

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ
تَبَارَكَ الَّذِي بِيَدِهِ الْمُلْكُ يَوْمَ الَّذِي يَخْلُقُ مَا يَشَاءُ وَيَخْتَارُ إِنَّكُمْ كُنْتُمْ عِنْدَ اللَّهِ
وَهُوَ بِنُورِ الْإِيمَانِ إِذَا مِنْ يَتَجَمَّعُ إِلَيْهِ لِيُفْطَرِ
الْعِزِّ الْعَظِيمِ وَالَّذِينَ يَخْلَفُونَ مَا فِي الْأَرْحَامِ يُخْفُونَ الْبَصِيرَ مَنْ

Money, Islamic Banks and the Real Economy

ABDUL GHAFAR ISMAIL



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Dedication

To al-marhum my father, who inspired me to pursue my studies, to al-marhum my grandfather and my ustaz who taught me how to understand the “old” book of fiqh; to al-marhumah my grandmother who taught me how to appreciate the value of money. Al-Fatihah to all of them. To my wife who argued tirelessly about the current issues in Islamic banking.

About the Author

Abdul Ghafar Ismail is a professor of banking and financial economics at the School of Economics, Universiti Kebangsaan Malaysia. He got his PhD from University of Southampton, England. He is currently the Head, Center for Research in Islamic Economics and Finance (EKONIS) and Chairman, of the Shariah Committee of Citibank He has published extensively in several refereed journals among others; Review of Islamic Economics, Journal of Islamic Economics, Banking and Finance, Humanomics, International Journal of Social Economics, Savings and Development, Global Journal of Finance and Economics and Review of Financial Economics. His papers have also been presented in many international and local conferences, such as the International Seminar on Islamic Economics and Finance, IRTI International Conference and the Malaysian Finance Association Conference. His research interests include inter-temporal allocation of resources, earning management, capital adequacy standards for Islamic banks, and risk management. He has been a lecturer since 1987 and has been teaching several economics courses such as money and banking, financial economics, advanced macroeconomics, money and capital market in Islam, Islamic economics systems, Islamic economics analysis, and international finance.

Author's Preface

All praise be to Allah for guiding us to His law and His way, and for inspiring us with the means of realizing His higher objectives (maqasid) and outlining systematic argumentation to establish them. May Allah's blessings be upon our Prophet Muhammad (saw) through whom Allah has laid the solid foundation for reform. May His Mercy be upon the Prophet's Companions and the members of his family, luminaries of Islam and jewels in its crown, and upon the leading scholars through whom divine knowledge has radiated following the advent of Islam.

I intend in this book to develop some important discourses on three important subjects, that is, money, Islamic banks and the real economy. The discussion on money will highlight the role of money as capital. It starts with an understanding of why money is so important to the smooth functioning of the economy and how it improves human well-being, we need to understand exactly what money is. To quantify the impact of money on the economy, we need to be able to measure it. Those are the goals of this discussion: to understand what the concept of money is, how we use it, how we measure it and how we channel it to Islamic banking.

The discourse on Islamic bank will focus on the management of Islamic banks' funds. After completing this, we should be able to: explain the composition of a typical Islamic bank's balance sheet and the interrelationships between its accounts, including assets, liabilities and owners' equity; note the use and importance of Call Reports, and state why balance sheets must be accurate and timely. In this discourse, we also examine how regulators regulate and supervise Islamic banking operations.

Finally, the link between money, Islamic banks and the real economy will become the third discourse of this book. The contribution of the Islamic banking industry to the current economic order is based upon a renewed application of Islamic law (or the Shariah), in modern economic and financial transactions. These measures must be seen as integral to developing the Islamic ideals of society and economy, based on the Islamic principles of social justice and humanity.

The financial transactions in modern Islamic banking imply a conceptually different relationship between finance and economic activity. The lender-borrower link is replaced by equity risk-sharing between a capital provider (rabbul mal) and an entrepreneur (mudarib). The main consequence of this different approach of Islamic economics is the prohibition of paying or charging interest.

The elimination of interest from the economic system is meant to “promote economically just, socially fair, and ethically correct dealings according to Islamic principles, to foster the solidarity and cohesion of the ummah, harmonize trade, create powerful economic incentives, and bring about cooperation and co-participation in our economic activities.

The promotion of the Islamic economic system is suggested by trying to link monetary policy tools with the Islamic bank’s balance sheet and the Central Bank’s balance sheet. Then, a look at how financing affects the behavior of economic agents.

In addition, several learning tools will be included in this book. **Key terms and concepts** – a listing of all the technical terms introduced and defined in the chapter. **Summary** – The aim is to digest the key lessons in the chapter. **Questions** – each chapter contains several questions, both conceptual, analytical and computational of varying levels of difficulty. These questions are designed to reinforce the lessons in the chapter.

Allah knows best.

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I have also benefited from my interaction with my post-graduate students at the Islamic economics and finance programme, Universiti Kebangsaan Malaysia and with post-graduate students at the Islamic economics and finance programme, Universitas Trisakti.

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