“FAITHFUL MONEY” AS A NEW MONETARY CONCEPT OF THE ISLAMIC BANKING

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Abstract

Coinciding with the Great Recession, Islamic banks have grown rapidly and have crossed the significant milestone of increased wider acceptance at a global level. In part this is due to their unique behavior in considering both ethical and economic activities rather than focus of profit only. This presents a departure from the conventional finance systems based on the use of the interest and the time value of money. This has led to propose new pattern named 'Faithful Money' for valuation of money and for a performing monetary policy according to Islamic finance basics. This paper presents how following Islamic finance principles can offer substantive contributions to the economic and social development of the world by revealing the rational route to the vision of the highest good without the anathema of interests and debts' dependence and to embrace the goal to advance the needs of humanity as a whole.

Keywords: Faithful Money, Interest, Time Value, Islamic Banking

1. INTRODUCTION

The banking is considered one of the main components of the world financial system. It has a broad impact on the entire financial market stability and the real strength of the economy. Banking system connects the fundamental economic units and plays the role of financial intermediation. It helps in the creation of wealth through the establishment of a series of interconnected economic relations. Consequently, any disturbance in the conventional banking sector has significant implications for the overall economic, primarily due to the banks' heavy reliance on interest rates which are marked by instability and volatility.

While conventional banking uses the interest rate mechanisms to perform its financial tasks, Islamic finance, by contrast, is based on the notion of the prohibition of interest (riba). Attempts to avoid dealing in interest have led to the introduction of an interest-free banking system, commonly known as Islamic banking. Islam disallows interest but calls for trade-based banking or a system of profit and loss sharing as the basis of investment. Given the special features and characteristics of Islamic finance, modern Islamic banking has developed techniques that replace interest income with cash flows from productive sources. It particularly attempts to find more socially acceptable and attainable substitute to the interest bearing modes of financing in the desire to provide justified distribution of wealth.

Since the consecutives financial failures, the efforts of economists, experts, policymakers and governments around the world have been focused on strengthening market forces to achieve optimal economic growth and sustainable development at national and global levels. A relatively small number of individuals and corporations control huge pools of capital and find no other way to continue to make money on the required scale, than through a heavy reliance on finance and speculation. This is a deep-seated contradiction intrinsic to the development of capitalism itself. If the goal is to advance the needs of humanity as whole, the world will sooner or later have to embrace an alternative financial system. There is no other way. (Usmani, 2010) (Brand, 2014-2015) (IFSB, 2015) (El-Gamal, 2006)

Money is the most strategic factor in the functioning of any financial system. The status, value, role and functions of money in Islamic finance are different from those in conventional finance. In the conventional system, money is considered a commodity that can be sold/bought and rented against profit or rent that one party has to pay, irrespective of the use or role of the lent money in the hands of the borrower. As this is not the case in Islamic finance, the philosophy, principles and operation of Islamic finance differ to a large extent from the principles and operations of conventional finance. Islamic finance concedes money as a measure of value or a medium of exchange, this concept leads to the necessity of a new pattern of money valuation “Faithful Money”.

2. INTEREST AND TIME VALUE OF MONEY

Since the institution of interest, no discussion on a society’s duty to its offspring can be isolated from an examination on interest. The questioning of interest on theoretical grounds is not a recent development and since the ancient time, almost all of the philosophers thought about the rationality of interest. Plato regarded interest as a means whereby the rich could exploit the poor, and Aristotle believed that money was to be used in exchange not to increase at interest. (Abbadi, 1984) (AAOIFI, 2010)

Prohibitions on usury appear in all the heavenly books such as Torah, Bible and Quran:

"*If your brother becomes poor, and his ability [to earn a living] is weakened - give him a hand - so that he can live with you. Do not take from him interest; you shall fear your God and let your brother live with you. Do not lend him your money with interest, nor your food shall you lend at an increased price*". [Leviticus 25:35-37]

"*If you advance money to any poor man amongst my people, you are not to act like a money lender; you must not extract interest from him*". [Exodus 22:25]

"*They say: 'buying and selling is but a kind of usury' - while God has made buying and selling lawful and usury unlawful*". [Quran, Al-Baqarah 1:275]

However, many Jews later interpreted the prohibition on usury as applying only to loans made between Jew and Jew, not between Jew and Gentile.

Although all scholars of Islam have always condemned interest, the spread of the interest-based practices in the world economic system has lead, nowadays, to admit that the injunctions against usury from religious quarters are little more than an embarrassing appendage of backwardness. Often, the religious arguments seem unscientific and weak when placed before the articulate economists of the pro-interest camp. (Kettell, 2011)

Therefore, we should be aware of these two of the most common approaches. Of these, the simplest is that which views interest as the price of money. This approach portrays money like an item that can be bought and sold like other goods or services. It should be asked why, if money is indeed sold, how we can buy and purchase this money? Of course, money is not so much sold as lent and interest cannot therefore be the price of money. The money is the same; its material, its form, its composition and its value are equal, because all units of money belonging to the same denomination are fully equal to each other. (A.Alchian, 1950)

The second frequent argument which justify this notion: money "now" as worth more than an equal amount of money "later". Hence, with this statement interest is made to be looked at as a major and positive factor to boost economic activity even if that is to happen in total disregard for the different risks to be incurred in terms of currency rate and inflation.

Monetarism reflects how rational individuals will prefer money now to money later, because we can deal better now with money than later. Because somewhere, we have a market, we have supply and demand which determine the prices of goods and give us the big opportunities for the best deals. It is not the value of money that changes over the time, the money still the money, and as the market prices can increase in the time, it can also fall in the time easily. This rule stills obsolete. (H.Bhattacharya, 2010)(Magazine, 2009) (Soddy, 1936)

These two fundamental arguments try to justify the time value of money which justifies interest, but surely they want to make up the interest limits and ignore the ultimate definition of money that underlines the fact that the money has no quality, except that it is a measure of value or a medium of exchange. (Hansen, 1932) (Shelton, 1994)

3. FIDUCIARY MONEY UNDER CONVENTIONAL SYSTEM

Fiduciary money, another term for state money, is money whose value in exchange for goods and services. In many ways, modern fiat money bears a similarity to an "IOU" (I Owe You). An "IOU" is the amount of virtual wealth which is equal to the wealth that some members of the society have given up in favor of promises by other members to repay at late date. In a modern day goods for cash transaction, the seller receives a similar piece of paper of little or no intrinsic value. The only real distinction to be made is that these pieces of paper are printed under the authority of a central bank and are generally accepted in exchange for goods and services, whilst an "IOU" drawn up by private individual.

Nowhere in the issue of either an "IOU" or state money need an interest charge arise. The material and immaterial wealth (Gold, Silver, Intelligence…) does not bear interest to exist. It does not have to be borrowed in order to exist. It simply exists. Paper money does not bear interest in order to exist. Its existence is not dependent on loan transaction. It simply exists. However, bank money cannot be created other than by loan and therefore almost inevitably bears interest as a condition for its existence. (Patinkin, 1972) (Soddy, 1936)

It is shown that central banks from time to time increase / decrease the policy rate or buy or sell financial instruments on the open market. These so called open market operations are often undertaken not because the state wishes to repay debt or borrow money, but instead because there appears to be too much or too little money in circulation in the economy.

Whatever the course of monetary policy, a serious conflict eventually arises. Bank money supply cannot grow for ever if reserve ratios have a lower limit and the supply of state money remains fixed. The commercial banks ultimately have to increase their reserve ratios, either by calling in loans (destroys money as fast as loans are repaid and thus results a vicious recessionary cycle) or by sourcing new reserves from the state. (Wright, 1996) (Modi, 2007) (Patinkin, 1972)

In consequence, the neoclassical contention holds that money supply is a major determinant of the general price level and affects widely the degree of the inflation in an economy.

So, the purpose of the next section is to build a new pattern of money valuation which reflects the real wealth of the economy not virtual, and is not based on an interest-yielding money supply, but must be based on actual nation wealth. (Keynes, 1973)

4. FAITHFUL MONEY IS THE NEW PROPOSED PATTERN

The monetary policy in any economy has a great impact on the functioning of its financial system through their impact on the quantity and value of money. Experts in Islamic economics concede the advantages of money as a measure of value and a medium of exchange. The holy Prophet "blessings and peace for him" himself favored the use of money in place of exchanging goods with goods. The prohibition of usury in Islam is a step towards the transition to a money economy and is also a measure directed at making barter transactions rational and free from the elements of injustice and exploitation.

Giving that the ultimate definition of the money is a measure of value and a medium of exchange, the money is considered like the sole tool for measuring the wealth of a person, a company, a state or of the whole world.

So, it is unfair to find, in the world, many contradictions between the value and the quantity of money and the actual wealth. For example, almost all the poor countries (especially African countries) have very important sources of natural wealth such as gold, oil, diamond, human resources…However; their currency has very poor international value due to the currency rate and the interest which are created through the common conventional virtual practices. Their rich people must possess a huge amount of their state money to have an equal level of wealth in developed countries, even if the developed country does not have enough actual wealth like their own countries.

The second dilemma is very common throughout the globe; it is the inability to measure the actual wealth of one country through the actual quantity of money circulating in the place! This issue must be rational once the sole tool, until now, for measuring the actual wealth of individuals and corporations is the quantity of money that is possessed. However, the reality of the current economic system presents many contradictions that are shown especially in the manufacturing of money which is completely linked to the virtual wealth instead of the actual wealth, and in consequence the valuation of the money is still related to the market fluctuation which is dependent of the money supply and loans transaction, instead of the equivalent in term of actual wealth whether natural, industrial, human or others…

This discussion leads to this unresolved question: How can conventional money measure a wealth, while it is not enough wealthy in itself?

Money is created, slowly and naturally, when one commodity becomes used, in barter, as a medium of exchange. The commodity is accepted in trade, not because the acquirer plans to use it, but because he or she expects to be able to trade it again in the future. For example, in ancient China, farm tools became a medium of exchange. As the tools were used more and more for exchange and less and less for farming, they became abstracted and miniaturized.

In fact, nobody invented money. It is as natural as clothing or shelter and has emerged independently all over the world. Certainly governments are not necessary for its creation. All manner of goods have been pressed into service as money: cowry shells, slabs of salt, elaborate beaded belts, giant stone wheels and so forth. Even in modern times, if no better medium is available, people will adopt as money, whatever available commodity which is most suited for the task.

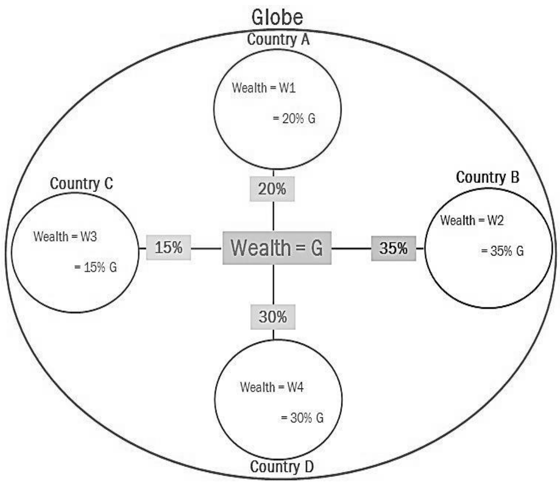
For most of the past three millennia, the world's commercial centers have used one or another variant of gold standard. A gold standard, in any of its many forms, shall be defined as a system that ties the value of money to the value of a fixed quantity of gold.

Indeed, during much of the twentieth century, major government gold holdings have been stored in the basement of the U.S. Federal Reserve. "International gold transfers" consisted of shuffling gold bars around the Federal's basement. These "gold movements" have been blamed in all manner of economic upheaval, oddly enough by people who criticize others for their supposed faith in gold's supernatural powers! It should be one of the best understood of human institutions, but it is not. That is because that the gold or silver is not the ultimate unit of measure of the wealth in the world. (Soddy, 1936) (Patinkin, 1972)

Rationally, the wealth of any nation is formed by a combination of many precious sources such as gold, silver, diamond, oil, phosphate, water, human resources, industry and others.

Therefore, it seems very pertinent to tie the money supply to the actual value of wealth, and result a true currency which reflects the actual image of the wealth; it is the faithful money which is a new pattern of money valuation such as shown in figure 1.

Figure 1. Faithful money pattern



Faithful Money Pattern is the new concept of valuation of money.

The pattern underlines a new concept of valuation of money which is based on actual wealth. In this pattern, the wealth is formed by three fundamental components of P.I.H:

- Precious resources: Gold, Silver, Oil, Diamond, Phosphate…
- Industry power: Plans, Cars…
- Human resources: Labor, Intelligence, study…

So, each nation wealth is composed by different percentages of these three components. In consequence, the globe wealth is formed by these nations' wealth.

For example, according to the pattern: G = W1 + W2 + W3 + W4.

Meanwhile, each country needs its own currency which reflects its wealth; the state is free to build its currency according to its wealth components. The state currency must be composed of a basket of the three components of wealth

(P.I.H), according to the percentage of ownership according to the valuation of each one (from the most precious).

Therefore, the money supply must reflect exactly the amount of the valuation of the nation wealth, and it should be controlled according to the state wealth changes.

Otherwise, each country need to deal with the rest of the globe, it is in the obligation to exchange currencies. In this case each state currency presents a percentage of the globe wealth (e.g. W1 = 20% G), in consequence, the globe currency constitutes the medium of exchange between foreign currencies and reflects the actual globe wealth.

The faithful money pattern aims to evaluate the actual state wealth as well as the globe wealth.

The faithful money tries to keep the monetary system more and more stable with an appropriate money supply according to the state wealth and the globe wealth.

5. CONCLUSION

It believed that the socio-economic problems facing humanity today have emanated from the unbridled creation of fictitious assets, particularly reserve currencies, and the unhindered forces of demand and supply with exploitative tools of "sovereignty" of individuals, "unfettered self-interest" and the "interest"-based corrupt financial system. Human beings could have avoided massive losses to life and property had the creation of fictitious monetary assets not been so easy and rampant. The solution lies in disciplining the creation of money, limiting self-interest with social interest and business ethics, and transforming the corrupt financial system to make it free from exploitation and games of chance, thus enabling mankind to optimally use the resources for benefits on a larger scale.

While Islamic principles of finance have proved their viability worldwide, and individual Islamic financial institutions and giant multinational groups are queuing to exploit the potential benefits, Muslim countries are not yet playing any effective role in the promotion of Islamic finance as a policy objective at the state level.

Having said that, the Islamic banking and finance industry has a large potential ahead in retail, corporate and investment banking and fund management. An inspiring performance so far and the huge potential ahead, combined with the resolution of issues which could boost the growth momentum of the Islamic finance industry, gives rise to a number of challenges. The future relies on the policymakers and the practitioners and how they face the challenges.

Indeed, the prospects for Islamic banking and finance are bright but the task ahead is challenging.

Therefore, in the absence of interest, the economic engine will be healthier in term of solvency and profitability. Furthermore, the economic efforts would be directed away from wealth transfer and towards wealth creation. The entrepreneur would share his profit with the financer according to mutual good fortune, not an arbitrary rate of interest. This is the purpose of the new concept of money valuation "Faithful Money" which is based on Islamic banking beliefs and it promotes the creation of money from an actual wealth not from fictitious assets.

The new Faithful money concept provides a solid basis for these reformatory measures, and debunk the limits of the current conventional theory of wealth creation, except of scientific evidences, by the simple unresolved question: How can conventional money measure a wealth, while it is not enough wealthy in itself?

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