one if the country adopted a pure Law from the Shari'a law and zero otherwise, MIXED CIVIL LAW / SHARI'A LAW: dummy variable equals one if the country adopted a mixed Law from the French Civil law and Shari'a law and zero otherwise; MIXED COMMON LAW/ SHARIA LAW: dummy variable equals one if the country adopted a mixed Law from the French Civil law and Shari'a law and zero otherwise; CIVIL LAW/ COMMON LAW: dummy variable equals one if the country adopted Civil and Common Laws together and zero otherwise; INCOME LEVEL: the logarithm of the real GDP per capita in US dollars; RELIGION: dummy variable equals one if the country's primary religion is Islam and zero otherwise; ETHNIC FRACTIONALIZATION: it measures the probability that two randomly selected individuals from a given country will not belong to the some ethnic group; INDEPENDENCE: equals the fraction of years since 1776 that a country has been independent.

TABLE 3: LEGAL ORIGIN AND ISLAMIC ASSETS TO GDP

Variables	Y= ISLAMIC ASSETS TO GDP					
	(1)	(2)	(3)	(4)	(5)	(6)
Sharia Law	0.21 (1.57)*					
Civil Law		0.223 (0.95)				
Common Law			-0.14 (0.62)			
Civil Law/Sharia Law				0.074 (2.34)**		
Common Law/Sharia Law					0.159 (0.85)	
Civil Law/Common Law						-0.003 (0.01)
Income Level	0.051 (1.39)	0.056 (1.23)	0.534 (0.77)	0.263 (0.38)	0.067 (0.08)	0.491 (0.71)
Religion (Islam)	0.619 (2.73)***	0.481 (1.97)**	0.632 (2.78)***	0.061 (0.17)	0.584 (2.67)***	0.585 (2.63)***
Ethnic	0.546 (1.15)	0.58 (1.23)	0.642 (1.33)	0.123 (2.27)**	0.771 (1.47)	0.576 (1.2)
Independence	0.484 (0.39)	0.615 (1.68)*	0.539 (1.53)	0.441 (1.3)	0.652 (1.68)*	-0.51 (1.44)
R^2	0.18	0.18	0.16	0.21	0.18	0.18

T-statistics for the coefficient are between parentheses

*** Significant at 1%, ** significant at 5% and* significant at 10%.

CIVIL LAW: dummy variable equals one if the country adopted its company/ commercial law from the French, German or Scandinavian Civil law and zero otherwise; COMMON LAW: dummy variable equals one if the country adopted its company/ commercial law from the British Common law and zero otherwise; SHARI'A LAW: dummy variable equals one if the country adopted a pure Law from the Sharia law and zero otherwise, MIXED CIVIL LAW / SHARI'A LAW: dummy variable equals one if the country adopted a mixed Law from the French Civil law and Sharia law and zero otherwise; MIXED COMMON LAW/ SHARIA LAW: dummy variable equals one if the country adopted a mixed Law from the French Civil law and Sharia law and zero otherwise; CIVIL LAW/ COMMON LAW: dummy variable equals one if the country adopted Civil and Common Laws together and zero otherwise; INCOME LEVEL: the logarithm of the real GDP per capita in US dollars; RELIGION: dummy variable equals one if the country's primary religion is Islam and zero otherwise; ETHNIC FRACTIONALIZATION: it measures the probability that two randomly selected individuals from a given country will not belong to the some ethnic group; INDEPENDENCE: equals the fraction of years since 1776 that a country has been independent.

TABLE 4: LEGAL ORIGIN AND ISLAMIC DEPOSITS TO GDP

Variables	Y= ISLAMIC DEPOSITS TO GDP				
	(1)	(2)	(3)	(4)	(5)
Sharia Law	0.06				
	(1.78)*				
Civil Law		-0.072			
		(2.64)***			
Common Law			0.138		
			(4.80)***		
Civil Law/Sharia Law				0.034	
				(0.77)	
Common Law/Sharia Law					0.014
					(1.97)**
Income Level	0.298	0.338	0.391	0.298	0.327
	(3.51)***	(4.02)***	(4.83)***	(3.54)***	(3.27)***
Religion (Islam)	0.124	0.146	0.032	0.087	0.118
	(4.23)***	(4.76)***	(0.98)	(1.74)**	(4.05)***
Ethnic	0.199	0.204	0.143	0.246	0.232
	(3.58)***	(3.76)***	(2.67)***	(3.48)***	(3.73)***
Independence	0.212	-0.198	-0.143	0.232	0.251
	(3.56)***	(3.35)***	(2.45)***	(3.91)***	(4.05)***
R^2	0.57	0.58	0.61	0.56	0.56

T-statistics for the coefficient are between parentheses
*** Significant at 1%, ** significant at 5% and* significant at 10%.

CIVIL LAW: dummy variable equals one if the country adopted its company/ commercial law from the French, German or Scandinavian Civil law and zero otherwise; COMMON LAW: dummy variable equals one if the country adopted its company/ commercial law from the British Common law and zero otherwise; SHARI'A LAW: dummy variable equals one if the country adopted a pure Law from the Sharia law and zero otherwise, MIXED CIVIL LAW / SHARI'A LAW: dummy variable equals one if the country adopted a mixed Law from the French Civil law and Sharia law and zero otherwise; MIXED COMMON LAW/ SHARIA LAW: dummy variable equals one if the country adopted a mixed Law from the French Civil law and Sharia law and zero otherwise; CIVIL LAW/ COMMON LAW: dummy variable equals one if the country adopted Civil and Common Laws together and zero otherwise; INCOME LEVEL: the logarithm of the real GDP per capita in US dollars; RELIGION: dummy variable equals one if the country's primary religion is Islam and zero otherwise; ETHNIC FRACTIONALIZATION: it measures the probability that two randomly selected individuals from a given country will not belong to the some ethnic group; INDEPENDENCE: equals the fraction of years since 1776 that a country has been independent.

TABLE 5: LEGAL ORIGIN AND ISLAMIC BANKING ASSETS CONCENTRATION

Variables	Y= ISLAMIC ASSETS TO total banking assets					
	(1)	(2)	(3)	(4)	(5)	(6)
Sharia Law	0.578					
	6.49888					
Civil Law		-0.169				
		-2.4				
Common Law			0.133			
			1.75*			
Civil Law/Sharia Law				0.022		
				2.51**		
Common Law/Sharia Law					0.109	
					1.72*	
Civil Law/Common Law						0.019
						0.06
Income Level	0.019	0.037	0.038	0.0551	0.186	0.047
	0.97	1.72*	1.71*	2.58***	0.56	2.17**
Religion (Islam)	0.129	0.293	0.167	0.427	0.224	0.233
	1.98**	4.05***	2.13**	4.14***	3.26***	3.35***
Ethnic	0.354	0.363	0.312	0.196	0.475	0.377
	2.69***	2.56**	2.03**	1.24	3.08***	2.59***
Independence	0.0388	0.267	0.23	0.132	0.085	0.158
	0.32	2.02**	1.75*	1.05	0.64	1.25
R^2	0.42	0.32	0.32	0.32	0.29	0.28

T-statistics for the coefficient are between parentheses

*** Significant at 1%, ** significant at 5% and* significant at 10%.

CIVIL LAW: dummy variable equals one if the country adopted its company/ commercial law from the French, German or Scandinavian Civil law and zero otherwise; COMMON LAW: dummy variable equals one if the country adopted its company/ commercial law from the British Common law and zero otherwise; SHARI'A LAW: dummy variable equals one if the country adopted a pure Law from the Sharia law and zero otherwise, MIXED CIVIL LAW / SHARI'A LAW: dummy variable equals one if the country adopted a mixed Law from the French Civil law and Sharia law and zero otherwise; MIXED COMMON LAW/ SHARIA LAW: dummy variable equals one if the country adopted a mixed Law from the French Civil law and Sharia law and zero otherwise; CIVIL LAW/ COMMON LAW: dummy variable equals one if the country adopted Civil and Common Laws together and zero otherwise; INCOME LEVEL: the logarithm of the real GDP per capita in US dollars; RELIGION: dummy variable equals one if the country's primary religion is Islam and zero otherwise; ETHNIC FRACTIONALIZATION: it measures the probability that two randomly selected individuals from a given country will not belong to the some ethnic group; INDEPENDENCE: equals the fraction of years since 1776 that a country has been independent.

TABLE 6: LEGAL ORIGIN AND ISLAMIC DEPOSITS CONCENTRATION

Variables	Y= ISLAMIC DEPOSITS TO TOTAL BANKING DEPOSTS				
	(1)	(2)	(3)	(4)	(5)
Sharia Law	0.599				
	(13.57)***				
Civil Law		0.023			
		(5.30)***			
Common Law			0.282		
			(5.77)***		
Civil Law/Sharia Law				0.423	
				(6.33)***	
Common Law/Sharia Law					0.088
					(2.41)***
Income Level	0.075	0.226	0.183	0.421	0.181
	(0.73)	(1.68)*	(1.36)	(3.31)***	(1.06)
Religion (Islam)	0.008	0.189	0.77	0.478	0.102
	(0.24)	(4.03)***	(1.44)	(6.56)***	(2.19)**
Ethnic	0.47	0.469	0.361	0.0477	0.641
	(7)***	(5.28)***	(3.92)***	(0.41)	(6.21)***
Independence	-0.038	0.378	0.448	0.169	0.142
	(0.57)	(4.25)***	(4.89)***	(2.06)**	(1.52)
R^2	0.76	0.59	0.58	0.61	0.54

T-statistics for the coefficient are between parentheses
*** Significant at 1%, ** significant at 5% and* significant at 10%.

CIVIL LAW: dummy variable equals one if the country adopted its company/ commercial law from the French, German or Scandinavian Civil law and zero otherwise; COMMON LAW: dummy variable equals one if the country adopted its company/ commercial law from the British Common law and zero otherwise; SHARI'A LAW: dummy variable equals one if the country adopted a pure Law from the Sharia law and zero otherwise, MIXED CIVIL LAW / SHARI'A LAW: dummy variable equals one if the country adopted a mixed Law from the French Civil law and Sharia law and zero otherwise; MIXED COMMON LAW/ SHARIA LAW: dummy variable equals one if the country adopted a mixed Law from the French Civil law and Sharia law and zero otherwise; CIVIL LAW/ COMMON LAW: dummy variable equals one if the country adopted Civil and Common Laws together and zero otherwise; INCOME LEVEL: the logarithm of the real GDP per capita in US dollars; RELIGION: dummy variable equals one if the country's primary religion is Islam and zero otherwise; ETHNIC FRACTIONALIZATION: it measures the probability that two randomly selected individuals from a given country will not belong to the some ethnic group; INDEPENDENCE: equals the fraction of years since 1776 that a country has been independent.

TABLE 7: INSTITUTION QUALITY AND ISLAMIC ASSETES GROWTH

Variables	Y= ISLAMIC ASSETS TO total banking assets			
	(1)	(2)	(3)	(4)
Rule of Law	0.474			
	6.95***			
Control of corruption		0.308		
		4.29***		
Regulatory quality			0.285	
			4.89***	
Political stability				0.114
				2..40***
Income Level	0.796	0.587	0.297	0.119
	2.96***	1.80*	1.15	1.37
Religion (Islam)	0.217	0.049	0.074	0.091
	1.31	0.63	1	1.02
Ethnic	0.113	0.105	0.307	0.234
	1.81*	0.7	2.24**	1.55
Independence	0.111	0.257	0.119	0.176
	1.96**	2.09**	0.99	1.37
R^2	0.42	0.35	0.36	0.29

INCOME LEVEL: the logarithm of the real GDP per capita in US dollars; RELIGION: dummy variable equals one if the country's primary religion is Islam and zero otherwise; ETHNIC FRACTIONALIZATION: it measures the probability that two randomly selected individuals from a given country will not belong to the some ethnic group; INDEPENDENCE: equals the fraction of years since 1776 that a country has been independent.

TABLE 8: INSTITUTION QUALITY AND ISLAMIC DEPOSITS GROWTH				
	Y= ISLAMIC DEPOSITS TO TOTAL BANKING DEPOSTS			
Variables	(1)	(2)	(3)	(5)
Rule of Law	0.269			
	(5.72)***			
Control of corruption		0.189		
		(3.76)***		
Regulatory quality			0.006	
			(2.19)**	
Political stability				0.006
				(0.19)
Income Level	0.238	0.175	0.361	0.036
	(1.38)	(0.84)	(1.63)*	(4.96)***
Religion (Islam)	0.002	0.021	0.091	0.093
	(0.04)	(0.36)	(1.39)	(1.39)
Ethnic	0.425	0.406	0.508	0.51
	(4.76)***	(4.20)***	(4.94)***	(4.94)***
Independence	0.167	0.319	0.217	0.217
	(2.00)**	(3.47)***	(2.32)**	(2.32)**
R^2	0.60	0.56	0.53	0.53

INCOME LEVEL: the logarithm of the real GDP per capita in US dollars; RELIGION: dummy variable equals one if the country's primary religion is Islam and zero otherwise; ETHNIC FRACTIONALIZATION: it measures the probability that two randomly selected individuals from a given country will not belong to the some ethnic group; INDEPENDENCE: equals the fraction of years since 1776 that a country has been independent.

TABLE 9: THE EFFECT OF LEGAL ORIGIN AND INSTITUTIONA QUALITY ON ISLAMIC FINANCE DEVELOPMENT (1)

Variables	Y= ISLAMIC ASSETS TO TOAL BANKING ASSETS		Y= ISLAMIC DEPOSITS TO TOTAL BANKING DEPOSITS	
	(1)	(2)	(3)	(4)
Rule of Law* Mixed Civil Law/ sharia Law	2.05 (7.58)***		0.022 (1.59)*	
Regulatory quality * Mixed Civil Law /Sharia Law		0.145 (1.93)**		0.012 (2.28)**
Income Level	0.571 (1.09)	0.086 (2.91)***	0.029 (3.46)***	0.029 (3.48)***
Religion (Islam)	-0.05 (1.25)	0.254 (3.65)***	0.124 (3.91)***	0.113 (3.23)***
Ethnic	0.92 (2.17)**	0.389 (2.72)***	0.205 (3.56)***	0.217 (3.72)***
Independence	0.391 (1.27)	0.173 (1.38)	0.237 (4.07)***	0.234 (3.98)***
R^2	0.30	0.29	0.56	0.56

INCOME LEVEL: the logarithm of the real GDP per capita in US dollars; RELIGION: dummy variable equals one if the country's primary religion is Islam and zero otherwise; ETHNIC FRACTIONALIZATION: it measures the probability that two randomly selected individuals from a given country will not belong to the some ethnic group; INDEPENDENCE: equals the fraction of years since 1776 that a country has been independent.

TABLE 10: THE EFFECT OF LEGAL ORIGIN AND INSTITUTIONA QUALITY ON ISLAMIC FINANCE DEVELOPMENT (2)

Variables	Y= ISLAMIC ASSETS TO TOTAL BANKING ASSETS		Y= ISLAMIC DEPOSITS TO TOTAL BANKING DEPOSITS	
	(1)	(2)	(3)	(4)
Rule of Law* Common Law/ Sharia Law	0.022		0.071	
	(2.22)***		(1.78)**	
Regulatory quality * Common Law/ Sharia Law		0.203		0.186
		(1.94)**		(2.43)**
Income Level	0.072	0.424	0.065	0.043
	(2.42)***	(1.96)**	(3.50)***	(3.14)***
Religion (Islam)	0.245	0.155	0.117	0.178
	(3.52)***	(1.95)**	(2.49)***	(3.23)***
Ethnic	0.394	0.432	0.552	0.446
	(2.74)***	(2.97)**	(5.86)***	(4.48)***
Independence	0.178	0.179	0.24	0.198
	(1.4)	(1.43)	(2.69)***	(2.24)**
R^2	0.31	0.29	0.53	0.54

INCOME LEVEL: the logarithm of the real GDP per capita in US dollars; RELIGION: dummy variable equals one if the country's primary religion is Islam and zero otherwise; ETHNIC FRACTIONALIZATION: it measures the probability that two randomly selected individuals from a given country will not belong to the some ethnic group; INDEPENDENCE: equals the fraction of years since 1776 that a country has been independent.