

THE ISLAMIC VIEW ON MONEY AND ITS IMPLICATION FOR FINANCIAL INSTRUMENTS[#]

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I. BACKGROUND OF RESEARCH

The backdrop of Islamic finance in the existing conventional framework has great influence on Islamic financial operations and instruments. Despite the advantage of becoming the most preferred products, a greater disadvantage is foreseen, alarming the whole system. Assimilation of 'Islam' into the financial system needs absolute integration in conceptual foundations and applications. The gap in Islamisation of the financial system has not only been observed in the misuse of terminology, but extends throughout the overall system. The central issues in this misconception are the functions and applications of money.

Money is an integral subject in finance and it is the lubricant of an economic system. From the Islamic point of view, money should be observed as a medium of exchange and a standard of measurement (of economic value). Money is consideration, not an object that can be traded or something that is expected to generate returns without economic activities. Money is neither a productive good nor a consumption good. Therefore, if money needs to be exchanged with money, the Islamic injunction on trading *ribawī* material is applied. Such a transaction must take place with the condition that it is on spot basis and for an equal amount. Similar to conventional finance, in Islamic finance money exchanged with money on a deferred basis has become a norm, and the repayment of loaned money with additional

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charges over the principle amount is practised (Anwar 2003). Bearing in mind such prohibitions in Islam, there are many other Islamic financial products and instruments which have been developed based on the same basis as the money creation role of the central banks and the commercial banking system.

This is where the pivotal differences concerning money in Islam and conventional finance arise. The above Sharī'ah injunction not only has been less observed in financial products and instruments, but to some extent, is unable to prevent the 'entrepreneurs' of money i.e. the financial institutions, from making 'profit'.

The activity denoted by the word 'Islam' would appear to be the activity of submitting, surrendering and delivering oneself to the safety and security of Allah (Qur'ān 66: 40). Islam as a '*dīn*' (Qur'ān 109), is a way of living, obedience to a set of rules of behaviour, a way of conduct in service of something or someone (Al-Attas, 1995). Islam therefore is:

- a) divinity-centered;
- b) rules-based; adherence to its institutional structure determines the degree to which Islam as a *dīn* constitutes the actual behavior of individuals and collectivities;
- c) universal in scope; it transcends temporal, spatial, racial, linguistic and other criteria of differentiation among humans. (Mirakhor & Hamid 2009).

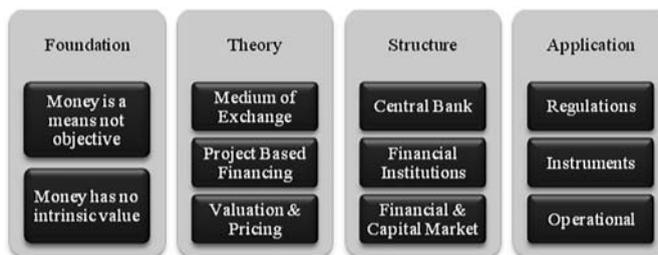
The Meta Framework of Islam is the Qur'ānic view of the conditions necessary for individual and collective human progress and wellbeing. While the Archetypal Model, i.e the ultimate frame of reference for application and implementation of the Meta framework, falls under the mainstream of compliance. The Meta Framework has drawn stern parameters on permitting sale while prohibiting *ribā* with the association of the satanic character as condemned for those who deduce that *ribā* and sale are alike. The specific verse in the Qur'ān is the longest verse and connotes significant issues regarding injustice and the opposition of the Great Creator to the current phenomenon. The epistemology of the material difference between *ribā* and sale is an intellectual challenge to guard social-ethical values and resolution of the jurisprudence puzzle. The issue of *ribā* in transactions involving an exchange and money is a serious matter and remains contemporary

until the end of the world, as mentioned by the Prophet (pbuh) when he highlighted that nobody can free themselves from *ribā*.

Looking back on the phenomenon and reality, a thorough investigation is necessary when something is associated with ‘Islam’. It is either inspired by Islam, or claims its name that signifying, or it may share nothing with Islam except a label. It may be or may not be in harmony with Islam in totality, in part, or not at all. It may be connected directly or indirectly with Islam.

Islam perceives money as a medium of exchange and unit of measure (al-Ghazali, d. 505 AH) (Ismail, 2010). Money is a means to achieve certain objectives; it is not the objective itself, and money in itself has no intrinsic utility (Usmani, 2010). Therefore, money cannot be considered as capital ($M \neq K$); which is occasionally associated with the risk-sharing element in an exchange. Money also cannot be considered as a commodity (or asset) ($M \neq C$) to enable tradability as it is just a consideration in the transaction. If profit making is the motive of an exchange, money needs to be integrated into capital by legal combination (*and assume the risk which is associated with the project/property*) $M \neq L \rightarrow K$ (Toutounchian, 2006), or be interchanged to a commodity/asset (*to assume the intrinsic utility transformation function*).

Money is a social convention and was invented based on the need to facilitate socio-economic activities. Progress in business has transformed money, and it has evolved from its original basic functions to sophisticated modern applications. Money is an integral part of the financial system and has a fundamental effect on the whole system. This research is intended to explore related questions concerning money and its implication for financial products and instruments from an Islamic point of view. The theoretical foundation of the study is as follows:



II. RESEARCH QUESTIONS AND OBJECTIVES

The market-oriented development in financial instruments has caused severe effects on the Islamic injunction. Somehow or other, if the current practice of Islamic finance is carefully observed, to some extent it ignores and unilaterally manipulates the Islamic principles. This happens due to the lack of a clear theoretical foundation, particularly about money. Therefore, this research is intended to investigate the questions:

- i. What is the theoretical foundation and implication of money in Islam?
- ii. What are the features and applications of money in Islamic finance?
- iii. What is the Shari'ah compliance that is fundamental to Islamic financial products and instruments?
- iv. Does Islam provide appropriate methods and controls for accommodating money in economics?

The main purposes of the research are to lay down the foundations of Islamic finance in the light of the Meta Framework and the Archetypal Model. What that means in detail is to:

- i. Crystallise the theoretical foundation of money and its application in the Islamic financial system.
- ii. Provide a comprehensive analysis of the functions of money and instruments in Islamic finance.
- iii. Articulate a juristic stance on money and financial instruments that identifies the principles of Shari'ah compliance.
- iv. Suggest the Shari'ah application on money and instruments in product development

III. METHODOLOGY

The research will use both qualitative and quantitative methodologies. The main focus of the qualitative method is to explore literature reviews in journals, published articles and reports, product and instrument documentation and related Acts, guidelines and regulations. On top

of that is an interview session with a Sharī'ah panel/adviser directed to investigate the process of product and instrument development. The quantitative method, meanwhile, will address three hypotheses as follows:

- a) Hypothesis I is proposed to test the relationship of the Islamic Inter-bank Rate (IIR) and Conventional Inter-bank Rate (CIR) at overnight, 1 week, 1 month and 3-month inter-bank deposit rates. The null hypothesis is $H_0 = \beta = 0$. The expected result is that both IIR and CIR have a positive relationship or unidirectional effect due to the interest rate influence of CIR (Bacha, 2008). This potentially signifies that an Islamic money market is impossible in the given conventional structure as it is in now.
- b) Hypothesis II is to test the relationship between demand on deposits and savings and the financing account of a particular Islamic bank. The null hypothesis is $H_0 = \beta = 0$. The hypothesis is expected to observe positive relationships and enables us to identify the degree of leveraging activity.

The Employed Analysis for both hypotheses is Ordinary Lease Square (OLS) Regression Analysis; using the Granger Causality Test and Pearson Pair-Wise Correlation Test.

- c) Hypothesis III is to test the relationship between the price of a stock and the real value of the particular stock in a capital market. The monthly closing price is then supposed to be aligned to monthly Net Asset Value (NAV) of a particular stock as shown below:

$$P_t = NAV_{t-1}$$

Where;

P_t = Price of stock in given time

NAV_{t-1} = Net Asset Value of particular stock at t-1

The test is structured to investigate the relationship between the above hypothesis $H_1 = 1$; or alternatively $H_1 \neq 1$. Type I error α (*probability rejecting null hypothesis when it is true*) with 95% confidence level. The expected result is the mean of the market

value of stock \neq mean asset value of the same stock. This means that the market price does not reflect the real value of the company due to unexplained interest behaviour in speculation activities.

IV. EXPECTED OUTCOME OF THE RESEARCH

From the above brief, the research expects to add new knowledge of and improvements to Islamic finance in terms of providing concepts and applications of money in Islam. The research also looks at the possibility of proposing Shari'ah-compliant financial instruments, ranging from liquid, short- and medium- to long-term instruments, at the same time supporting the real sector in sustaining economic growth and price stability. As a result, this research will enable us to suggest a prudent framework of operations based on Shari'ah-compliant financial instruments.

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