

TAZKIA *ISLAMIC FINANCE & BUSINESS*

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RESERVE REQUIREMENT FOR COMMODITY TRADE
AMONG ASEAN COUNTRIES**

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THE IMPLEMENTATION OF EFFICIENT TRADE MATRIX AND GOLD RESERVE REQUIREMENT FOR COMMODITY TRADE AMONG ASEAN COUNTRIES

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Abstract

Objective - This study attempts to implement the efficient trade matrix among five selected ASEAN countries and its settlement by the gold reserve requirements through Multi-Bilateral Payments Arrangement (MBPA).

Methods – The study is a qualitative research with analytic description. The purpose of this qualitative-descriptive study is to simulate the implementation of gold in the Multi-Bilateral Payment Arrangement among ASEAN countries using the current trade data.

Results – This paper argues that the Southeast Asian countries can solve the problem through their internal coordination, particularly in terms of trade. One of the efforts is to reduce even eliminate the market risk by using the efficient payment arrangement.

Conclusions – The study implied that the quantity amount of gold required to settle the trade balance will be reduced from the early gross payment. However, the ASEAN countries need to strengthen the cooperation among them through maximizing the trade relationship.

Keywords: Asian Crisis, Efficient Trade Matrix, Gold Reserve Requirement, Commodity Trade, ASEAN

Abstrak

Tujuan – Penelitian ini mencoba untuk mengimplementasikan *efficient trade matrix* di antara lima negara ASEAN yang terpilih, dan juga penyelesaian transaksinya menggunakan persyaratan cadangan emas melalui *Multi-Bilateral Payments Arrangement* (MBPA).

Metode – Penelitian ini adalah penelitian kualitatif dengan analisis deskriptif. Tujuan dari penelitian kualitatif-deskriptif adalah untuk mensimulasikan penerapan emas dalam *Multi-Bilateral Payment Arrangement* di antara negara-negara ASEAN menggunakan data perdagangan.

Hasil – Penelitian ini berargumen bahwa negara-negara Asia Tenggara dapat menyelesaikan permasalahan melalui koordinasi internal, terutama di bidang perdagangan. Salah satu upayanya adalah mengurangi atau bahkan menghilangkan risiko pasar dengan menggunakan perjanjian pembayaran yang efisien.

Kesimpulan – Penelitian ini berkesimpulan bahwa jumlah kuantitas emas yang dibutuhkan untuk menyelesaikan neraca perdagangan akan dikurangi dari *early gross payment*. Meski demikian, negara-negara ASEAN mesti memperkuat kerjasama di antara mereka melalui maksimalisasi hubungan perdagangan.

Kata Kunci: Krisis ASIA, Efficient Trade Matrix, Persyaratan Cadangan Emas, Commodity Trade, ASEAN

1. Introduction

Gold dinar, one of the currencies that is still keeping the intrinsic value. Dinar refers to gold coins used as a medium of exchange by the Muslims from the beginning of *Khulafa Rashidin* until the end of the Ottoman Caliphate (Lee, 2011). This medium of exchange can prevent society from various crises, for instance ASEAN financial crisis in 1997. The series of currency devaluation hit Southeast Asia in 1997. This led to several protectionist regulations to ensure the stability of national currency. Generally speaking, the reason why most of the countries suffered is, that the US Dollar, which originally is unstable currency, hikes dramatically in 1997. Therefore, based on history, using gold dinar as a stable medium of exchange in order to prevent fluctuation in currency is desirable.

The Southeast Asia has been one among the fastest growing economies in the world, since 14 years after millennium. The Southeast Asian countries that comprise this dynamic region represent a developing trade and center of economic, despite its infrastructure and regulatory challenges. The countries have average growth rate of more than five percent per year over the past decade. If all these Southeast Asia countries were merged into one country, it would be the world's ninth-largest economy. It would also be the most trade-dependent, with an excess of 150 percent trade-to-GDP ratio (Brown, 2013). Nowadays, Southeast Asia has become one of the top destination for trading and investment especially during the recession in US and several of European countries around 2008.

However, the 1998 financial crisis in Southeast Asia will still be endured in mind. The Southeast Asian crisis guide some financial reforms, specifically relates to currency trading and national accounts management. The most influenced countries hit by the crisis are Indonesia and Thailand that try to recover by borrowing money from IMF. They created a series of bailouts ("rescue packages") for the most-affected economies to enable affected nations to avoid default, tying the packages to currency, banking and financial system reforms which include increased interest rates. Unlike the other countries, Malaysia prefer to far away from IMF and World Bank, to avoid raising the interest rate. Malaysia keep fixed exchange rate and disallow the currency traders from accessing the ringgit. These strategies were done by their Prime Minister Dr. Mahatir Mohamad, brought Malaysia to recover faster than the rest. He mentioned in financial times that a new "Bretton Woods" should be convened with adequate representation from the poor countries. It should consider a trading currency based on gold, against which all other currencies should be valued. The fluctuation of the price of gold would be minimal. Business would be exposed to less uncertainty. Governments should fix the

exchange rate based on gold or economic performances. There should be no trading in currencies. (Mohamad, 2012)

Almost in two decades after ASEAN crisis, ASEAN build mechanism to prevent the crisis hit them again since 1 December 1997. ASEAN goals in that time are to decide to transform ASEAN into a stable, prosperous, and highly competitive region with equitable economic development, and reduced poverty and socio-economic disparities (ASEAN Vision 2020) (ASEAN, 2008). Is it gold still possible to resolve the problem in order to achieve ASEAN vision 2020. Several summits have been done by leaders in ASEAN countries afterwards. The Leaders affirmed their strong commitment to accelerate the establishment of an ASEAN Community by 2015 as envisioned in the ASEAN Vision 2020. The leaders believed the importance of external trade to ASEAN and the need for the ASEAN Community as a whole to remained outward looking and eliminating several market barriers, so that ASEAN Vision 2020 can be achieved. The AEC envisages the following key characteristics: (a) a single market and production base, (b) a highly competitive economic region, (c) a region of equitable economic development, and (d) a region fully integrated into the global economy. These characteristics are inter-related and mutually reinforcing. Incorporating the required elements of each characteristic in one Blueprint shall ensure the consistency and coherence of these elements as well as their implementation and proper coordination among relevant stakeholders. (ASEAN, 2008)

Presently, ASEAN just have one year remaining to complete their strategy into ASEAN Economic Community in 2015. However, no one can ensure after key characteristics already settle, ASEAN will free from financial crisis that hit them heavily in 1997. Realizing most of member countries trade with US dollar as their trading currency, additionally several developed country invest their foreign reserve in ASEAN countries, this can bring them into financial crisis again due to instability mechanism. Consequently, ASEAN countries have to promote free trade mechanism with more stable currency.

In 2003, a statement by Dr. Mahatir Mohamad, prime minister of Malaysia in that time to utilize gold dinar as medium of exchange in Bilateral Payment Arrangement (BPA) with Iran. However, nothing has happened, Iran has not engaged in settlement of bilateral trade with Malaysia using gold dinar. Besides, the gulf countries, have withdrawn their gold dinar and started more discuss diversification into the Euro due to political interest. Political interest still one of the big issue of causality stagnant gold dinar as medium of exchange. The other fear of using gold dinar as medium of exchange is incapable of gold dinar to face with completely

commoditized societies in nowadays financial mechanism. (Woertz, 2006). It is always wise to implement changes gradually in order to build strong basic for the new financial mechanism of gold dinar as medium of exchange. With small changes, one may be able to monitor the impact of the changes and take necessary action where needed. (Meera & Larbani, 2004)

This paper analyses ASEAN countries trade behavior assuming gold is used as medium of exchange to settle the free trade between the countries. The objective is to determine the efficient trade matrix and level of gold required to support their commodity trade.

The specific objectives of this study therefore:

1. To analyze the efficient trade can be happened among ASEAN countries through its Multi-Bilateral Payment Arrangement (MBPA) as they start to implement ASEAN Economics Community (AEC) by the end of 2015
2. To simply simulate the implementation of trade using the gold requirement based on the commodities commonly contributed among these participated countries (Malaysia, Indonesia, Singapore, Thailand, and The Philippines) from the United Nation Comtrade database (UNCOMTRADE).

2. Methodology

2.1. Data and Analysis

The study is a qualitative research with analytic description. The purpose of this qualitative-descriptive study is to simulate the implementation of gold in the Multi-Bilateral Payment Arrangement among ASEAN countries using the current trade data. Hence, the intra-trade commodity data of 2012 for selected ASEAN (Association of Southeast Asian Nations) countries is mainly used for this study. Five ASEAN countries and five major primary commodities of these countries were used in our analysis to form a five-by-five matrix. The five countries were selected as they are the founding fathers of this association and have the major contributions to the ASEAN economy. The selected countries are: Indonesia, Malaysia, Philippines, Singapore and Thailand. The five commodities are derived from Meera & Aziz (2002) and Bashir (2012) and also commonly used between these countries. The products include: Palm oil, crude; Rice; Wheat; Crude petroleum; Meat, beef. These products are choosing base on their importance to ASEAN countries, either in term of production and consumption.

The United Nations Commodity Trade (UNCOMTRADE) data served as the main source of data used in this study. This database reports disaggregated data to six digits. Annual intra trade

commodity data for the year 2012 of the five selected ASEAN countries based on the United Nation COMTRADE SITC Revision 3 classification was used. According to (Bashir, 2012) this is because, of all the four classification under UNCOMTRADE, this classification is the one recommended for economic analysis by the provider, recommended by World Trade Organization, World Bank.

Table 1 Selected Commodities

No.	Commodity Name	Code
1	Palm oil, crude	PALM_OIL/
2	Rice	RICE_5
3	Wheat	WHEAT_US_HRW
4	Crude petroleum	CRUDE_PETRO
5	Meat, beef	BEEF

Intra ASEAN trade, import and export, of the selected products among the chosen countries for the year 2012 were used throughout this analysis. To prove and answer the objective of this paper, we decided to do analysis only on Multi-Bilateral Payments Arrangement (MBPAs) by using Microsoft Office (Excel). The reason is as there were limitations to do a nonlinear optimization as Meera & Larbani (2004) and Bashir (2012) did in the prior research.

3. Results & Analysis

3.1 The Gold Function: Played the Role of Money in International Trade

Gold money was first used during the era of the Roman and the Persian and it was widespread extending into the land of the Arabs and was adopted by the Prophet Muhammad (peace be upon him). Dinar that refers to gold coins was used as a medium of exchange since the reign of *Khulafa Rashidun* until the end of the Ottoman Empire. Islamic gold dinar is a round gold coin weighing 4.25 grams and Dirham is silver coins weighing 2.975 grams. Nevertheless, gold dinar is referred as the only sharia-compliant currency for the Muslims.

The idea of using gold dinar as money has been proposed by many Muslim scholars. Social cycles study by Ibn Khaldun states that God created gold and silver as the measure of value for all things, and he emphasizes the importance of using these two metals for that purpose. Al-Maqrizi in his book *Ighatah*, Qudamah Ibn Jaafar in *Kharaj* and al-Ghazali have the same opinion that God created the two metals to circulate as a medium of exchange and measure of value (Sanusi, 2002:73-89). Significantly, the statement is supported by the recent study of Meera and Aziz (2002), as they explain the number of advantages that have been offered by Gold Dinar as follows:

1. Stable Money

The elimination of money creation/destruction is one of the biggest advantages of the gold dinar system. The gold dinar could play its role as a store of value much better than the fiat money does in an interest-based economy

2. Excellent Medium of Exchange

Since gold is priced and referred globally, it is always valued by people of all nations and creed. The gold dinar could easily play the role of a preferred global currency.

3. Minimizes Speculation, Manipulation and Arbitrage

The speculative and arbitrage activities that take place in the current system are possibly caused by the existence of different currencies and the cross exchange rates between them. With gold dinar acting like a single currency to eliminate all these exchange rates, speculation and arbitrage will not be possible. This would further strengthen and stabilize the economy.

4. Minimizes Business Cycle Effects

In the gold dinar system, each transaction is an exchange within the real sector with actual funds. Unlike the interest-based monetary system with intermediate credit (i.e., credit cards) and virtual transactions, the gold dinar system will create a harmonious relationship between the monetary and the real sector.

5. Dinar Promotes Trade

A single currency will facilitate trade among the participating countries, bringing them closer in line with the broad principles of *Ukhuwah* (brotherhood). By fostering closer ties among the Muslim nations, it will enforce closer relationship in trade and other forms of partnership.

In the gold payment system, gold is to be used as medium of exchange and as a unit of account, in place of the national or international reserve currencies, for settling international trade balances (Meera & Larbani, 2004). As for those functions, weights of gold used as the pricing the total exports and imports. As a function, it is worth to note that gold itself is only used for pricing and not as national currencies backed by gold. The central bank would play an important role in keeping the national trade accounts, and providing a secure place to hold gold. As for implementation in ASEAN countries trade, Malaysia and Indonesia for example, will only record the trade accounting and settle the net difference periodically; hence a physical gold movement between the countries is not necessary. This structure however eliminates exchange rate risks and speculation risk as in forward, futures and options markets. If participating countries agree to use the gold dinar payment system, it is much as if the three currencies

become a single currency. Accordingly, speculation and arbitrage among the currencies will be reduced or even eliminated, thus contributing to greater economic efficiency and increasing real financial inclusion among countries.

3.2 Regional Trade Agreement

A trade agreement is classified as bilateral trade agreement (BTA) when it is signed between two countries. If the participating countries signed in the trade are more than two countries, it is classified as multilateral trade arrangements (MTA). Both agreements also called Bilateral Payment Arrangements (BPAs) and Multilateral Payment Arrangements (MPAs). Another types of trade agreement is Regional trade agreements (RTAs), RTAs is a multi-bilateral agreements with a specific objectives within the participating countries. It can be defined as groupings of countries that come together with the goal of reducing trade barrier among member countries. These groupings or union may be an arrangement between countries that do belong to the same geographical region.

According to Whalley (1998), the main reason which makes nations seek these arrangements is none other than the even mutual agreements taken to become more explicable. The most conventional objectives thought to underline a country's participation in the trade negotiation is the idea that through reciprocal exchanges of concessions on trade barriers there will be improvements in market access from which all parties to the negotiation will benefit. It is supported by the proposed idea by Yusuf et al. (2012), which state RTAs impact will lead to trade creation and trade division. The traditional theory of trade proposes that removal of trade barriers give consumer and producers opportunity to buy from the cheapest most competitive source of supply. This however will boost efficiency and promote welfare. Because of this, it was traditionally believed that regional trade blocks would create gains from trade due to member countries' decrease in trade barriers with one another.

A further objective for countries that adopt regional trade agreements is to increase their bargaining power with third countries by negotiating an agreement with common external barriers. RTAs are also used to provide access for the larger country market in the region and more security for the smaller country. To sum up, Whalley (1998) explains a final set of objectives that considers the advantages of RTAs and its purposes for the member countries to achieve their objectives.

3.3 Economic Integration among the ASEAN Countries: ASEAN Economic Community

The Association of Southeast Asian Nations, or ASEAN, was established in 1967 by the Founding Fathers of ASEAN, namely Indonesia, Malaysia, Philippines, Singapore and Thailand. Then Brunei Darussalam, Viet Nam, Laos PDR, Myanmar and Cambodia are joining along the way, making up what is today the ten member States of ASEAN. The ASEAN leaders at their summit in 1997 decided to transform ASEAN into a stable, prosperous and highly competitive region with equitable economic development, and reduced poverty and socio-economic disparities, later known as ASEAN vision 2020.

At the Bali summit in 2003, ASEAN leaders declared that the ASEAN Economic Community (AEC) shall be the goal of regional economic integration. The AEC, as espoused in the vision of 2020 is based on a convergence of interests of ASEAN Member countries to deepen and broaden economic integration through existing and new initiatives with clear timelines. AEC will establish ASEAN as a single market and production base making ASEAN more dynamic and competitive with new mechanisms and measures to strengthen the implementation of its existing economic activities; accelerating regional integration in the priority sectors; facilitating movement of business persons, skilled labor and talents; and strengthening the institutional mechanisms of ASEAN. Based on these and taking into considerations the importance of external trade to ASEAN and the need for ASEAN Community as a whole to remain outward looking, the AEC envisages the following key characteristics:

1. A single market and production base
This idea comprises five core elements:
 - (a) free flow of goods;
 - (b) free flow of services;
 - (c) free flow of investment;
 - (d) free flow of capital; and
 - (e) free flow of skilled labor.
2. A highly competitive region
3. A region of equitable economic development
4. A region fully integrated to the global economy

ASEAN has ready to participate in regional trade arrangements, also preparing to compete globally. This will support the idea of Regional Trade Agreements in trade creation and trade division, the challenge is then how to implement this types of trade agreements using gold dinar.

3.4 Implementing the Gold Dinar in ASEAN Regional Trade Agreement

The trade agreement among the ASEAN countries has been conducted for many years before. It uses US dollar currencies in settling the trade, in which they have to manage foreign exchange risk to minimize its impacts to their national currency. The worst crisis faced by ASEAN member countries is when the 1997 East Asian financial crisis, The Malaysia, Thailand, Singapore and Indonesia lost billions of dollars due to the collapse of their respective currencies. They were struggled and scrambled to save themselves from speculative attacks on their currencies. The use of gold in the transaction is the best solution to tackle this issues regarding fiat money. Mundell (2001) avers that the best path to international monetary reform is through a new international currency based on G3 monetary union possibly linked to gold.

Implementing gold dinar for settling international trade balances only replaces international reserve currencies, like dollars, with implications for the national currency. As mentioned in the study conducted by Meera and Larbani (2004), gold dinar in the trade settlement system need not exist in physical form. However, external trade needs to be denominated in dinar, i.e. a standard unit of weight of gold. All external trade transactions need the presence of central banks from respective countries to keep the trade accounts. Exporters will be paid in gold, or in their own national currencies, by their respective central banks on the due date of exports, based on the gold dinar exchange rate prevailing at the time of the transaction. Similarly, the importers will make payments to their respective central banks. The commercial banks are viable intermediaries, between the importers and exporters on one side and the central bank on the other.

Practical examples mentioned by Meera and Larbani (2004) is when countries involve in the trade, the gold accounting is kept through the medium of the central banks and only the net difference between the countries is settled periodically by the transfer of an equivalent amount of gold. Hence, every transaction, in essence, involves gold “movement”. Nonetheless, a physical transfer of gold from one country to another is not necessary, but only a transfer of beneficial ownership in gold custodian’s account. The custodian role can be played by reputable banks like the Islamic Development Bank (IDB), or the Bank of England or any others banks. The role of the custodian could be expected to decrease the default risk and, thereby, increase confidence in the system. However, as mentioned earlier, any gold that needs to be settled can always be brought forward for settling future transactions. Where it is not possible to transfer gold, payment can be made by way of an equivalent amount in other acceptable currencies, using the real-time gold price. Through this structure, gold would only play the role of a unit of account. Only the net balance remaining in the matrix of trade needs to be settled in gold. A

smaller amount of gold through net settlement balance can settle a larger trade matrix in RTAs. Countries should aim for such efficient trade so that the system need not stock up large amounts of gold.

3.5 The Challenges in Implementing Multilateral Payment Arrangement (MPA) among ASEAN countries

There have always been challenges to implement the initiation of currency union though its benefits has been discussed by some empirical researches. The most discussed one is the significant increase in the trade integration which will benefit to all members. As Alberto Alesina (2002) shows the strong relationship between country and international trade through the 85% ratio of the number of currencies to the number of countries between 1947 and 2001. It is strengthen by Rose in Alberto Alesina (2002) that even a bilateral trade of the same currency will be different for 200% compared to the same currency countries. Others may vary from 100, 220, and 290% in the result of the currency union as concluded in Bacha (2008).

In the particular area of implementing in ASEAN countries, Bacha (2008) comprehensively discussed benefits which are shown below:

1. It will be beneficial for ASEAN countries so they will be able to reduce their emerging market risk premium.
2. Other than goods trade between countries, it will encourage more development of the regional financial markets integration.
3. It is however can decouple from being reluctant to the external currencies, in particular the US\$.

In addition, the common currency discussed in the case of ASEAN brings other advantages, not only minimizing exchange rate risk but also reducing transaction cost due to currency conversion. As for the trade, it will stimulate a faster growth, competitiveness and efficiency.

Gold however is proven as the best real money for many centuries since the Roman Byzantine up to the breakdown of Bretton Woods in 1971. Its characteristics has fulfilled the requirements of becoming good money; valuable for its own, homogenous, stable, durable, divisible, mobile, and play the role of a stable floating exchange rate system. As such, gold can be expected to significantly increase trade (Meera & Larbani, 2004).

Implementing the gold based as the common currency in international trade would be beneficial for ASEAN countries, as this idea proposed by one of the leaders, Dr Mahathir Mohamad. The

main difference in the application is that in the bilateral and multilateral trade settlement systems, the gold dinar need not exist in its physical form.

The further detail is explained in Meera A. K (2004), the main play role will be the central banks of participating countries in the implementation of the gold dinar in the bilateral and multilateral trade settlement mechanisms. All external trade transactions pass through the central banks that keep the trade accounts. Exporters and importers will do the transaction in their own national currencies based on the gold exchange rate on the time of transaction and get the payment on the agreed date. In the operationalization area, it is the commercial banks that support gold accounts through the accounts would take place in the implementation of the gold dinar with individual businessmen, corporations and traders. These commercial banks would, in turn, deal with the central bank for their respective gold accounts. Through the points of what have been discussed in those literature, the implementation of efficient trade can be happened among ASEAN countries particularly as they start to implement ASEAN Economics Community (AEC) by the end of 2015. A set of applied case is shown in the next topic to prove that this settlement may really occur in Multi-Bilateral Payment Arrangement (MBPAs)

3.6 The Simulation of Multi-Bilateral Payments Arrangement (MBPAs)

a. Conditions of the Multi-Bilateral

In the actual efficient trade matrix model by Meera & Larbani (2004) and Bashir (2012), needs and potentials of these countries need to be computed using non-linear programming as discussed under the theoretical frame work. Yet as we mentioned before, there are limitations to do so, we just display the amount of potential export and import in the participated countries. The 2012 price for product k was taken the World Bank primary commodity prices and converted to the gold equivalent in ounce for 2012 as shown in Table 2.

Table 2 Price of Commodity in US\$ and Gold

No.	Commodity Name	Price (in \$/unit)	Converted Price (in Gold/unit)	Source
1	Palm oil, crude	\$999.3/mt	0.60/mt	World Bank Commodity Price Data (nominal price)
2	Rice	\$544/mt	0.33/mt	
3	Wheat	\$304.3/mt	0.18/mt	
4	Crude petroleum	\$105.01/bbl	0.06/bbl	
5	Meat, beef	\$4,140/mt	2.48/mt	
Note : \$ = US Dolar ; mt = metric ton ; bbl = barrel ; kg = kilogram ; Gold (measured in toz, troy ounce of gold = \$1670/toz)				

The commodities' data was obtained from UNICOMTRADE, the price per unit of each of the commodity and the price of gold per ounce in dollar were obtained from the World Bank. We assume prices are fixed for the trading period. In table 1, the first column presents the serial number of the selected products; column 2, the products; column three shows their code according to UNICOMTRADE; column 4 the dollar prices and the last column show their corresponding gold prices.

Table 3 Potential Export in 2012

Countries Potentials (p)	Products (1000 ton)				
	Palm Oil, crude (mt)	Rice (mt)	Wheat (mt)	Crude Petroleum (bbl)	Meat (mt)
Indonesia (1)	7252.519	0.897176	0.044051	1785.405	0.000962
Malaysia (2)	4801.874	0.931329	3.991097	1427.371	3.438657
Singapore (3)	3.30961	109.8914	1.857251	0.003727	6.525063
Thailand (4)	218.4285	6734.427	0.005014	258.799	19.823713
Phillipines (5)	34.7598	3.934046	0.005128	100.6521	0.05237

Source: Author's Computation based on UNCOMTRADE data

Table 4 Import (Maximum quantity needed) in 2012

Countries Import max. (t)	Products (1000 ton)				
	Palm Oil, crude (mt)	Rice (mt)	Wheat (mt)	Crude Petroleum (bbl)	Meat (mt)
Indonesia (1)	-	1810.372	6250.49	1496.478	33.50644
Malaysia (2)	825.8028	1005.968	1028.637	1311.525	123.662
Singapore (3)	536.1833	1022.801	168.3941	5594.786	27.43691
Thailand (4)	-	357.8475	2581.987	5019.082	25.16432
Phillipines (5)	-	26.94922	2999.126	1057.087	85.09613

Source: Author's Computation based on UNCOMTRADE data

Table 3 shows the potential export of the selected products by the selected countries in 1000 tons of the designated weight. Palm oil, rise meat and wheat are measured in kilogram while crude petroleum is measured in barrel. The last row shows that Philippines exports 34.7598 thousand ton of palm oil crude; 3.934046 thousand ton rice; 0.005128 thousand ton of wheat; 100.6521 cubic barrels of crude petroleum and 0.05237 thousand ton meat.

Table 4 presents volume of imports for selected products for selected countries. Column one presents the countries with their serial numbers. The first row of the table shows that Indonesia imports 1810.372 thousand rice; 6250.49 thousand ton of wheat; 1496.478 cubic barrels of crude petroleum and 33.50644 thousand ton meat respectively.

b. The Results of the Multi-Bilateral Payments Arrangement (MBPAs)

As stated earlier, we simplify to get the settlement amount of the Multi-Bilateral Payments Arrangement (MBPAs). First step, we computed the payment due from one country to another and converted them to the gold equivalent in ounce for 2012. Then putting these in a matrix gives us the multi-bilateral setup as shown in Table 5. The total trade amount is **8,540,892.11** ounce of gold among the five countries. The table also provides each country with a target gold holding for the trading period, the payment is due from column to row. Column three shows that Singapore will pay Indonesia, Malaysia, Thailand and Philippines the sum of 1,146,639.42 ounce of gold, 231,553.36 ounce of gold, 179,827.19 ounce of gold and 32,897.64 ounce of gold respectively. The result of Meera and Larbani (2004), and (Yusuf et al., 2012) show as the quantity of gold needed to settle trade balances reduces from gross settlement to multi-bilateral to multilateral trade arrangement, confirming that cooperation pays. Meanwhile, in our study we only get the result of multi-bilateral trade arrangement (MBPAs).

Table 5 Result of the Multilateral Payments Arrangement in ounce of gold

Gold (toz)	Indonesia	Malaysia	Singapore	Thailand	Philippines	Export
Indonesia		499,765.26	1,146,639.42	795,351.01	11,325.47	2,453,081.16
Malaysia	930,861.91		231,553.36	1,109,348.59	170,890.38	2,442,654.25
Singapore	347,550.96	340,506.88		197,899.83	19,579.95	905,537.62
Thailand	899,994.69	1,363,715.76	179,827.19		24,363.97	2,467,901.61
Philippines	12,058.43	200,152.08	32,897.64	26,609.32		271,717.48
Import	2,190,466.00	2,404,139.98	1,590,917.62	2,129,208.74	226,159.76	8,540,892.11

Source: Author's Computation

Table 6 shows the import and export payment, in ounce of gold, due from each country. Indonesia export total amount 2,453,081.16 ounce of gold to the rest four countries and import total amount of 2,190,466.00 ounce of gold from the rest four countries, thus Indonesia need to receive 262,615 ounce of gold from other country. With a net payment of only 685,380 ounce of gold takes place a total trade of 8,540,892.11 ounce of gold among the 5 countries.

Table 6 Multilateral Payment Arrangement in Ounces of Gold

Gold (toz)	Export	Import	Net Settlement
Indonesia	2,453,081.16	2,190,466.00	262,615
Malaysia	2,442,654.25	2,404,139.98	38,514
Singapore	905,537.62	1,590,917.62	-685,380
Thailand	2,467,901.61	2,129,208.74	338,693
Philippines	271,717.48	226,159.76	45,558
Total	8,540,892.11	8,540,892.11	0

Source: Author's Computation

The net settlement due from country to country is presented in Table 7. A minimum ounce of gold 685,380 needed to settle whole trade with a simply way: Singapore pays Indonesia,

Malaysia, Thailand and Philippines the amount of 262,615 ounce of gold, 38,514 ounce of gold, 338,693 ounce of gold and 45,558 ounce of gold respectively.

Table 7 Bilateral Payment Arrangement

Payment of The Country	Amount in Gold (toz)
Singapore pays Indonesia	262,615
Singapore pays Malaysia	38,514
Singapore pays Thailand	338,693
Singapore pays Philippines	45,558
Minimum Gold Needed	685,380

Source: Author's Computation

The main difference will be seen if we compare the net settlement in ounces of Gold and US dollar. The amount to be settled between these five ASEAN countries have to reach **\$1,144,584,610** as the reserve with the exchange risk involved.

Table 8 Multilateral Payment Arrangement in US\$

Gold (toz)	Export	Import	Net Settlement
Indonesia	4,096,645,529	3,658,078,222	438,567,307
Malaysia	4,079,232,594	4,014,913,768	64,318,826
Singapore	1,512,247,819	2,656,832,429	-1,144,584,610
Thailand	4,121,395,694	3,555,778,597	565,617,097
Philippines	453,768,184	377,686,804	76,081,380
Total	14,263,289,820	14,263,289,820	0

Source: Author's Computation

4. Conclusion

This study examined the net settlement that can be achieved between ASEAN five countries in trade agreement. The previous research by Meera & Larbani (2004) is a theoretical paper in mathematical model while Yusuf et al. (2012) enriched this study by analyzing an empirical study across five OIC countries. Among these are synchronous findings and similarity, it is also found in this study that the net settlement for five ASEAN countries and five major primary commodities of these countries in 2012 is decreasing. The results show that the amount of settlement reduces to 685,380 ounce of gold from the total payment of 8,540,892.11 ounce of gold with Multi-Bilateral Payments Arrangement (MBPAs).

In line with the previous studies, it can be concluded that using gold dinar system as common currency in RTAs, especially to settle larger trade matrix with the small amount of gold, is highly recommended. In further, the more beneficial will be attained as more countries apply this settlement. It can be obviously evident from the decreasing risk in emerging market premium and reluctant to US dollar.

This study has presented the possibility for ASEAN countries to consider gold as the efficient unit of measurement for intra-trade among them. However, the study has number of limitations: the major one is the lack of reliable and available data at the disaggregated level, the same problem with Yusuf et al., (2012). Other than that, we do not apply the nonlinear optimization solution for MBPAs as the prior research did. As for Multi-Bilateral Payments Arrangement (MPAs), a further study need to be conducted especially using the same method to find the minimum and maximum potential of their trade. At the same time, it will provide a further reduction for minimum gold amount required to settle the payment.

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MASLAHAH AND STRATEGY TO ESTABLISH A SINGLE STATE-OWNED ISLAMIC BANK IN INDONESIA

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Abstract

Objective - The market share of Islamic banking in Indonesia has continually decreased from 4.89% in 2013 to 4.85% in 2014 and 4.83% in 2015. As a result, the idea to establish a single state owned Islamic Bank occurs. This conceptual paper aims to contribute the *maslahah* framework regarding the future of Islamic banks in Indonesia.

Methods - The methodology that used in this paper is a qualitative method which supported by quantitative data that align with the theory of the benefit of the *Ummah (maslahah)* and the community theory.

Results - The breakthrough to increase the market share and deliver Indonesia becoming an Islamic financial hub is the option to convert the BRI as the biggest retail bank to a full fledge Islamic bank, and the next action is to acquire the Islamic banks which are subsidiary of conventional state-owned banks (Bank Syariah Mandiri-BSM, Bank Nasional Indonesia Syariah-BNIS, Bank Rakyat Indonesia Syariah-BRIS, and Bank Tabungan Negara Syariah-BTNS).

Conclusions - Establishing a single state owned Islamic bank is beneficial for the future of Islamic banks in Indonesia

Keywords: State-owned Islamic bank, Conversion, Acquisition

JEL Classification: G02, G14, G21

Abstrak

Tujuan – Pangsa pasar perbankan syariah di Indonesia terus mengalami penurunan dari 4,89% di tahun 2013 ke 4,85% di tahun 2014 dan 4,83% di tahun 2015. Akhirnya, muncullah gagasan untuk mendirikan Bank syariah milik Negara. Penelitian konseptual ini bertujuan untuk memberikan kontribusi kerangka kerja masalah terkait masa depan perbankan syariah di Indonesia.

Metode – Metode yang digunakan dalam penelitian ini adalah metode kualitatif didukung dengan data kuantitatif yang bersinggungan dengan teori masalah dan teori komunitas.

Hasil – Terobosan untuk meningkatkan pangsa pasar dan menjadikan Indonesia sebagai pusat keuangan Islam adalah pilihan untuk mengkonversi BRI sebagai bank retail terbesar menjadi Bank Umum Syariah, kemudian dilanjutkan dengan akuisisi bank syariah lainnya yang merupakan anak perusahaan dari bank konvensional milik negara. (Bank Syariah Mandiri-BSM, Bank Nasional Indonesia Syariah-BNIS, Bank Rakyat Indonesia Syariah-BRIS, and Bank Tabungan Negara Syariah-BTNS).

Kesimpulan – Mendirikan hanya satu bank syariah milik negara adalah bermanfaat bagi masa depan perbankan syariah di Indonesia.

Keywords: State-owned Islamic bank, Conversion, Acquisition

JEL Classification: G02, G14, G21

1. Introduction

Indonesia is the fourth largest population in the world, and more than 85% of the population are Muslims. That makes Indonesia, the country with the largest Muslim population in the world (Pew Research Center, 2015). On the other side, Indonesia also has big portions of middle class, according to the data from Bank Indonesia (BI) 2010 is 56.5% of the total Indonesian population (Pew Research Center, 2015). Statistical data from the Central Bureau of Statistics in 2010, the population of Indonesia is 237.641.326 people, so that the number of Muslims in Indonesia are 201.995.127 people and the middle class population of Indonesia is 134.267.349 people. Based on those data, Indonesia is an attractive economic potential (emerging markets) to develop Islamic banking.

Emerging markets are countries with rapid economic growth. These countries are generally located in the eastern part of the world that are characterized by having a high number of populations such as Brazil, Russia, India, China and Indonesia (Uribe and Yue, 2006). Furthermore, the emerging market creates a high demand in the *Shariah* industries such as fashion, travel, hotel, food, etc. (Alamsyah, 2013) and also a very prospective potensial market for Islamic banking, especially in Indonesia. This is indicated by the data assets of Islamic banking growth year on year (yoy) in September 2013 reached 35%. The growth is the highest achievement in Islamic banking industry in previous years and even exceed conventional banking assets yoy growth which is only reached 17.4%. Furthermore, the average growth of the Islamic banking in the world is 15% to 20% per year (Alamsyah, 2012). The comparison of data between the Islamic banking growth and conventional banking growth yoy are as follows (Indonesian Banking Statistic and Indonesian Islamic Banking Statistics, December 2015):

Table 1 Data yoy Asset Growth in Banking Business

	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15
Conventional Banking	18.73%	21.40%	16.69%	16.23%	13.34%	9.12%
Islamic Banking	47.55%	49.17%	34.06%	24.23%	12.41%	8.78%

Source: Indonesian Banking Statistic and Indonesian Islamic Banking Statistic, December 2015

According to Table 1 Islamic Banking growth in Indonesia between 2013 until 2015 has decreased compare to the 2010 to 2012 period when the asset growth rapidly grew. It showed that the growth of Islamic Banking does not sustain among the year. The impact of the decreasing is the decline of the Islamic Banking market share as follows:

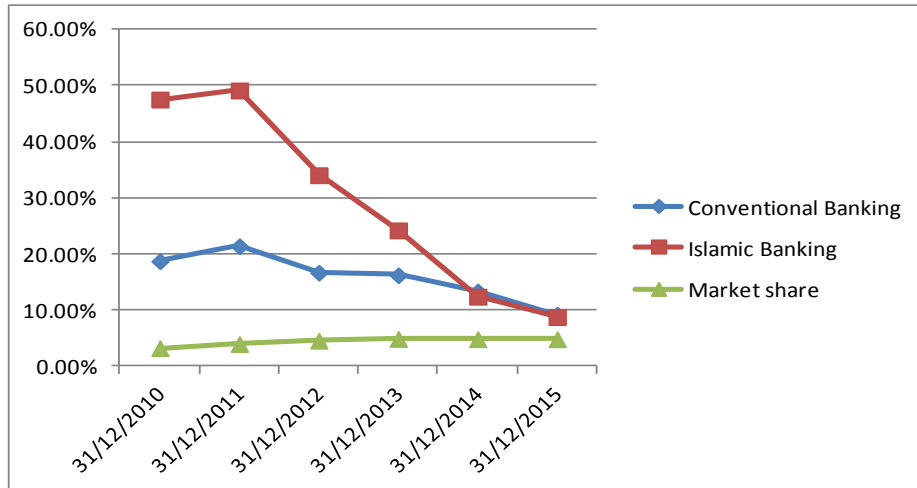


Figure 1 Market Share of Islamic Banking

Source: Indonesian Banking Statistic and Indonesian Islamic Banking Statistic, December 2015

Table 2 Market Share of Islamic Banking

Year	31/12/2010	31/12/2011	31/12/2012	31/12/2013	31/12/2014	31/12/2015
Market Share	3.24%	3.98%	4.58%	4.89%	4.85%	4.83%

Source: Banking Statistics Indonesia and Indonesian Islamic Banking Statistics, December 2015

Based on the conditions above (Figure 1), the growth of Islamic banking in Indonesia has decreased since 2010 until 2015. In the otherside, there is also the great challenges that immediately facing in the near future, the ASEAN Economic Community from 2015 to 2020. Based on the asset scale perspective, Islamic banking in Indonesia has a lower asset than Islamic banking in Malaysia, even though Malaysia has a fewer Moslem population than Indonesia. There are currently two Islamic banks (Bank Syariah Mandiri and Bank Muamalat Indonesia) in Indonesia which reach the asset above Rp40 trillion but still below Rp70 trillion. While in other ASEAN countries, they have more than one Islamic banks that its assets had reached Rp175 trillion (Alamsyah, 2013). Related to this condition, there is a large gap between the Indonesian Islamic banking assets with Islamic banking assets in ASEAN countries which could lead to the exploitation of the potential opportunities in Indonesian economy if domestic banks can not prepare business strategies to anticipate the future competition in the ASEAN region. Therefore, to catch up with ASEAN countries, it is necessary to support Islamic Bank business with the government policies and regulation in term of the existence of Islamic banking to meet the needs of the Indonesian Muslim community financial transaction services.

The interest of the world community towards Islamic banking in the aftermath of the global economic crisis has increased since the Islamic finance, particularly Islamic banking the alternative to reduce the possibility of a global economic crisis in the future. This is due to

Islamic banks that have market discipline which is able to monitor and to maintain between the balance of credit or financing growth with the real sector growth (Ahmed, 2010). In addition, compare to conventional banks, Islamic banks aims at not only improving its financial performance, but also on the distribution of welfare such as poverty alleviation (financial access for the poor and remote communities) and also providing care in realizing social welfare for the people. These concerns are also aligned with the Islamic bank's commitment to achieve economic objectives of Islam (*maqashid sharia*) which includes social justice, equitable distribution of income and wealth and economic development supports (Dusuki, 2008.).

The challenges of development and growth of Islamic banking in Indonesia are different from Islamic banking in other countries. The impact is on the stagnation condition of Islamic banking growth in Indonesia. This stagnancy of Islamic banks in Indonesia also can be traced by the histories. The history and the causes of the establishment of Islamic banks in various countries including in Indonesia is as follows (Syufaat, 2011, Nugroho and Chandra, 2014):

The development of Islamic banks in Europe is an alternative for investors from the Middle East to keep their funds as a result the blessing of petrodollars. Furthermore, the United Kingdom impose a policy to encourage conventional banks to maintain the fund from Middle East investors and provide incentives and facilities for conventional banks to open *sharia* services in the country.

The development of Islamic banking in Malaysia is driven by the government's role by making policies which result in the rapid growing of Islamic banks (government driven). The development of Islamic banking in Malaysia occurs because it has the desire to become a hub for international Islamic funds. Malaysian government policies and regulations, in the form of tax breaks and incentives to get license and placement of public funds in Islamic banks, become a potential opportunity for investors to open Islamic banks. A milestone in the establishment of Islamic banking is the establishment of Bank Islam Malaysia Berhad (BIMB) in 1984.

The Islamic Banking in Indonesia develops fairly late because Indonesia has not only a secular constitution which separates between religion and economic activity, but also it is because of the Pancasila (five pillars) as the Indonesian fundamental way of life which recognizes the freewill of people to hold a religion as their values (Christian, Budha, Hindhu, Catholic, Kong Hucu, and Islam) even though the majority population in Indonesia is Moslem, which is around 85% (Bureau statistic of Indonesia, 2010). The Muamalat Bank is the pioneer of Islamic Bank in Indonesia. Bank Muamalat was founded in 1992 caused by the encouragement and demand of the association of Muslim scholars (ICMI), an association of the scholars (MUI) and several

Muslim businessmen. The reason for the request is the presence of Islamic banks are very important to support business activities and also to the principles of Islam as a whole (*Kaffah*).



Figure 2 The Development of Islamic Bank Among Countries in The World
Source: Nugroho and Chandra, 2014

The reasonable thing when Indonesian Islamic Banks has not been able to compete with Islamic Banks in other countries is because they have long existed and have the support from the community, government policy and regulation, and legislation that specifically regulate the Islamic banking system.

The objective and contribution of this paper is to support the government to establish the state-owned Islamic Banking (BUMN) in Indonesia in order to create a benefit the community (Ummah) as an effort to maintain the five basic requirements (*maqasid sharia*), which are religion, life, intellect, lineage and property (Rivai, et.al, 2012). Governments have an important role in realizing the economy that brings prosperity through economic justice and income inequality (Chapra, 2001). The verses of the Qur'an which show the importance of the government role are as follows:

يَا أَيُّهَا الَّذِينَ آمَنُوا أَطِيعُوا اللَّهَ وَأَطِيعُوا الرَّسُولَ وَأُولِي الْأَمْرِ مِنْكُمْ فَإِنْ تَنَازَعْتُمْ فِي شَيْءٍ فَرُدُّوهُ إِلَى اللَّهِ وَالرَّسُولِ إِنْ كُنْتُمْ تُؤْمِنُونَ بِاللَّهِ وَالْيَوْمِ الْآخِرِ ۚ ذَلِكَ خَيْرٌ وَأَحْسَنُ تَأْوِيلًا

Meaning: "O you who have believed, obey Allah and obey the Messenger and those in authority among you. And if you disagree over anything, refer it to Allah and the Messenger, if you should believe in Allah and the Last Day. That is the best [way] and best in result (An-Nisa: 59)".

This verses related to the value of the government's role (Choudhury, 2010) that the public must accept. The Conditions of growth and market share in Indonesia nowadays need a government intervention because the Islamic Bank's market share in Indonesia still tends to decrease and during five years from 2010 to 2015 the market share still trapped below 5%. Government intervention is permitted in term of ensuring the community or Ummah which can carry out their religion in the case of worship and daily activity or muamallah in totality or kaffah, this is stated in Qur'an Surah Al-Baqarah: 208:

يَا أَيُّهَا الَّذِينَ آمَنُوا ادْخُلُوا فِي السِّلْمِ كَافَّةً وَلَا تَتَّبِعُوا خُطُوَاتِ الشَّيْطَانِ ۚ إِنَّهُ لَكُمْ عَدُوٌّ مُّبِينٌ

Meaning: "O you who have believed, enter into Islam completely [and perfectly] and do not follow the footsteps of Satan. Indeed, he is to you a clear enemy."

2. Research Methodology and Literature Review

2.1 Research Methodology

This research uses secondary data which consist of the annual report of state-owned banks and Islamic banks that exist as a subsidiary of state-owned banks by December 31, 2015. The data is from Bank Indonesia statistics and the Indonesian Islamic Banking Statistics 2015. The research method is based on a qualitative research framework supported by quantitative data to explain the evidence. The object of study is the amount of assets and human resources (employee/worker) of conventional banks that will be converted to Islamic Banks. The Analysis of the data includes the following stages:

1. Identify patterns of conversion of conventional banks into Islamic banks in Indonesia;
2. Analyze the benefit of conversion and acquisition of conventional state-owned banks to Islamic banking.

2.2 Literature Review

Economic and financial crisis currently is experienced by almost all countries in this hemisphere and the chronology of the financial crisis that occurred at this time is as follows (Mitton, 2002):

- 1987 – 1990 : US Savings & Loan Industry Collapse
- 1990 : High Yield Debt Tumble ('Junk Bonds Crash') & Nikkei Crash
- 1991 – 1992 : Gulf war market disruptions
- 1992 : European Exchange Rate Mechanism (ERM) Crisis
- 1994 : Unexpected US Interest Rate Increases and Bond Market Crisis
- 1994 : Mexican Peso Crisis
- 1995 : Latin American Crisis
- 1997 : Asian Currency and Debt Crisis
- 1998 : Russian Default Triggered Debt Crisis & Long Term Capital Management (LTCM) Collapse
- 1999 : Brazilian Crisis
- 2000 : 'DotCom Crisis – 'New Economy' Technology, Media & Telecoms Bubble Burst'
- 2001 : World Trade Center Attack Triggered Credit Spread Widening
- 2002 : Enron Bankruptcy – Argentine Crisis – WorldCom Default
- 2003 : Iraqi War
- 2006 : Oil Price Rise Triggered Economic Dislocations
- 2007-2012 : 'Sub Prime Mortgage' Securitisation Triggered Global 'Liquidity Crunch', Credit Related Losses, Co Ordinated Global Markets Stimulus, Banking Regulatory Reform, and Financial institution Recapitalisation Measures, European Debt Crisis & Bank Capital Increases, etc.

The conditions that occur in the 2007-2012 creates an imbalance and causes financial crisis which can be simply described in the Figure 2.1 below (Masyita, 2015):

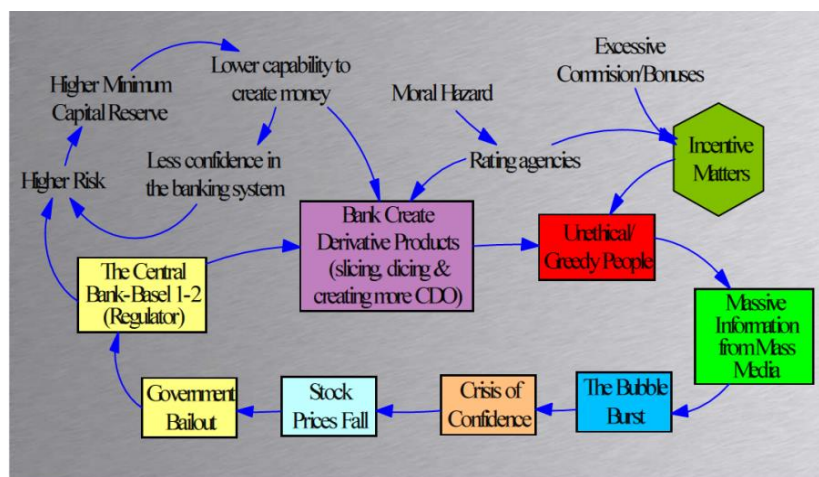


Figure 3 The Cause of Financial Crisis
Source: Masyita, 2009

Conventional banks are forced to reform the problems that caused the global financial crisis. Some of those problems are derivative products that are not backed by real assets, the implementation of risk transfer in the application of interest rates, market prices do not

correspond to the actual conditions and banking capital that can not cover the losses (Gupta, 2010). According Masyita (2015) the principles embodied in Islamic banking can be used as a solution to prevent the financial crisis. Those principles are the prohibition mechanism "Maghrib": maysir (gambling and speculation), gharar (uncertainty) and riba (interest) and the objectives of Islamic banks is to create a social well-being does not to create a communities crisis (Arafah and Nugroho 2016). Furthermore, the role of Islamic principles in preventing the financial crisis can be explained in the figure below :

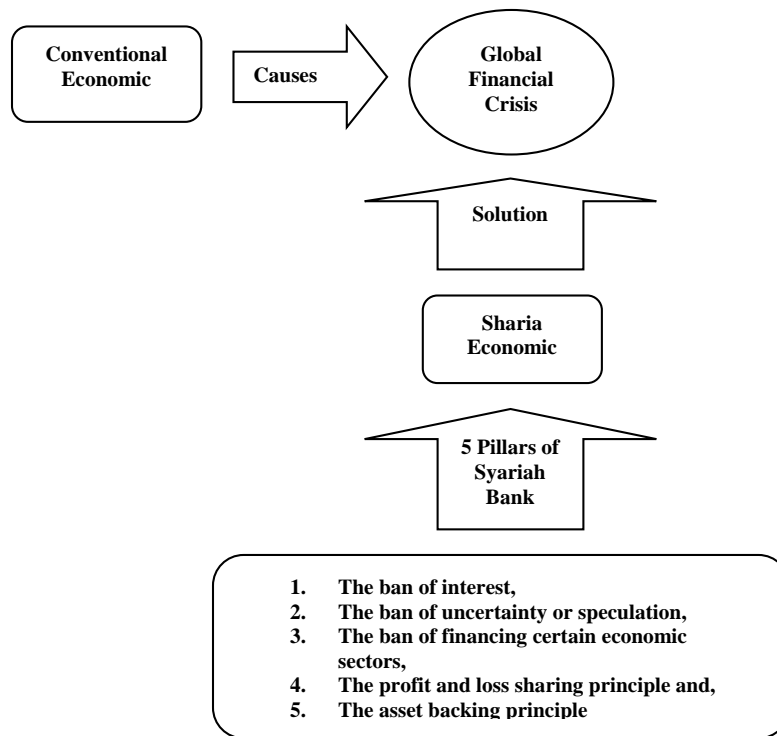


Figure 4 The Islamic Finance Principles as The Solution for Financial Crisis
Source: Masyita (2015)

The global economic crisis affects the banking system in Indonesia. Islamic banks use the sale and purchase system. The results show the different conditions with conventional banks that use the concept of interest. The impact of the financial crisis is the rise in interest rates, which affect the liquidity of conventional banks. While in Islamic banks are not affected directly by the increase in interest rate (BI rate) and it will not change during the time of the contract that has been agreed by both parties (the bank and the customer) (Sudarsono, 2009).

Indonesia as the largest Muslim country in the world should be the pioneer of Islamic financial center in the world. It is based on the potential of Indonesia to become a global player supporter. to Alamsyah (2012), the potential includes: (i). The Large Muslim population becomes potential customers of the Islamic financial industry, (ii). Promising economic outlook, reflected in the

relatively high economic growth (which are supported by solid economic fundamentals), (iii). The Increase in Indonesia's sovereign credit rating to investment grade which will increase the investment in the domestic financial sector, including Islamic finance industry and (iv). The abundant natural resources that can be used as underlying Islamic financial industry transactions.

The presence of community can't be avoided and detained. A community is born organically because equation experiences, interests and hobbies of its members are deliberately designed and sponsored by a particular manufacturer (Prambudi, 2008). Supposedly there is a similarity in communities such as Indonesia as the country with the largest Muslim can be used to make Indonesia has the largest Islamic bank in the world and even become an international financial center.

Currently, the development of Indonesian Islamic finance industry is still left behind compare to other Muslim countries. For example, Malaysia's market share reached 23%, while Indonesia only reached 4.8%. Although this may seem ironic considering that Indonesia is the country with the largest Muslim population in the world, indeed the potential in the world's largest population of Muslims makes Indonesia being the leader/player of the global Islamic financial development in the world. Therefore, Islamic banking also requires real alignments from government innovation, ie converts government state-owned banks that have human resources to further acquire.. This Merger should be guided by the spirit and confidence that will bring '*maslahat*' for economic development and equitable distribution of welfare.

Nevertheless, regarding to Ibn Khaldun concept that all stakeholders should be complemented each other and cannot separate from each other, **IE** Sharia (S), Community (N), government (G), welfare (W), construction (g) and justice (j) so that the function can be written as follows: $G = f(S, N, W, g \text{ and } j)$. (Chapra, 2001):

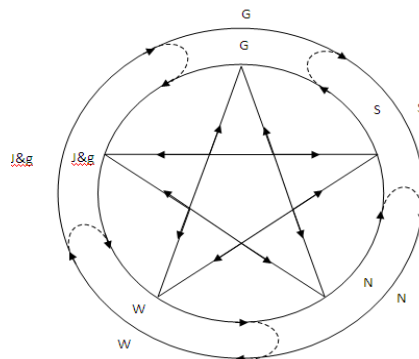


Figure 5 Ibn Khaldun Concept
Source: Chapra, 2011

Based on Figure 5, G is Ibn Khaldun as the dependent variable because the government or leader must ensure the welfare (W) for the community (N) to provide an environment that is conducive to development and to create fairness (g) and (j) through the implementation of *maqhasid sharia* (S) so as to create beneficiaries to the community. To face the challenges, Indonesian Islamic banking requires not only government supports (government driven) but also driven society/market driven), which has been formed but not yet achieved optimal performance. The Ibn Khaldun concept that argues the optimization of welfare is the collaboration among all stakeholders (government, community and all player elements) to provide positive contribution.

Another phenomenon that also inherent with Ibn Khaldun is Community concept. Community becomes a necessity, unavoidable and detained. No community is born organically because of the similarity of experience, interests and hobbies of its members, and they are deliberately designed and sponsored by a particular manufacturer (Prambudi, 2008). Utilization of the community is a reality that is required for the actual existence of the community emerged, when a product is consumed in bulk or many customers. The simulation of conversion and merge based on law of community theory. According Nurtantiono (2011) there are three communities theory:

1. Sarnoff's Law, this law stated that the value of a broadcast is proportional to the number of his audiences so that if the number of audiences is (N), then the value that can be generated based on this law is $(N) = (N)$.
2. Metcalfe's Law, this law stated that the value of the community will be proportional to the square of the number of members of the community so that if the number of his audience is (N), then the value that can be produced is $(N)^2$.
3. Reed's Law, this law stated that the utilization of networks among communities, especially social networks, can double the value. So, if the number of his audience is (N), then the value that can be generated is $2(N)$.

3. Analysis

3.1 Analysis of Acquisition and Conversion Pattern

The establishment of Islamic banks can be done through the mechanism of acquisition and conversion (Anshori, 2010). Acquisition or that the Act No. 40 of 2007 on Limited Liability Company is known by the term of 'take over' which is a legal act performed by a legal entity or individual to take over the shares of the Company which resulted in the shift of control of the Company. While the conversion here means changing the operational activities from the

previous conventional bank to *sharia*. The Implementation can be done through three approaches:

1. Conventional banks already have *Sharia* (UUS) to acquire a relatively small bank then converts it into *Sharia* and merge its UUS with the new converted bank;
2. Conventional banks do not yet have UUS, it can acquire a relatively small bank and convert it into a *sharia*;
3. Conventional banks to separate (spin-off) with UUS, and use Islamic Banks (BUS) separately.

In practice, the three things mentioned above have been done, but its impact on the growth of Islamic banking assets have not shown a significant improvement. The current condition of Islamic banking is difficult to achieve the targeted market share of 5%. Based on that requirement, the intervention of the government to increase its market share by establishing a state-owned Islamic bank can give a big impact to the market share.

3.2 The Analysis of Islamic Banking Conditions When Conventional Bank Converts to Islamic Bank

At the macro level, the high growth of Islamic banking can provide carrying capacity of the financial system stability and the national economy. To realize Islamic state-owned bank in Indonesia as a financial power in Indonesia, it is necessary to unite the potential strength of those existing Islamic Banks. In the last decade, asset of Islamic banking has increased to 30% and the conventional banks was only 16%, the growth of Islamic bank was almost doubled from the conventional bank, but there isn't a big impact on the market of Islamic bank that is still locked under 5%.

Table 3 The Asset Growth of Islamic Bank and Conventional Bank

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	CAGR
Islamic Bank (Billion Rp)	20,880	26,722	36,538	49,555	66,090	97,519	145,467	195,018	242,276	272,343	296,262	30%
Conventional Bank (Billion Rp)	1,448,947	1,667,128	1,949,963	2,261,002	2,534,106	3,008,853	3,652,832	4,262,587	4,954,467	5,615,150	6,132,583	16%

Source: Banking Statistics Indonesia and Indonesian Islamic Banking Statistics, December 2015

In the simulation, Bank Rakyat Indonesia (BRI) will be appropriate to convert to Islamic bank because BRI is the biggest retail bank in Indonesia. BRI is suitable to the criteria and it also inherits with the Ibn Khaldun theory and Community theory which determined by most beneficiaries or *maslahah*, and it gives a big impact to the community especially for low income

people who stay in rural area. Furthermore, BRI will join with BRI Syariah to become an Islamic Bank, and the next step, it will acquire all the Islamic bank which is owned by state owned conventional bank (Bank Syariah Mandiri, BNI Syariah and BTN Syariah). The mechanism of “The best alternative to convert and acquire the Islamic bank to become State Owned Islamic Bank”. Is described in the figure 6.

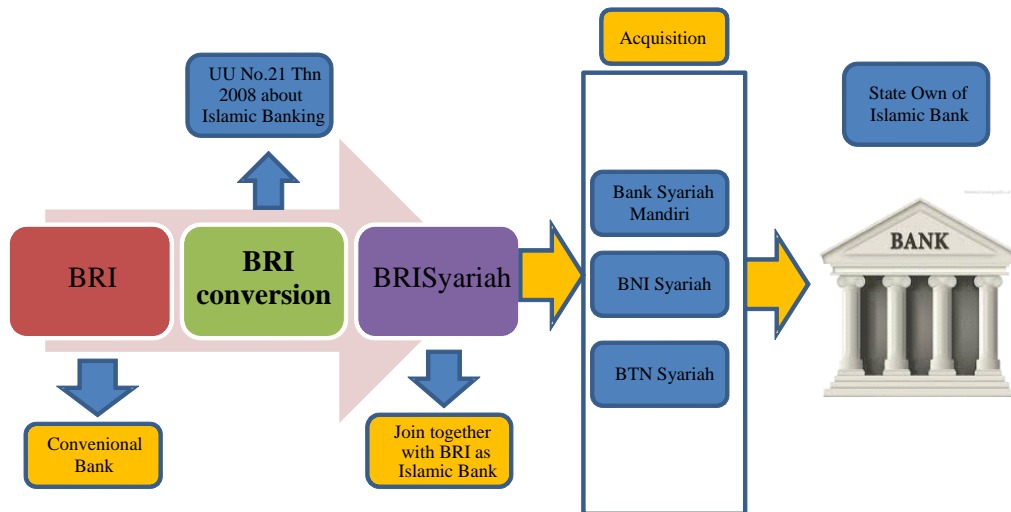


Figure 6 The Best Alternative of Conversion and Acquisition of Islamic Bank

Table 4 Simulation of BRI Conversion Become Islamic Bank

	2015
Islamic Bank Market Share	296,262
Bank Rakyat Indonesia	845,998
Total in billion Rupiah	1,142,260
Market Share Total	5,286,585
Islamic Bank Market Share (%)	21.6%

Source: Banking Statistics Indonesia and Indonesian Islamic Banking Statistics, December 2015

Based on figure 6, the outcome is shown in table 4 as the increasing of Islamic bank market share is 21.6%. This mechanism can raise up the Islamic Banking market share very significantly. According to syafii (2016), the conversion from conventional bank to the Islamic bank is a better option in term of increasing the market share. Furthermore, the important factor to take this action is the strong motivation and policy from government to legitimate the decision with underline *maslahah* principle. Nevertheless, the point of view of *maslahah* is also linked to the community theory. if simulating the community theory based on the BRI employee

can understand and have knowledge of Islamic products and influence their relatives and friends, the people who will use the Islamic products can increasing. It can be shown in the following table:

Table 5 Simulation of Community Theory

Community Theories	Number of Employee of BRI (\pm in 2015)	Community Value added (Maslahah)
Sarnoff's Law	130,000	130,000
Metclafe's Law	130,000	16,900,000,000
Reed's Law	130,000	260,000

Source: detik finance.com 02/12/2015

According to table 5, the *maslahah* of Ummah/community can be possibly achieved by the increasing number of the people who can understand about the Islamic Bank products and services which can increase the number of people who use the Islamic bank products and services, from 130.000 people can increase maximum to 16.900.000.000 people all over the world. Nevertheless, the scope of the people in the rural area also can access the Islamic bank services by the branch of BRI who has the biggest network in the world, regarding the company website, BRI has 10.200 branches.

Implementation of Indonesia as the international hub and Islamic financial center in term of achieving the *maslahah* of Ummah needs a collaboration from all stakeholders and it is not easy. Therefore, the intervention of government policy can be as a locomotive to engage all stakeholders to it real. Furthermore, the challenges must solve, if all stakeholders have consciousness related to this action which is very important for *maslahah* of the Ummah in *maqashid al-Shari'ah* (objectives of sharia), the point is that everything is done based on the principle of ease for the benefit of human life. Allah has said, which is stated as follows (Surat-al-Baqarah 185) :

شَهْرُ رَمَضَانَ الَّذِي أُنزِلَ فِيهِ الْقُرْآنُ هُدًى لِّلنَّاسِ وَبَيِّنَاتٍ مِّنَ الْهُدَىٰ وَالْفُرْقَانِ ۚ فَمَنْ
شَهِدَ مِنْكُمُ الشَّهْرَ فَلْيَصُمْهُ ۖ وَمَنْ كَانَ مَرِيضًا أَوْ عَلَىٰ سَفَرٍ فَعِدَّةٌ مِّنْ أَيَّامٍ أُخَرَ ۗ يُرِيدُ
اللَّهُ بِكُمُ الْيُسْرَ وَلَا يُرِيدُ بِكُمُ الْعُسْرَ وَلِتُكْمِلُوا الْعِدَّةَ وَلِتُكَبِّرُوا اللَّهَ عَلَىٰ مَا هَدَاكُمْ وَلَعَلَّكُمْ
تَشْكُرُونَ

Meaning: The month of Ramadhan [is that] in which was revealed the Qur'an, a guidance for the people and clear proofs of guidance and criterion. So whoever sights [the new moon of] the month, let him fast it; and whoever is ill or on a journey - then an equal number of other days. Allah intends for you ease and does not intend for you hardship and [wants] for you to complete the period and to glorify Allah for that [to] which He has guided you; and perhaps you will be grateful.

Currently, the Islamic Banking condition in Indonesia needs a breakthrough to carry out from the decreasing of market share because:

1. Islamic bank in Indonesia is as a local player and still in a small scale. It means that Islamic bank in Indonesia doesn't have an international competition advantage which includes: lack of technology, lack of employee who has sufficient competency in Islamic bank, lack of capital and limited human resources;
2. The existence of Islamic Bank supported by the need and demand of the community as the biggest Moslem population in the world (bottom up initiatives-society driven), but the government doesn't have initiative to boost Islamic Bank among the competition with conventional bank that already established earlier more than 10 (ten) years;
3. The growth of Islamic bank market share wasn't encouraging, because during the last three years the Islamic bank market share decreased;
4. The scope of Islamic bank services in Indonesia is still limited, even though the rural bank such Baitul Mal Wa Tamwil (BMT) is already available reaching all across of Indonesia, but the scope of their services is still finite to support the small and medium enterprises, so they didn't use BMT as their bank for business transactions.

On another side, there is a challenge regarding the globalization, competition of Economic ASEAN community, but there is also opportunity to realize the state owned Islamic bank by the regulation and the role of the government to intervene in the policy side. The government action is allowed by sharia principle as long as it creates masalah for the community and it is aligned with the community theories. The establishment of the state owned Islamic Bank in Indonesia, which has a market share above 20%, will give a strong foundation impact in Indonesian economy and can deliver Indonesia as the Islamic bank global player. Related to Indonesia as a global player in Islamic bank in the world, it will give a lot of beneficiaries for local economic activity, Islamic education, Islamic business and the stability of financial condition.

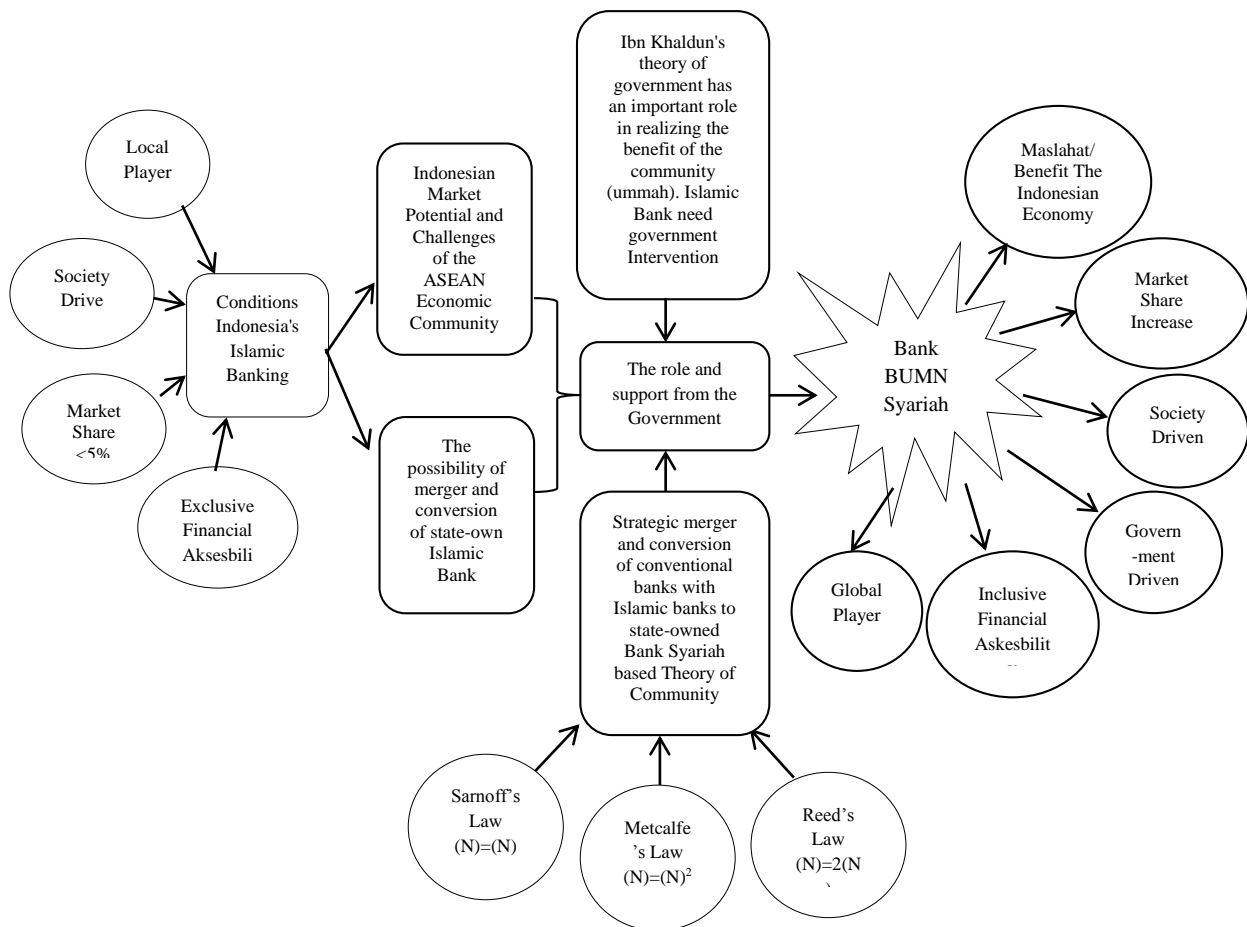


Figure 7 The Strategy to Increase The Market Share and Realizing Indonesia as The Islamic Financial Hub in The World

4. Conclusion

The Islamic Bank market share condition in Indonesia should be released from the trap below 5% by Indonesia government intervention policies. The breakthrough to increase the market share and deliver Indonesia becoming an Islamic financial hub is the option to convert the BRI to a full fledged Islamic bank, and the next action is to acquire the Islamic banks which are subsidiary of conventional state-owned banks (Bank Syariah Mandiri, BNI Syariah and BTN Syariah). This action will increase the Islamic bank market share to 21.6% and will be the biggest bank in the world that will imply the increasing of Islamic economic activity and Islamic education in Indonesia. Furthermore, there are also some alternative solutions which can strengthen the Islamic Bank in Indonesia as follows:

1. Project-based sukuk are recognized as financing;
2. Recognition of Hajj funds as a component of capital of Islamic Bank;
3. Recognition of fund liquidity facility housing construction (FLPP) as a component of

capital;

4. All the activities and financial transactions of Hajj and Umrah must be in Islamic banking;
5. Placement of funds from expenditure and budget government (APBN) in Islamic banking;
6. And financing of infrastructure projects, ministries, state-owned enterprises must be included Islamic banking.

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STRENGTHENING THE ROLE OF ISLAMIC PAWNSHOP IN ISLAMIC FINANCING FOR MICRO SMALL AND MEDIUM ENTERPRISES : ANP APPROACH

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Abstract

Objectives – This study aims to strengthen the role of Islamic pawnshop in financing for Micro, Small & Medium Enterprises (MSMEs)

Methods – This study is employing Analytic Network Process (ANP) approach

Results - The main problem of Islamic pawnshop in expansion was its internal. The most priority solution was socialization through promotion and advertisement. The appropriate strategy to be executed was marketing strategy to expand Ar-Rum product (financing for MSMEs) through sales marketing.

Conclusion - The considered action is massive socialization to the societies using effective and efficient marketing strategy.

Keywords: Islamic Pawnshop, Ar-Rum (financing for MSMEs), ANP

Abstrak

Tujuan – Penelitian ini dimaksudkan untuk memperkuat peran pegadaian syariah dalam pembiayaan Usaha Mikro Kecil dan Menengah (UMKM)

Metode – Penelitian ini menggunakan pendekatan Analytic Network Process (ANP)

Hasil – Permasalahan utama dari pegadaian syariah dalam melakukan ekspansi adalah permasalahan internal. Solusi yang paling prioritas adalah sosialisasi melalui promosi dan periklanan. Strategi yang tepat untuk dilaksanakan adalah strategi pemasaran untuk ekspansi produk ar-Rum (pembiayaan untuk UMKM) melalui *sales marketing*.

Kesimpulan – Tindakan yang mesti dipertimbangkan adalah sosialisasi masif kepada masyarakat dengan menggunakan strategi pemasaran yang efektif dan efisien.

Keywords: Pegadaian Syariah, Ar-Rum (Pembiayaan untuk UMKM), ANP

1. Introduction

The classic problem of Micro Small and Medium Enterprises (MSMEs) is lack of access to capital. The wall barrier blocking the capital flow makes the MSMEs' actor suffer in terms of financial. The banks as intermediary was expected to be source of fund to penetrate the MSMEs market, however, bank's outreach was not extent to grass root level of societies. The failure of bank raised the alternative of financing mode to the MSMEs. In practice, the MSMEs actors overcome their financial stress to loan shark as the easiness of requirement and short of time. Although the high interest charged, the MSMEs actor still depended of them.

To fight the *practice* of loan shark, Islamic microfinance comes to overcome the problem. Islamic microfinance in Indonesia was the unique institution with high flexibility to help the poorest. According Central Bank of Indonesia (2016), the loan granted to MSME segment was only 18% of total loan granted by banks figured IDR739 Billion. The microfinance institutions in Indonesia which finance the MSMEs sector consisted of two institutions: banks and non-banks. The non-bank institutions consisted also into two: formal and non-formal. The formal institutions on non-bank were cooperatives (\pm 110.000 units), pawnshop (4.456 branch), LDKP (village fund and credit institution) (1.351 units), Lembaga Keuangan Mikro (micro credit institution) (35 units) (Bank Indonesia, 2016). Muftifiandi (2015) in his research stated that financing institution consisted of two; bank and non-bank. The non-bank institution played a significant role to help non-bankable societies. They transacted in small amount in term of saving and lending and also access to the fund.

Various financial institutions Islamic banks and Non-bank institutions at present can provide the financing for individuals who need sources of capital. Non-Bank Financial Institutions such as Pawnshop, offering access which is much easier, it can be done in a relatively short time and affordable terms and conditions than banks (Muftifiandi, 2015). According to Triandaru *et al.* (2000), Pawn is the only entity in Indonesia officially authorized to carry out the activities of financial services in the form of a payment, lending to the public based on the Act of pledge.

However, the practice of pawn institutions was still attached to conventional system operation in the form of interest based. Islamic finance has its own rule to operate with considering *riba* (usury), *gharar* (uncertainty), *maysir* (gambling) and other restrictions as the avoidance element. Pledge contract originally was appeared in the time of Prophet Muhammad, which recorded in history. The pawning system purely helped others in financial needy to overcome the deficit side.

Islamic pawnshop was regulated under the government regulation No.10 of 1990 affirmed that usury should be eliminated in practice, and amended by government regulation No.13 of 2000 became the cornerstone of Islamic pawnshop activities until now. Various products were adapted to serve the societies, such Ar-Rahn (Islamic pawn), Ar-Rum (Islamic financing for MSMEs), gold installment, deposit services and others. To contribute in financing, Islamic pawnshop offered Ar-Rum financing for the small and medium enterprises sector to provide the sources of capital (www.pegadaian.co.id).

Ar-Rum was an Islamic financing product of Islamic pawnshop for the development of SMEs through a guarantee of Buku Pemilik Kendaraan Bermotor (certificate of vehicle ownership) (Marketing Division & Market Intelligence, 2015). Ar-Rum transaction mechanism based on Islamic principles implemented fairness and free of interest referred to the National Sharia Board- Majelis Ulama Indonesia (DSN-MUI) No. 80/DSN-MUI/III/2011. Ar-Rum Financing services offered easiness and appropriate solution in addressing the financial distress, particularly in providing capital to the MSMEs. The growth of Ar-Rum can be seen in Figure 1 over last 5 years:

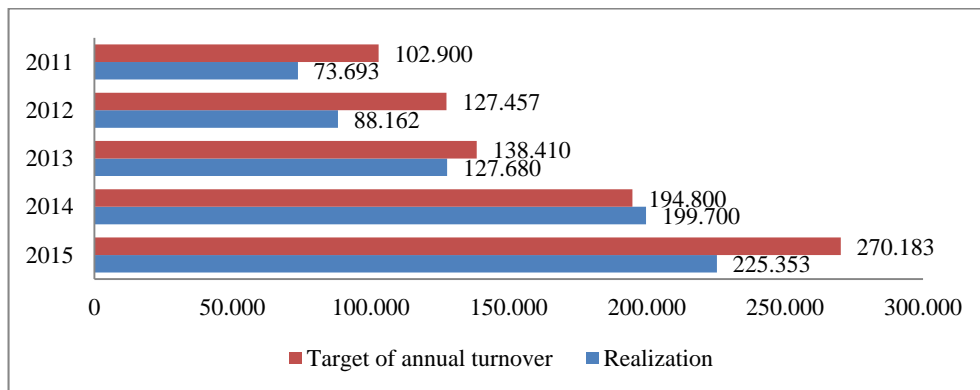


Figure 1: The growth of Ar-Rum for financing MSMEs on PT. Pegadaian (In billion)
Source: Official Website of PT. Pegadaian (2016)

The Figure shows that the growth of Ar-Rum turnover from 2011 to 2015 in Islamic Pawnshop was increasing gradually due to high public demand. However, in terms of Ar-Rum turnover achievement, 2011 to 2013 had not been able to reach the target set by the company. In 2014, its turnover can be achieved by 3% higher than the targeted and followed 2015 dropped once again. This depicted that Islamic pawnshop was experiencing problems with Ar-Rum product development. Several factors among problems are the lack of socialization, the new publication of the draft legislation on pawn system which led to the rise of opening pawn business conducted by banks with sharia system, as well as low public confidence to the Islamic pawnshop (Muliawaty, 2012).

The enactment of the Civil Code Book II, Chapter XX of Article 1150 of the service pawn established by the government was directly a threat to the pawnshop. It triggered mushrooming in various financial institutions that operated business or similar business to pawnshops. Competition was increasingly tight and the private sector would be market leader, because it excelled in service, especially in terms of lower prices than pawnshops.

The existence of the Islamic pawnshop especially for Ar-Rum financing services obviously had significance role for national economic development, especially solutions for the MSMEs empowerment. This indicates that Islamic pawnshop played an important role in solving problems faced by MSMEs in respect to capital stress. However, the targeted financing set by company was unachievable until today. Therefore, this study aimed to find the effective and appropriate solutions and strategies to enhance the financing turnover on Islamic pawnshop.

2. Methodology

This study used a qualitative analysis employed Analytic Network Process (ANP) approach. Qualitative study was a process or an attempt to understand the problems of nature based on the overall description of the complex through the information reported on the views of informants and conducted in a natural situation (Sugiyono, 2006:1). The data used consisted of primary and secondary data. The researchers obtained the primary data by conducting interviews and questionnaires with experts who held their statement in line with experience and expertise (Sumarwan, 2014:149). While secondary data obtained from various sources such as books, literature, journals and official website of pawnshops.

There were three stages of data collection in this study, namely literature, in-depth interview and questionnaire. At the stage of literature study, researchers conducted a literature review on various materials as a reference as well as to collect relevant data to the object of research. Literature study aimed to gain a theoretical framework in determining the direction and purpose of the study and the search for materials that matched to the context of the problems, followed by in-depth interviews with some selected experts respondents. The expert respondents were a business development manager, product managers, marketing managers, experts and academicians. In the interview process, there were two types of questions; open-ended and closed-ended. In this study using open-ended questions, the respondents were more open to answer the questions. The last step was to design a questionnaire in accordance with the framework of Analytic Network Process (ANP). The questionnaire would be distributed to the experts who surely mastered the problems.

ANP was the development of methods Hierarchy Analytical Process (AHP). AHP was a weighting method, was often used in designing a performance measurement system (Hidayati, 2012:54). Thomas L. Saaty was the first inventor of AHP and developed it to the next level named ANP. This decision support modeling was multi criteria in assessing the priority of criteria and used indicators (Ibrahim, *et. al*, 2013:38). ANP had more advantages compared to AHP that was a network which need not to establish such level in the hierarchy in the AHP. ANP network structure more freely allowed to present various problems of decision making regardless of what elements were first and what elements were beyond as the hierarchy (Sumarwan, 2014: 200-201). The collected data will be processed using Super Decisions software.

3. Result and Discussion

3.1. Problem Identifications

Problems in the development of Ar-Rum financing products in Islamic pawnshops were divided into three clusters, namely the internal problems of Islamic pawnshops, customer issues and competition issues. From each of these problem had the alternative solution, namely an internal solution of Islamic pawnshop, customer and competition solutions; moreover, each cluster had three criteria. In addition, the researchers also suggested appropriate strategies to enhance the MSMEs financing in Islamic pawnshops.

1) Problems and Solutions of Internal of Islamic Pawnshop

a. Product Marketing

A significant element affected the product development was marketing on the product. Marketing was an organizational function and a set of processes for creating, communicating, and delivering value to customers and for managing customer relationships in ways that benefited the organization and its stakeholders (Kotler & Keller, 2009:5). In terms of product marketing, Islamic pawnshop was still under performed compared to other Islamic financial institutions. Recently, pawnshop still favored the conventional promotion of sales using the brochure as considered the most effective in introducing the product to the customer. Islamic Pawnshop did not have a sales marketing to introduce products such as Islamic banks. This could lead to a decrease in product sales of pawnshops since losing in terms of promotion. Therefore, Islamic pawnshop needs to expand its marketing strategy consequently, customers knew in detail about the products that existed in Islamic pawnshops, especially Ar-Rum financing products that helped entrepreneurs in developing their business. This was supported by Taqiyuddin (2016) and just in line with a study conducted by Putra and Purnawati (2013).

b. Human Resources Development (HRD)

Factor quality and quantity of human resources became an operational impact for the institution. Islamic Pawnshops had limitations in the provision of Human Resources. There was an employee who doubled duty as cashier and customer service at once. It led to the ineffectiveness of the employee's performance. Therefore, Islamic pawnshops should increase the quantity of employees to improve performance and took an advantage of any potential existing opportunities, in order to promote a product as stated by Agung (2016). This matter was also supported by research conducted by Mahalli and Saputra (2014) and Wakhyudin and Rais (2009).

c. Information Technology

Technology was a means linking among people. Its benefit was to facilitate a transaction process. Islamic Pawnshop did not maximize in utilizing information technology to support its operations, such as utilizing a debit card in payment (Agung, 2016). In order to facilitate the customers in terms of payment, Islamic pawnshop could use technology facilitating access to installment through debit cards. Thus, customers did not need to come to the pawnshop outlet to pay the installment (Banu, 2016), it is also supported by Mahalli and Saputra (2014).

2) Problems and Solutions of Costumer Issues

a. The Absence of Willingness in Islamic Transaction

Financial Services Authority (OJK) assessed number of people who borrowed fund from moneylenders "loan shark" due to the ease of its loan process and can be done in a relatively short time. Loan Sharks or other types of moneylenders charged the societies with high interest rates. In Islam, usury or interest was totally prohibited (QS. Al-Baqarah 275). The verses on the prohibition of usury and its dangers had not been conveyed to the entire Muslim community. Additionally, the people who had been aware of usury prohibitions and its dangers were still reluctant to switch to an institution obviously free of usury. This is driven by rationality intuition considered interest as fixed income that actually certainly grounded irrationally at all. An additional, the absence of wilingness could be depicted through the low market share of Islamic banking industry. It became one of the obstacles in product development for MSMSEs financing in Islamic pawnshop, as expressed by Agung (2016). Mahalli & Saputra (2014) stated the warning on usury restriction and its dangers was the responsibility of authorities and Islamic preachers.

b. Lack of Knowledge on the Islamic pawnshop

This factor caused by lack of knowledge of people on product offered by Islamic pawnshop. As elaborated by Agung (2016) and Taqiyuddin (2016) most people assumed that PT Pegadaian just an institution for pawning the goods and it was not the institution to get financing. In general, society did not know any other product other than a pawn in Islamic pawnshops such as Ar-Rum financing product for MSMEs. Therefore pawnshop should socialize to people for the introduction of products that existed in Islamic pawnshops. It referred to study conducted by Putra & Purnawati (2013) and Mahalli & Saputra (2014).

c. Lack awareness of Customers on Their Debts

The lack awareness of customer on their liabilities will impact to high non-performing financing rate of pawnshop. The customer's moral hazard was one main problem must be considered. Since the customers did not fulfill their debts, it affected to low performance of Islamic pawnshop. Still many people were reluctant to pay off the installment payment towards their financing (Agung, 2016). To that end, the Islamic pawnshop should continuously remind customers of their obligation to pay, as consequence they were aware of their obligations.

3) Problems and Solutions of Competition Issues

a. Growth of Financing Institutions

The number of financial institutions in Indonesia reached 263 (www.ojk.go.id). This showed, the level of competitiveness in financing institutions was tight, it became constrain of Islamic pawnshops to develop Ar-Rum financing product for MSMEs. Financial institutions offered financing to SMEs with ease requirements, became a competitor of Islamic pawnshops that could hinder the distribution of funding for SMEs (Ar-Rum) operated by Islamic pawnshops. Heri (2016) stated that Islamic pawnshop must optimize the existing services to embrace customers, as a result, customers would not switch to transact on competitor institutions. This was supported in a study conducted by Mahalli & Saputra (2014).

b. Growth of Islamic Banking Industries

Islamic banking was currently also open up financing for MSME entrepreneurs in the form of linkage and direct expansion program. In order to muffle the financing of Islamic bank in the form of pawn, Islamic pawnshop should conduct a comprehensive evaluation to improve the performance of the product and employees. Furthermore, Islamic pawnshop had to also determine an appropriate alternative to win the competition and maintain its position as market leader (Agung, 2016), supported also by Nisfi (2016).

c. The Rise Of Pawn Business

Civil Law Book II, Chapter XX of Article 1150 of pawn business was set by the government boosted the rise of state and private enterprises to open a pawn product (Wakhyuddin and Rais, 2009). This was a threat to Islamic pawnshop. Competition was getting tougher and it opened the chances for the private sector to take over the position (market leader) because it excelled in service. Therefore pawnshop should have a strategy that differed from competitors in order to attract customers to transact in Islamic pawnshops as claimed by Banu (2016).

4) Strategy

a. Product Socialization

Product socialization was a most strategy dominating for internal of PT Pegadaian. It was elaborated by Putra and Purnawati (2013), dissemination and socialization of the product were an important element, and it would determine the development of a company. In improving the business of an institution, it was seen from how they introduce their products. If they could socialize their products, the customer would be interested and come to the venue to transact. Therefore, Islamic pawnshop should be able to maximize the strategy in terms of product socialization, as a result, more people interested in transaction in Islamic pawnshop.

b. Improvement of Service Quality

As a financial institution, improving service quality was crucial for the continuation of the operational business activities. Service quality was the main factor to attract costumes in any transactions. If the institutions could perform and provide an excellent service, the customer would be comfortable and chose to continue transacting at that institution. Thus, Islamic pawnshop should continue to improve the service quality that customers felt comfortable in the transaction, it was in line to the study conducted by Nisfi (2016).

c. Strengthening and Synergizing Relationship among Islamic Financial Institutions

Strengthening the relationship and synergizing among Islamic financial institutions as stated by Mahalli and Saputra (2014) was core strategy to promote the Islamic pawnshop's products. It, thus will certainly impact on increasing revenue of the institutions. The stronger relationship among the IFIs held; the bigger market share of each financial institution would be. Instead of competition among the IFIs, the co-opetation among them was obviously encouraged. When the pie of IFIs Industry was going to expand, the revenue of institution would rise significantly. In brief, Islamic pawnshops needed to establish strong cooperation and more synergy with other financial institutions in order to introduce and promote its products.

3.2. Synthesis and Results

Expert respondents in this research were seven grouped into two, namely expert practitioners and academics. The results of questionnaires inputted into ANP framework through super decision software. At this point, the result would be discussed and analyzed from overall respondents. Geometric means was employed to generate the result of both combination practitioners and academicians with stressing point to Rater Agreement (W) value which showed the agreement among the expert.

A. Result of Rater Agreement: Problem Cluster

1) Problem Rater Agreement

Figure 2 showed the priority issue that caused a decrease in Ar-Rum financing product of PT. Pegadaian was an internal issue that dominated the issue by limiting priorities (LP) 0.3618. The second priority issue was the customer issues with LP 0.3416, and ranked third problem was a competition issue with LP value 0.2966. The result of a joint level agreement (W-Tot) of both groups of respondents was 0.25 or 25 percent.

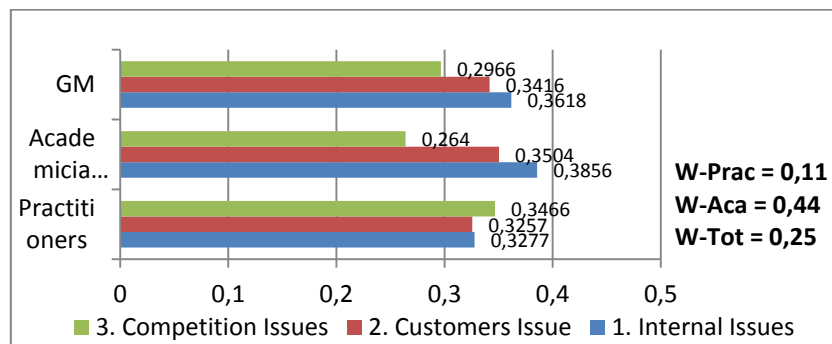


Figure 2. Result of Problem Rater Agreement

Referred to the standpoint of each respondent expertise, in the opinion of practitioners, there were three existing problems; the most dominant issue was the competition with LP value 0.3466, followed by an internal problem with LP value 0.3277, and the last issue was the customers issue with LP value 0.3257. Level agreements (W) obtained from practitioners was 11%, it can be sum that it was low level of agreement among them. Meanwhile, according to academicians, from the three existing problems, the most dominant problem was an internal problem with LP value 0.3856. The second problem was the problem of customers 0.3504, and followed by the competition issue with LP value 0.264. Level agreements (W) obtained from academicians was 44 percent. The level agreement resulted from academicians was higher than the level agreement of practitioners.

2) Rater Agreement of Internal Issues

Based on data processing, the value of agreement (W) according to each category of practitioners was 81 percent. The most dominant problem in the internal issue was the lack of product marketing with LP value 0.472; this view was stated by practitioners as they knew well how marketing was run by Islamic pawnshops, especially Ar-Rum financing products. The second problem priority was information technology had not been fully utilized with LP value 0.3157, as the fact, pawnshops had not optimized the utilizing of technology in terms of payment. The final problem was the limited human resources with LP value 0.2123, as pawnshop only had one cashier in each outlet.

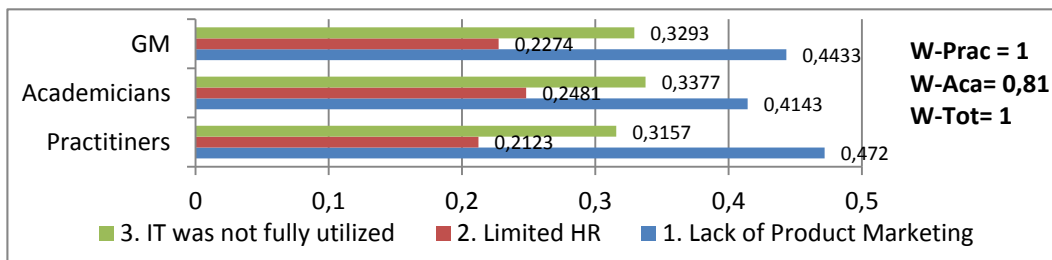


Figure 3. Result of Internal Matter *Rater Agreement*

The academics also argued the same thing as proposed by practitioners, that the problem of the lack of product marketing was the most problem influence on internal issues with LP value 0.4143. According to the academicians, marketing expansion was still very low level, this happened due to inconsistency between plan and implementation. The second cause was the information technology had not been fully utilized with the LP 0.3377, and the last priority problem was the limitation of human resources with LP value 0.2481. Level agreements (W) obtained from academicians was 75 percent.

In level agreement (W) of combination between practitioners and academics showed the optimum agreement by 100 percent, which depicted the perfect deal among them. The lack of product marketing constituted the most dominant with LP value 44.33 percent. The second issue was the information technology, had not been fully utilized with LP value 0.3293. The last priority was the limitation of human resources with 22.74 percent of LP value.

B. Result of Solution Cluster Rater Agreement

1) Solution Rater Agreement

Figure 4 reflected the priority solutions that could be implemented to improve the Ar-Rum financing product on PT Pegadaian by the overall respondent were the internal solution with limiting priorities 0.4233. The second solution priority was the solution of competition by LP value 0.2974. Meanwhile, the last priority was the customer solutions with LP value 0, 2793.

The level agreement (W) value reached 100 percent, it shown they agreed upon those priorities solution to be done respectively.

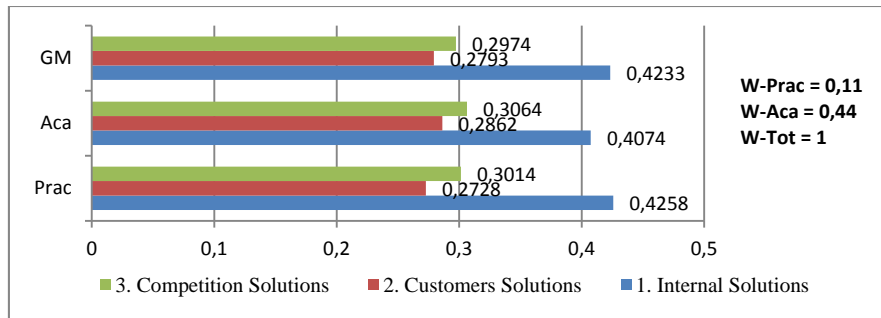


Figure 4. Result of Solution Rater Agreement

Based on perspective of practitioners and academics, the internal solution was the most priority solution for solutions cluster. Secondly was a solution of competition, and followed by customer solutions with each of agreement (W) value given by practitioners 11 percent and academics by 44 percent.

2) Rater Agreement of Internal Solution

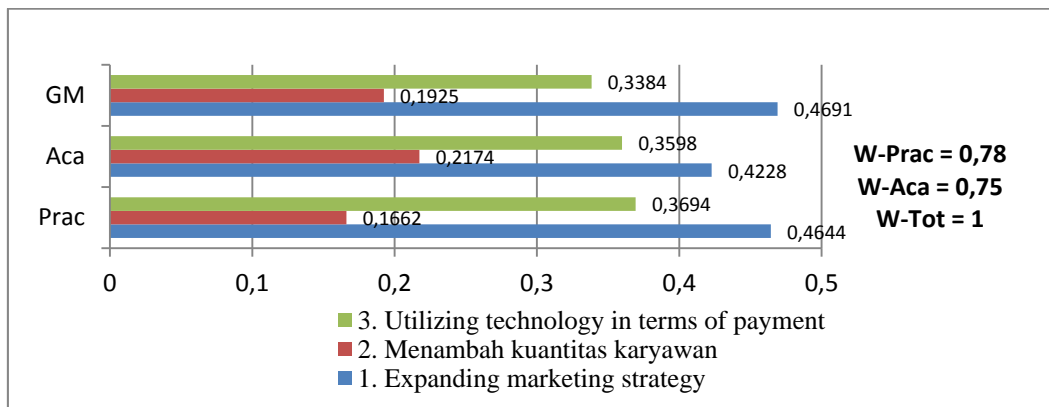


Figure 5. Result of Rater Agreement of Internal solution

The main priorities for an internal solution in the sight of overall respondents, was expanding the marketing strategy with LP value 0.4691. The next priority was utilizing technology solutions in terms of payment by 0.3384 of LP value. Last but not least, increasing the quantity of employees was the last priorities by LP value 0.1925. The overall respondents seemed agreed with such priorities as shown with the level agreement (W) values by 100 percent.

In the term of each category, the whole respondents had the same level priority, started by an internal solution with the value of deals (W) by 78 percent of practitioners and academics by 75 percent. The most important internal solution was expanding its marketing strategy by leveraging existing network. Next priority solution was to use technology in terms of payment

such having an online payment system or through ATM. The last solution was increasing the quantity of employees, consequently they might perform finely.

C. Result of Rater Agreement Of Strategy

The entire experts viewed the most powerful strategy to strengthen the role of Islamic Pawnshop in financing MSMEs was socialization strategy. It is supported by agreements (W) value 78 percent from practitioners and 100 percent from academics. This result obtained as finest strategy due to the most priorities in internal issue was lack of product marketing. In short, Islamic pawnshop was encouraged to expand and enlarge the marketing coverage within societies

Furthermore, the second strategic priority was improving the service quality named by service excellent. Islamic pawnshop should implement this strategy such as 3S (smile, greeting and salam) and others. The last priority was strengthening the relationship among financial institutions, where the pawnshop should also establish sticky relationships with other financial institutions in order to introduce its product.

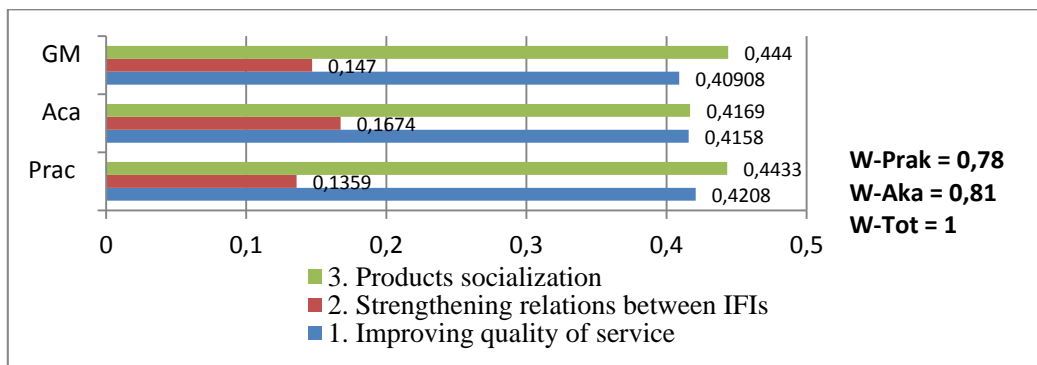


Figure 6. Result of *Rater Agreement* of Strategy

The result of agreement between practitioners and academics reached 100 percent; by means they convinced that socialization on product of Islamic pawnshop was the main priority to be executed. They agreed that product dissemination and promotion strategy was a key strategy in improving Ar-Rum financing for MSMEs in PT Pegadaian with LP value 44 percent. The second priority according to two groups was improving service quality with LP values 40.9 percent, and lastly was strengthening the relationship among Islamic financial institutions with LP value of 14.7 percent.

D. Result of Geometric Mean

a) *Geometric Mean* of Problems and Solutions

Figure below showed the priority issue which was analyzed using Geometric Mean approach among internal issues, customers and competition issues.

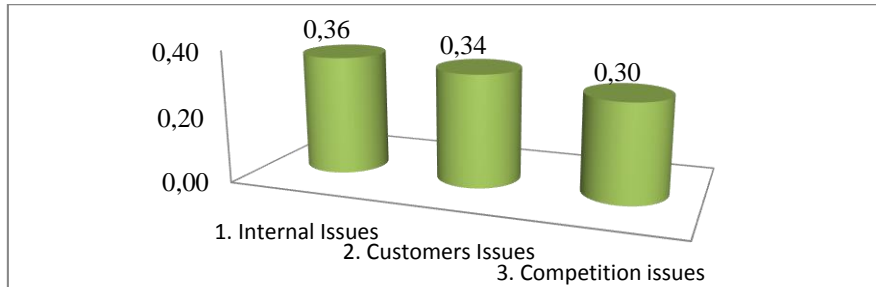


Figure 7. Result of Problem Geometric Mean

Referred to the geometric mean results, showed the priority issue according to the agreement of all respondents was internal problems with LP value 36.18 percent. Internal solution also viewed as the key solution to increase the number of Ar-Rum financing for MSMEs with LP value of 42.33 percent, it can be seen in Figure 8.

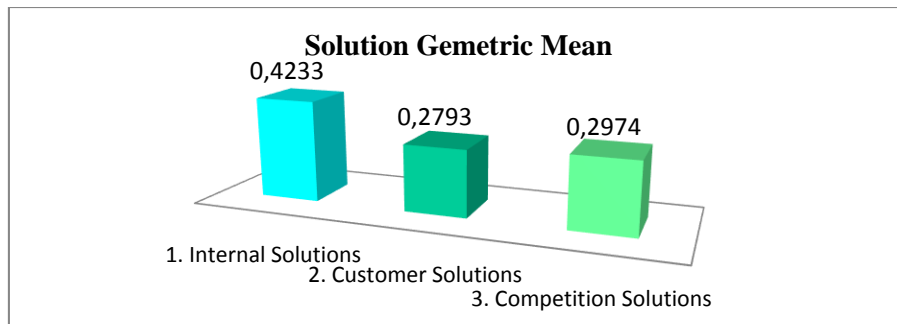


Figure 8. Result of Solution Geometric Mean

b) Result of *Geometric Mean* for overall Problem

Figure 9 showed the order of priority issues were analyzed using Geometric Mean among aspects of internal problem, customers and competition issues; each of it had three factors of each aspect.

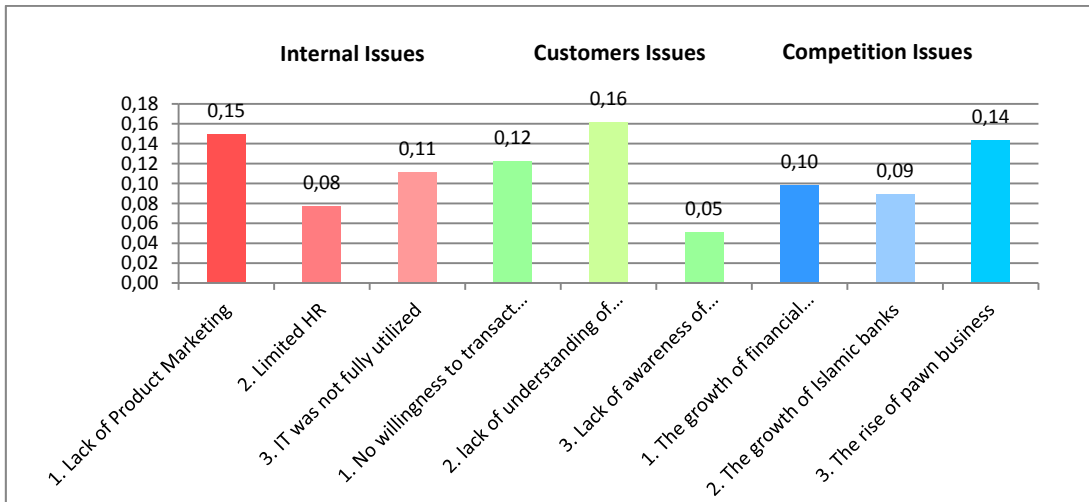


Figure 9. Result of *Geometric Mean* for overall Problems

It was depicted from Geometric Mean result overall respondents practitioners and academics, the order priority problems in strengthening the Ar-Rum financing for SMSEs on PT Pegadaian was lack of knowledge of Islamic pawnshop by LP value 16.11 percent. This was due to most of people did not understand Islamic pawnshop, as a result, the societies still traded at a conventional financial institutions.

c) Result of *Geometric Mean* for overall solutions

Figure 10 explained that the most priority solution in increasing the Ar-Rum financing for MSMEs at PT Pegadaian was internal solutions of Islamic pawnshop followed by costumer and competition solution. Based on the geometric mean, the priority factors of each aspect was socialization on product to societies with respect LP value 18.22 percent. The dissemination and promotion through advertisement in traditional and modern aspect were obviously encouraged to Islamic pawnshop in expanding the financing for MSMEs nationally.

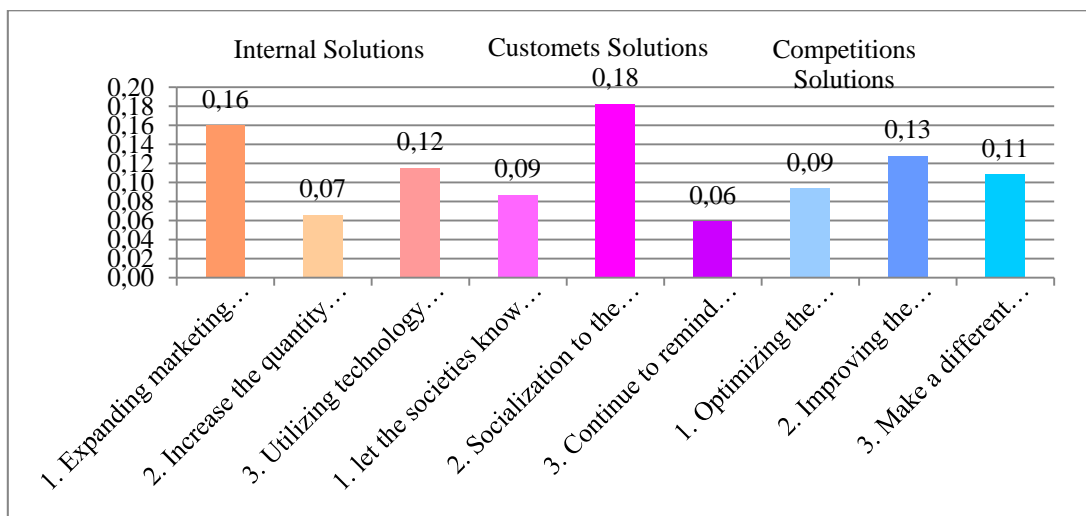


Figure 10. Result of *Geometric Mean* for Overall Solutions

d) Result of *Geometric Mean* for Strategy

Three strategies were offered in this study, the results of Geometric Mean for Strategy can be seen in Figure 11:

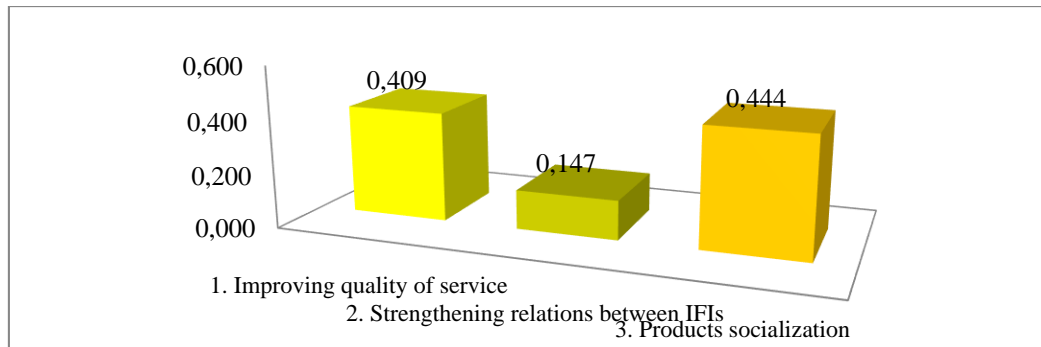


Figure 11. Result of *Geometric Mean* for Overall Strategy

Figure 11 showed the result of contributions aspects of the strategy. Based on the combined between practitioners and academics can be concluded that the main strategy as the top priority was the socialization of products with a LP value 44.39 percent. The expert respondents viewed that socialization was the key factor to accelerate the financing for MSMEs at PT Pegadaian.

4. Conclusion

Based on the study, the main priority issues on the customers issues was the lack of understanding of the Islamic pawnshop, next, the internal issues was the lack of product marketing and on the competition issues was the rise of pawn business. On side of the problem aspect, the most priority was an internal problem with the priority value 36 percent, followed by customer problems with the limiting priority value 34 percent, and the last was the issue of competition by 30 percent.

The order of solution priority starting from the customer solution with the socialization to the societies about Islamic pawnshop and continued by the aspect of internal solution was expanding the marketing strategy, and last competition solution was to make a different strategy with competitors. Furthermore, refer to the aspect of the solution; the solution of internal Islamic pawnshops was the main priority with a value of 42 percent.

Lastly, based on the weighted results using ANP approach, the practitioners and academics claimed from three alternatives strategy, the most dominant was the socialization of the product with limiting value 44 percent, followed by improving the service quality by 41 percent and last priority was strengthening the relationship among IFIs with value by 15 percent. This weighting has level based on Rater Agreement between practitioners and academics by 100 percent.

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CONSUMERS' PREFERENCE TOWARDS ISLAMIC BANKING

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Abstract

Objective - This research aims to provide empirical evidence on the factors motivating consumers to save in Islamic banking.

Methods - The one sample t-test is employed to test hypothesis. The validity and the reliability of research variables have been examined.

Results - The result proved that consumers' decision to save in Islamic banking are influenced by economic and religious factors, such as receiving economic benefits, quick services, online facilities, easily reachable locations, and having a better understanding of Islamic principles.

Conclusions - The existence of a relationship between economic and religious preference proves that, in making decisions, consumers wish to attain two satisfaction levels: satisfaction in the world and in the hereafter.

Keywords: Economic Preferences, Religious Preference, and Islamic Banking.

Abstrak

Tujuan - Penelitian ini bertujuan untuk memberikan bukti secara empiris faktor-faktor yang mendorong nasabah menabung di bank syariah.

Metode - Alat analisis yang digunakan untuk menguji hipotesis adalah one sample t test. Sedangkan test validitas dan reliabilitas digunakan untuk menguji variabel penelitian.

Hasil - Hasil penelitian menunjukkan bahwa dalam menabung di bank syariah, nasabah dipengaruhi oleh faktor ekonomis dan faktor agamis, seperti mendapatkan manfaat ekonomi, pelayanan yang cepat, fasilitas online, lokasi yang mudah dijangkau, dan memiliki pemahaman terhadap prinsip-prinsip agama islam dengan baik.

Kesimpulan - Adanya hubungan antara preferensi ekonomis dan preferensi agamis menunjukkan bahwa nasabah dalam menabung di bank syariah ingin mencapai tingkat kepuasan, yaitu kepuasan duniawi dan ukhrawi akhirat)

Kata Kunci : Preferensi Ekonomis, Preferensi Agamis, Perbankan Syariah

1. Introduction

One of the concepts often discussed by economist these days is Islamic banking. This concept applies Islamic teachings in the banking system, particularly related to interest-free financial transactions (Caragata, 2000). Islamic banking function as a financial intermediary institution conducts financial transactions that are similar to the conventional banking. Funds collected by Islamic banking from those having excess capital are further transmitted to those having shortage capitals, so that economic development process can be realized.

One main actor in the development of Islamic banking is Islamic Development Bank (IDB), which supervises the organization of Daar-al-Maal al-Islami (Islamic House of Funds) or DMI. Likewise, International Association of Islamic Banks (IAIB) was established as a technical advisory institution for Islamic banking in August 1997 (Erol and of El Bdour, 1989). The first attempt to establish local Islamic bank was managed at the end of 1950 in a rural area in Pakistan, where the essence of interest is missed. Later, followed by the Moslems in Malaysia, who tried to establish an interest-free bank in the middle of 1940-s.

In India, Jamaat-E-Islami Hind started the practice of free interest loan in 1968. While in Egypt, the first Islamic bank named Nasser Social Bank was founded in September 1971 (Erol and El-Bdour, 1989), in Iran, the Islamic banking system was started in 1979, by the nationalization of commercial banks (Yousefi et al, 1995).

On the first November 1991, the first Islamic bank was established in Indonesia, namely PT. Bank Muamalat Indonesia (BMI). At the beginning, the operation of BMI had not been strengthened with the banking act covering Islamic principles for banking practice. The existing Banking Act at the time, i.e. Act No. 7/1992, explains only “bank with profit sharing system” with no greater detail. Since the prevailing of Banking Act No.10/1998, the existence of Islamic banking has been expressly regulated. Banking Act No.10/1998 also regulates the opportunity for conventional banks to open Islamic branches or convert them to Islamic banks. While some conventional bank open Islamic branches, such as Bank IFI, Bank BNI, and Bank Jabar, a conventional bank, i.e. Bank Susila Bhakti, was transformed itself into Islamic bank and named as Bank Syariah Mandiri.

Fundamentally, objections from Muslims on conventional banking system comes from the understanding that interest is equal to forbidden *riba*, besides the operational activities of the banking system, within which un-Islamic business activities exist. These activities include the channeling of the fund to businesses concerning unlawful goods and services, the speculative

activities (*maysir*), the unjust profit sharing for lenders and borrowers (*jahala*), and the uncertain contracts (*gharar*) (Iqbal, 1997).

In making decision to save, consumers usually consider the interest rate. Savings is, according to neoclassical economists, a function of interest rate. The higher interest rate level, the more are money to be saved and current consumptions to be sacrificed. The sacrifice of current consumptions will benefit future consumptions. Keynes admits that interest rate influences consumptions, though he contends that in the short run, with constant income, the influence of interest on expending is not significant (Mankiw, 1997).

Interest rate agreed in advance by a conventional bank and consumers indicate certainty, i.e. a number of interest consumers will earn. This amount of interest can be counted as a certain percentage of savings. Concept offered by Islamic banking does not use interest rate. An agreement between an Islamic bank and consumers concerns the proportion of profit sharing and contains uncertainty. Earned profit sharing determined by the success of Islamic bank to make a profit (Karsten, 1982).

The uncertainty of profit earned by Islamic banking raises a question on whether consumer behavior in Islamic banking refers also to the general economic behavior, i.e. considering the profit as most important. If their behavior refers to profit, and the profit rate in Islamic and conventional banking is the same, consumers will have to decide whether to choose Islamic banking or choose the conventional ones.

In a situation where the economy is still predominated by the conventional banking system, the interest rate becomes a reference (bench-mark) for the consumers, though it does not prevail for those avoiding conventional banks because of *riba*. In recent economic crisis showed the low read sector growth, profit sharing earned by Islamic banking is also small, far smaller than the interest rate. Consequently, those choosing a bank with economic profit motives will consider saving money in Islamic as uninteresting (Karim, 2001).

An opinion stating that to save in Islamic banking is uninteresting can be argued as the third party fund in Islamic banking increases from year to year (except in 1998 when all banks experience serious crisis). In 1999, third party fund collected by Islamic banking (i.e. Bank Muamalat Indonesia) reached IDR 528.08 billion, meaning that there was an increase of IDR 136.16 billion or 34.78% from IDR 391.92 billion in 1998. This amount exceeds the attainment in 1997 when the economic crisis was starting, i.e. IDR 463.27 billion. The increase happened from demand deposit, savings, and time deposit. *Wadiah* increased 17.77% from IDR 68.01 billion to IDR 80.09 billion. *Mudharabah* savings, increased 44.48% from IDR 102.85 billion to

IDR 148.58 billion, whereas *mudharabah* time deposit increased 3.77% from IDR 221.08 billion to IDR 229.42 billion. This increase of third party fund indicated the restoration of society's and business partners' trust to Bank Muamalat Indonesia after the decrease in 1998 when interest rates in conventional banking were rapidly increasing (Bank Muamalat Indonesia, 1999).

Table 1: Third Party Fund Collected by Islamic Bank

Year	Third Party Fund (in billions of IDR)
1999	528.08
1998	391.92
1997	463.27

Source: Bank Muamalat Indonesia

From the above explanation, it can be concluded that if Islamic banking management believes consumers' attitude is different, Islamic banking will have to attain the same profit level as the conventional bank. However, if every consumer is also considered to have economic motive and expect more profit, Islamic banking will have to be able to compete with the conventional bank. Differences between the concept of Islamic banking and conventional banking can influence consumers' attitude in taking their choice. Here, special qualities must be offered by Islamic banking to compete with the conventional one.

Ratnawati (2000) studies to analyze potency, preference, and behavior of society to Islamic banking in West Java region. Using a logit model to all respondents, factors influencing society to use Islamic banking service are location/access, service, credibility, facility, status, and as well as knowledge of Islamic banking. Using a logit model to Islamic banking consumers, factors influencing society to continue to adopt Islamic banking is accessibility (having a negative effect on Islamic banks), as well as knowledge of Islamic banking, Islamic banking is more beneficial, and service easiness. Using logit model to all non-Islamic banking consumers, factors influencing the potency of society to adopt Islamic banking are: First, accessibility (having a negative effect on Islamic banks). Second, banking location/access. Third, service (tend to make consumer do not want to adopt Islamic banking). Fourth, knowledge of Islamic banking. Fifth, profit (Islamic banking is more beneficial). Sixth, Islamic banking follow the Islamic law. Seventh, easy service. Conclusion taken from this research is that society chooses Islamic banking because of economic factors.

The same study by Wiratno (2000) to analyze potency, preference and behavior of society to Islamic banking in Central Java and D.I Yogyakarta regions. The result is aimed at knowing

society's preference to place their deposits in Islamic banking. Using a logit model to all responders, factors influencing society's preference are their acceptance of new technology, mobility (preference to save enthused more by society with low mobility), tolerance to the religious deviation, and comprehensive (respondents' knowledge on Islamic banking comprehensiveness).

Preference to Islamic banking system indicates that society chooses an Islamic Bank because of its relative profit, its compatibility, its comprehensiveness or how far Islamic banking has a universal dimension concerning economic, culture and social aspects, and its observability. General conclusion taken from the logit model analysis is that society chooses Islamic banking because of economic and religious factors. Information on consumers' characteristics and behavior are very important for developing Islamic banking. In order to understand the consumers' characteristics and behaviors, this research is aimed at providing empirical evidence on their preferences toward Islamic banking and factors motivate them to save in Islamic banking.

In modern economics, the problem of choice is much depended on individual behavior and possibly taking no account of the norms prevails in society. In Islamic economics, we do not reside in a position to distribute resources in the way we are willing to do. There is a serious ethical boundary based on principles derived from the Quran and Sunnah (Mannan, 1993). The moral filter is, according to Chapra (2000), needed to less unlimited desires in exploiting resources. Islamic economics considered by economists as based on ethical values (El-Askher, 1987) because it has the philosophy of Tawhid as a background. Tawhid has ethical contexts referring to the integration of spiritual and temporal aspects of human being's existence (Muhammad, 2000). Ethics, a Moslem's Tawhid attitude is reflected.

The plan of this paper is as follows: section 1 is the introduction, section 2 provides the theory of consumer behavior, section 3 discusses the methodology, section 4 presents result and discussion, and finally section 5 is the conclusion.

2. Methodology

The spreading of questioners was conducted in January-February 2015 with total 43 respondents. The method used in taking the sample is purposive sampling. To identify factors motivating consumers to choose an Islamic banking, variables used by the researcher are grouped into two categories, i.e. Economic variables (consumers save because of economic factors) and religious factors (consumers save because of religious factors).

Test on research variables is important, to ensure whether used variables (which are formulated in detailed questions) are valid and reliable or not. The validity of research questioner indicates its ability to represent something that will be measured in the research, whereas reliability of question indicates the consistency of answer given by responders from time to time.

Test of validity and reliability was conducted using SPSS program. Validity can be seen from the correlation value while reliability is seen from the value of Cronbach alpha. A scale used to determine respondents answer is the scale of Likert, i.e. extremely agree (SS) or (1), agree (s) or (2), neutral or (3) disagree (TS) or (4), and extremely disagree (STS) or (5).

The test of the hypothesis is conducted to answer research questions so that objectives proposed in this research can be attained. The hypothesis proposed in this research is: It is expected that there are economic, and religious factors motivating consumers to save in Islamic banking. A tool used to analyze the first hypothesis is one sample test.

3. Result and Discussion

Test of Validity and Reliability

Test of validity and reliability was conducted using SPSS program. Validity is seen from the correlation value, while reliability is seen from the value of Cronbach alpha. The correlation value 0,7320 is more than r table ($\alpha=5\%$ $df=40$ equal to 1,684). Thus, it can conclude that is valid. While. The value of Cronbach alpha 0,8442 is more than r table ($\alpha=5\%$ $df=40$ equal to 1,684) or more than 0,5 and positive. Thus, it can conclude that it is reliable.

Table 2. Validity

Variable	Correlation Value	Valid or Not
Economic	0,7320	Valid
Religious	0,7320	Valid

Table 3. Reliability

Variable	Alpha Cronbach Value	Reliable or Not
Preference	0,8442	Reliable

Result of One Sample Test

One sample test is used to test the hypothesis concerning consumers' preference to Islamic banking, i.e. to identify factors motivating consumers to save in Islamic banking. The expected factor are economic and religious factors; all of them later to be tested. The result shows that the first null hypothesis is rejected. Obtained statistic (49.014) is more than t table ($\alpha=5\%$ $df=40$ equal to 1.684), and the probability is 0.00 (smaller than 0.05). Thus, it can be concluded that economic and religious factors have motivated consumers to save in Islamic banking.

Test on each variable (economic and religious variables) is also conducted, to see whether these variables motivate consumers to save in Islamic banking. The test is also conducted with one sample test, and the result indicates that null hypothesis is rejected. Such rejection can be seen from t statistics that is more than t table, or probability, that is less than 0.05. For the economic variable, t statistic (48,024) is again more than t table. At the same time, the probability is 0.00 smaller than 0.05. For religious factors t statistic (43,464) is again more than t table. At the same time, the probability is 0.00 smaller than 0.05). Here, there are factors significantly motivating consumers to save in Islamic banking, i.e. economic, and religious factors.

Table 4. One-Sample t-Test

Variable	T statistic Value	Probability (significant)
Economic	48,024	0.000
Religious	43,364	0.000

Metawa and Almosawi (1998) found evidence that the consumers' decision in choosing an Islamic bank is motivated by religious factors, where consumers emphasize their adherence to Islamic principles. Further, this decision is also motivated by the factors of profit, families and friends, and bank's location. These factors here in after contribute to responders' characteristics, such as age, income and education.

Erol and el-bdour (1989) through their empirical study found that motive in choosing an Islamic bank as a depository institution is not a religion, but profit. The existence of Islamic bank's new branch is not such an important consideration for the improvement of service. Besides, peer groups have an influence on consumers' decision to choose an Islamic bank and consumers' awareness to obtain profit from profit and loss sharing investment and income redistribution role of Islamic banking system. Later in 1990, Erol *et al.* Conduct and study or conventional banking. This study reports that consumer chooses an Islamic bank because of its quick and

efficient services, its reputation, and its banking services. The conclusion is that the profit motive (economic factor) exists in choosing Islamic banking.

Research conducted by Haron and Norafifah (2000) proves the relationship between the interest rate in conventional banking and the amount of deposits placed in Islamic banking and return given to these deposits. The result shows that the relationship between return and a number of deposits placed in Islamic banking positive, where the increase of return increases a number of deposits. At the same time, the relationship between the interest rate in conventional banking and a number of deposits placed in Islamic banking is negative, where the increase of interest rate in conventional banking decreases a number of deposits in Islamic banking. The conclusion can be taken from this study is that profit (economic factor) motivates a consumer to place their money in a bank.

The result of research conducted by Naser, Jamal, and Al-Khatib (1999) indicates that factors motivating consumers to choose Islamic banking are bank reputation, reason of religion, perception that Islamic banking do not only offering facilities which is equal to conventional banking but also apply Islamic principles, and its ability to take care of secrecy, as well as profit. At the same time, factors motivating consumers to choose both Islamic and the conventional bank is to diversify investment and the limitation of Islamic banking branches and service time. A conclusion can be taken from this research is that the consumer chooses Islamic banking because of both religious factors and profit (economic factors).

Gerrad and Cunningham (1997), Moslems' and non Moslems' attitude in choosing Islamic banking is not significantly different, where they choose an Islamic bank because of its expeditious service, its secrecy, and its reputation and image, its light costs of checking as well as the availability of parking. Pursuant to these results, consumers choose Islamic banking because of economic factors.

According to this research, the result proved that consumers' decision to save in Islamic banking is influenced by economic and religious factors. The result of research conducted by Naser, Jamal, and Al-Khatib is that the consumer chooses Islamic banking because of both religious factors and profit (economic factors).

One's motivation in doing an activity is related to his psychological condition. If one in doing an economic activity, such as saving in Islamic banking, motivated by religious and economics motive, this will be appropriate to those arranged by Islam. According to Qardhawi (1996), the human being is Allah's creation that having the character of *mukallaf* (shouldering religious obligation). Pursuant to this nature, the human being in conduction an activity is according to

religious demand. Besides, the freedom to do the economic activity (in the boundaries of Islamic law) is also a motivator for the human being to pursue profit, in order to reach happiness and welfare. The freedom given by Allah must be executed in a way agreeing with the principle of permissiveness-forbidden, committing to the obligations determined by Islamic law, and generating no disadvantage for the people, as well as supporting the existence of togetherness in realizing prosperity (Fikri, 1997).

4. Conclusion

The results of this research concerning consumers' preference to Islamic banking proved that economic and religious factors have prompted consumers to save in Islamic banking, such as taking in economic benefits, quick service, online facilities, easily reachable locations, and having a better understanding of Islamic principles. There is a relationship between economic and religious preferences in saving in Islamic banking.

The purpose of human life in Islam is to take for the rewards and favors of Allah. Every activity, including economic activity, will be addressed to attain such a purpose. According to Chapra (2000), the elementary principles formulating Muslim's worldview, i.e. Tawhid (the oneness of God), Khilafah (vicegerent), and justice. Thereby, the human being is Allah's vicegerent on the earth. In executing the function, the human being has to respect justice. This will be reached, when the human being has universal fraternal feelings, understanding that resources are trusteeship must be worked efficiently for human prosperity, and confession on the freedom of the human being.

The Islamic consumer behavior is that referring to the boundaries of Islamic law, which is enabled/allowed for and which is prohibited /forbidden. Islamic consumers are enabled to fulfill their needs by utilizing resources on the earth and without being luxurious because Islam frowns upon luxurious/extravagant life.

These conclusions indicate that consumers consider two satisfaction levels through saving in Islamic Banking, i.e., satisfaction in the world and the hereafter. Every Muslim is claimed to achieve happiness in the world and the hereafter (*falah*), i.e, by fulfilling needs in both life.

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THE EPISTEMOLOGICAL PERSPECTIVE OF FRACTIONAL RESERVE BANKING SYSTEM AND 100% RESERVE BANKING SYSTEM : WHERE SHOULD ISLAMIC BANKS STAND?

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Abstract

Objectives – this research is aimed to compare those epistemological bases to the mindset of Islamic Bank and try to drive the philosophy in practical operation whether based on the Fractional Reserve Banking System (RBS) or 100% RBS and analyze the challenges in deploying the 100%RBS.

Methods - This research will be conducted based on an extensive literature review.

Results - Based on the epistemological analysis of money and the business cycle as well as the views of Islamic scholars, 100%RBS should be the best for Islamic Bank. There are four types of 100% RBS namely Pure Commodity Money, Sovereign Money, Narrow Banking, and Limited Purpose Banking. To deploy it into the economic system, another philosophical work should be done to choose one of the types and strengthen it so that the theory of 100%RBS can be implemented for the goodness of Islamic Bank.

Conclusion - In Conclusions, Based on the epistemology defined by Islamic Scholars, FractRBS has more *mafsadah* if we compare to the *masalah*. Therefore, 100% RBS should be better for the Islamic Bank.

Keywords: Fractional Reserve Banking System, 100% Reserve Banking System, Islamic Banking, Epistemological

Abstrak

Tujuan – Penelitian ini dimaksudkan untuk membandingkan basis epistemologi dan *mindset* perbankan syariah dan mencoba untuk menurunkan filosofi tersebut ke dalam praktis operasional apakah berbasis FractRBS atau 100% RBS, kemudian mengalisa tantangan-tantangan dalam menerapkan 100%RBS.

Metode – Penelitian ini dilaksanakan berdasarkan kajian literatur yang mendalam.

Hasil – Berdasarkan analisis epistemologis tentang uang dan siklus bisnis serta pandangan dari cendekiawan Islam, 100%RBS mesti menjadi yang terbaik untuk perbankan syariah. Ada empat tipe dari 100% RBS, yakni Pure Commodity Money, Sovereign Money, Narrow Banking, and Limited Purpose Banking. Untuk menerapkannya ke dalam sistem ekonomi, kerangka filosofi lainnya mesti dilakukan untuk memilih satu tipe dari beberapa tipe di atas dan memperkuatnya supaya teori 100%RBS dapat diterapkan demi kebaikan bank syariah.

Kesimpulan – Disimpulkan bahwa berdasarkan epistemologi yang dijelaskan oleh para cendekiawan Islam, FractRBS memiliki dampak negatif yang lebih banyak dibandingkan manfaatnya. Oleh karena itu, 100% RBS adalah hal yang lebih baik buat bank syariah.

Keywords: Fractional Reserve Banking System, 100% Reserve Banking System, Islamic Banking, Epistemological

1. Introduction

The development of Islamic Banking (later stated as IB) in the modern era is overwhelming. The global financial industry has seen the fast development of IB since decades ago. According to the Ernst and Young Report of Islamic Banking Competitiveness, below is the growth of IB assets as of 2010 to 2014:

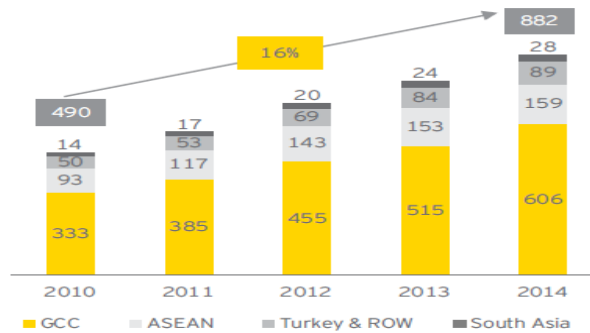


Figure 1 International Participations Banking Asset (US billion)
Source: E & Y World Islamic Banking Competitiveness Report, 2016

Since 2010, the Cumulative Annual Growth Rate (CAGR) of IB assets grew 16% annually from US\$ 490 Billion and almost doubled to US\$ 882 billion in 2014. GCC led the way by contributing almost 60% of Industry assets (Ernst and Young, 2016). Behind those numbers, the scholars should scrutinize deeper on how the amplification of IB theory. Most of the IBs are operated under the dual banking system. Moreover, It is also known that the growth of IB industry is now benchmarking to its conventional counterpart in all aspects including the liquidity management (Wan Ibrahim & Ismail, 2015). In this context, Both IB and Conventional Banking (later written as CB) use the same mode of liquidity management system which named FractRBS.

In the axiological perspective, the FractRBS is a technique that most banks including IB, used it to manage their liquidity by maintaining cash reserve as low as possible (Hanif, 2011). That means, banks as intermediaries between the surplus unit (depositors) and the deficit unit (debtors) maintain only a fraction of the surplus unit money to be channeled to debtors in optimized manner. For instance, if one bank has a \$ 1.000 of liability in form of demand deposit as well as fixed deposit then, the bank only hold a part of it, for example, a \$ 100 as a reserve and the rest is extended to debtors as a credit amounted \$ 900. For many banks, this means more profit instead of providing safety to its depositors. When the economy is good, FractRBS is the main “money machine” to accumulate the aggregate income. Otherwise, in the recession era; when most of the people think that holding cash in their faults is more comfortable for them, FractRBS will trigger a bank run because the banks somehow are illiquid and only have a reserve of \$ 100 which is not enough to meet the request of a large number of customers to

withdraw their fund at the same time since the money is stuck in the credit. On the broadside of the banking business, Both IB and CB which operated in a dual banking system, keep their \$100 money to be kept by the central bank in form of statutory reserve. If the statutory reserve determined by the central bank is low, by some economic school, it is “hair on fire” to steer the economic growth of a country since it used to finance the production as well as consumption of society (Werner, 2014, 2016).

On the other hand, there is a concept of 100% RBS which has opposite operational side when compared to the FractRBS. In axiological perspective, this concept drives banks to be conservative in using the depositor fund. For instance, one bank has recorded deposits in form of demand deposit \$ 800 and fixed deposit \$200. The 100% RBS only applies to guard the demand deposit of \$800 on their reserve because it must be available at all times for depositors. The amount of fixed deposit of \$200 will be given to the creditors. To some extent, at least the liquidity mismatch that happened in FractRBS can be reduced due to plotting the demand deposit as a mere of saving and separate it from fixed deposit. The fixed deposit fund in this system is an integral part to push the economy forward. This concept may lead to the trade-off that will be faced by banks. This is a choice between providing a safe and sound deposit product for depositors as well as optimizing the depositor's fund to create significant profit for the interest of banks (Allen, 2011).

So, the question now is what system should Islamic Bank operate? This paper will attempt to answer that noble question by scrutinizing the basis thinking or on the other words epistemological basis of FracRB as well as 100% RBS with looking up into the history and the scholar's opinion over the topic. Subsequent to that, this research is aimed to compare those epistemological bases to the mindset of IB and try to drive the philosophy in practical operation whether based on the FractRBS or 100% RBS and analyze the challenges in deploying the 100%RBS.

2. Research Method

This research will be conducted based on an extensive literature review. This paper aims to highlight, explain and discuss the academic treatise of Western scholars as well as Islamic scholars regarding the FractRBS and 100% RBS.

3. Fractional Reserve Banking and 100% Reserve Banking System From Time to Time

The Reserve Banking System has been introduced long ago by the Roman Empire after the death of Emperor Justinian in 565 BC. Those days, 100 % reserve applied and it was the true origin of the modern bank. The bank received the money from depositors who have put their

money for a safe keeping purpose. In this case, the orthodox said there was no transfer of ownership of the money happened (Ochaita, 2010).

The history of banking for a human being cannot be separated to the “Goldsmith” banking system that was established in England at 1660 by Restoration of Charles II. The Goldsmith Banking which was practiced in the 17th Century was claimed as the first Financial Revolution. Firstly, people were doing a business transaction using gold. Then, they begun to place their gold with the goldsmith who would store it for free. After receiving it they issue a receipt to the depositors. In next to no time, people were doing their business by Goldsmith receipt. The Goldsmith Company soon realized that those people did not redeem the deposited gold and produced more receipt beyond the value of stored gold. So, they were FractRBS with interest paid on the deposit, loans were furnished and also discounted cheque was available (Quinn, 1997). Basically, they were trying to make short term loans by analyzing the customer behavior who would not all attempt to take out their money at the same time (Mallett, 2011, 2015).

Leap into the mid-eighteenth century until 1930, it was a time of Chettiar Banking System (CBS) that was practiced by the South Indian state society whose at that time being the British State Colony. The CBS has been recorded since decades ago in the book of the history of banking as the first banking system which maintained no reserve in their daily operation. They tried to make maximum profit by lending the money to the real sector as well as placed it in the bank in the system. The CBS offered two products namely fixed deposit and the demand deposit (checking deposit). Both products gave interest which at the end triggered a dispute whether demand deposit checking account should be rendered an interest or not. By paying out interest on the checking account it implies the keeping of FractRBS. The CBS was also made some delay in the redemption of checking deposit. Cheque books were given to the depositor and will be paid usually one day after sight (or after the presentation of the cheque). The CBS paid the cheque in the same day if only marked “urgent”. The previous statement is based on this following testimony:

“Chettiars are not in the habit of keeping a reserve fund. If cash to pay depositors runs short at any time it is their practice to obtain what is required from another firm...”

Testimonials above was the embryo of so-called interbank fund placement in the modern era that supports the FractRBS (Nair, 2013).

The practice was going on to a time when United States of America (USA) won their World War II and led the world economy by constituting the Breton Wood Agreement on 1944. The

Agreement was designed by John Maynard Keynes of United Kingdom. It governed the rest of the world to use US Dollar as the primary currency of international trade mechanism. Those days, the US committed that every 35 US Dollar printed it would be backed by 1 troy ounce of gold. It was a good start to re-establish the economy which has been destroyed by the world war. However, this system was not long last and from 1973, the US via President Richard Nixon decided to end the agreement by omitting “Dollar Backed Gold System”. Again the end of this agreement was the start of FractRBS in the late 19 centuries (Ishaq & Mahjabeen, 2015; Meera & Larbani, 2009) .

4. The Debates over Fractional Reserve Banking System and 100% Reserve Banking System

It was a never ending debate on the matter of FractRBS as well as 100% RBS. First, this paragraph will discuss on the proponents of FractRBS. The FractRBS was promoted as well by Adam Smith. In Adam Smith’s view, money is a commodity that will be a benefit to the society in general whereas the bank is the main driver of economic development by substituting the previous medium of exchange which was gold and silver to paper money or fiat money. By substituting it, it created some productivity because the more money supplied by banks to the economy could give value addition from previously dead stock to be more productive for the greater society (Ahiakpor, 1999; Currott, 2016; Wallace, 1988). Besides Adam Smith, John Maynard Keynes on his book of General Theory also stressed the importance of the FractRBS. To support the Keynes theory of boom and bust business cycle it should use FractRBS as the media to expand money supply into the economy so that it will increase the consumption as well as investment (Cochran & Call, 1998, 2000). The proponents of FractRBS always stated that it provide such safety to the banks to meet its obligations whenever customers make some withdrawal and give liquidity benefit to the banks (Carlson, 2013). Moreover, Henry Thornton who was the first economist who introduced “Quantity Theory of Money” which explains the close relationship between quantity money supply, general price level, and purchasing power. The theory simply discussed that when more money supplied into the economic system, it creates more purchasing power that drives up the price level and creates inflation. This concept was based on the bank lending activities to raise profit to be paid to the borrower. By the explanation, it shows that banks should maintain a low level of reserve in their book to get maximum profit of investment based on interest bearing financing activities. This concept also restated by Milton Friedman in 1959 and used as the basis of monetarist macro policy (Ishaq & Mahjabeen, 2015).

After discussing the proponents of FractRBS, this paragraph will dedicate to explore the contra opinions. An economist from Austrian school argued that the practice that has been done by Banks in a way that they keep low reserves money has led to credit creation without any increment in the saving side. The practice is opposite to the definition of deposit “*the depositor's deposit goods with the depository because they wish for the depository to safeguard the goods while retaining at all time the availability of their use*” as well as the definition of a loan “*the borrower relinquishing the availability of good of their use*”. Thus it is counted as a risky manner since bank might delay the withdrawal that is done by depositors as well as the process of the loan drawdown by the creditor. Thus it creates some necessity to the Central Bank to give “Lender of Last Resort” due to all demand deposit are being invested mostly in credit to save guard the depositors interest (Bagus & Howden, 2009, 2010, 2011). FractRBS is fraudulent, unethical and could destruct the economy (Barnett II & Block, 2009).

On the other hand, another economist opined that it cannot be considered as a fraud but it is a risky way to manage liquidity since by nature depositors in only put their money in the bank for safe keeping purpose (Nair, 2015). Moreover, FractRBS is classified as economic parasitism (Nuri, 2002). It is also denoted that the FractRBS is the root of East Asian Financial Crisis (Radelet & Sachs, 2000). FractRBS caused a liquidity mismatch that triggered a chain reaction like a bank run. Likewise, FractRBS which began under Goldsmiths will be led to the fragility of the banking system because the short term demandable deposit is used to finance long-term illiquid financing (Rochet, 2003). FractRBS will be smoothly operated whenever bank can cover the daily withdrawal of demand deposit. Furthermore, the modern FractRBS is more than shell game or is known also as Ponzi Scheme¹ whereas by keeping the lowest reserve in Bank's fault or in central Banking, they pay the old depositors with the fresh fund from the new depositors. FractRBS is like bridge builder. The bridge builder does not calculate the total population of people that are in the particular area; they only estimate how many people will pass the bridge in a day (Rothbard, 2008).

Move on to the debates of *100% RBS*, this system is actually an alternative of the negative impact of FractRBS. The proponents of *100% RBS* are led by the Austrian School of Economics as well as Noble Prize Laureate named Friedrich A Hayek, Milton Friedman, James Tobin, Maurice Allais, and the Chicago School of Economics who are fed up by the negative impact of

¹ Is a system that is invented by Charles Ponzi on 1920. He was charged prison because of introducing this method because it is like a pyramid scheme where the fund from a new investor is used to service the investment that is made by the old investor.

FractRBS. The founder of Austrian School of Economics², Ludwig von Mises stressed the importance of *100% RBS* due to the role of the bank as the issuer of fiduciary media (issuer of fiat money) in form of bank deposit. He stated that the banks should back the fiat money with metallic commodity or it might use gold as the backing of fiat money. Should it implemented in the banking industry, it might help to control inflation (De Soto, 2006, p. 718). Mises idea was scrutinized by his brilliant follower named FA. Hayek. Hayek wrote an article of *100% RBS* and asserted that the banking system had to combine the fiat money and gold and keep a *100%RBS* against all their demand deposit obligations (De Soto, 2006, p. 725). Another Austrian School economist; Murray Rothbard with his article titled “The Case for a 100-Percent Gold Dollar”. In the article, He criticized the *FractRBS* since it creates boom-bust. On the other hand, he said that the *100% RBS* would result in not only economic stability it reduces the legal risk that is occurred by implementing the *FractRBS* whenever bankers making a profit on someone else’s asset (De Soto, 2006, p. 727). Besides the Austrian School Economist, the European Economist Maurice Allais of France who won Noble Prize 1988 also supported the *100% RBS* by stating that *FractRBS* is inflaming the economic crisis. He promoted the anti-view of Austrian School of Austrian Business Cycle to replace the boom-bust Cycle that was initiated by the proponents of *FractRBS*. In his proposal, he strained out that *100% RBS* might help the government to reduce the credit expansion as well as controlling the money supply. He also quoted the Chicago School of economic who promoted *100% RBS* as well (De Soto, 2006, p. 730). Last, there was a proposal from Chicago School of Economics in 1935 by making an article titled the Chicago Plan of Banking Reform. Henry Simmons as the leader of this school of thought pointed out that *100% RBS* was not only a macroeconomic policy but also as the tools for government in controlling the quantity of money. He added that the deposit that is submitted to banks is a mere of warehouse deposit only for purpose of fiduciary that implies bank to keep the money away to be exploited in form of credit. This proposal, later on, were taken up by Irving Fisher and Milton Friedman. As Freidman idea of *100% RBS*, he added up some interest that should be paid to the depositor (De Soto, 2006, pp. 731–735).

On the other hand, there is a group of an economist who is having a different opinion on the goodness of *100% RBS*. They criticized the fundamental hypothesis that is used to establish the concept of *100% RBS*. They stated that *100% RBS* is such a radical way to avert the financial turmoil. They argued on the basis of the proponent's economist of *100% RBS* which stated that it can control the money supply as well as the credit expansion. They asserted the three bases of it which are the role of money as well as the linkage within the credit money supply and the

economy. They discussed on the epistemological perspective of 100% RBS. The 100% RBS would not be work successfully even the money supply controlled smoothly. It is because the economic agent has a purpose of holding money as a mere of precautionary. By that, they mean that the 100% RBS will not work well whenever the economy is in recess because all demand deposits are secured and on the other hand the credit would not expand because of the act of holding cash money (Dow, Johnsen, & Montagnoli, 2015). To prevent the bank from keeping such excess reserves, some economist prefers to charge tax so that the credit can be channelled properly (Keister & Mcandrews, 2009). The Banking School is also criticizing the concept of 100% RBS. It is because neglecting the control of central banks as well as authorities on the economy. They emphasize clearly on the causation of money and the real economy via credit creation function that exists in FractRBS (Goodhart & Jensen, 2015). Finally, most of the economist who rejected the 100% RBS have the main concern on the disability of 100% RBS to make some near monies or in the other words financial innovation. Those haters of 100% RBS also highlight on the status of money that is a mere of easing the transaction and not as a commodity. 100% RBS is not the sole solution to recent financial instability. The major changes to implement the 100% RBS are to omit the interest bearing banking product (Van Dixhorn, 2013). The last comment likely supports the Islamic way of ethical economic which mainly prohibits interest because tantamount of *Riba*.

5. Epistemological Perspective of Fractional Reserve Banking Full Reserve Banking: Where Should Islamic Banking Stand?

Based on the historical perspectives as well as the debate over FractRBS and 100% RBS, we can draw some epistemological concept that has been discussed below:

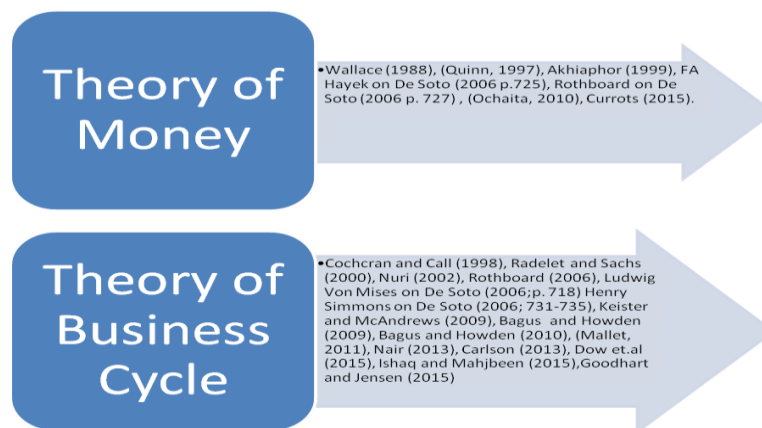


Figure 2 Summary of Reference of Historical & Debates on the Epistemological FractRBS and 100% RBS

Source: Author

Based on above table this paper will discuss more on the theory of money as well as business cycle before drawing a conclusion in which system Islamic Bank should be used in the future.

5.1. The Theory Of Money

Money <i>“When you start considering money as an asset or store of value, this is the key to almost all disputes in macro economy” Mark Blaug As stated in Tanjung and Siregar (2012) p. 51</i>		
FractRB - Money is Asset - Money is store of value (Cochran and Call,1998).	FullRB - Money is medium of Exchange (Ochaita, 2010), Currots (2015).	Islam Money is medium of Exchange (Hassan,2011)

Figure 3 The Theory of Money in FractRBS, 100% RBS and Islam

In general, money cannot be used except there is a social contract agreed upon by all members of a society. Before modern money is widely used, long ago most of the human used the barter system. This system was not long lasting because has the limitation on the scope of exchange and production. Mean that those who can't produce the goods would not participate in the barter system (Hasan, 2011; Rothbard, 2008, p. 4). In this case, money comes as a solution to replace barter system and overcoming the huge difficulties (Rothbard, 2008, p. 5).

Before going so far to discuss the concept of money in FractRBS and 100% RBS, let see below phrase that was said by Mark Blaug³ :

“When you start considering money as an asset or store of value, this is the key to almost all disputes in macro economy” (Tanjung & Siregar, 2012, p. 51)

Above phrase by Mark Blaug means much to this discussion section. FractRBS and 100% RBS have been set up on the different basis. As per section 4.0 of debate in FractRBS and 100% RBS, we are aware that Keynes as the supporter of FractRBS. We have to scrutinize deeper what Keynes suggest on the status of money not only as a medium of exchange but also more important as a store of value or on the other hand as a commodity. In this case, due to the status of money in FractRBS is not neutral, banks including Islamic Banks can use all deposit either demand deposit or fixed deposit for credit/financing by maintaining low reserves in the central bank (Cochran & Call, 1998). Because of the non-neutrality of money, as per said in section 3, The CBS offered interest to the demand deposit account holders.

On the other hand, the 100% RBS has instituted on the basis that money is only as a medium of exchange. So, the demand deposit which puts at bank account is more like warehouse receipt. By that, I mean that the money which is deposited under demand deposit cannot be channeled into financing credit (Cochran & Call, 1998). This principle was used long ago in the Roman Empire age who was introduced 100% RBS to the society. In this perspective, the neutrality of money in Islam is almost the same with the 100% RBS principle. Islam protects the money to neutral in every time by introducing the concept of Riba (Hasan, 2011). Islam also treats money as “actual capital” instead of “potential capital”. When money becomes "potential capital" it refers to what has been done in FractRBS whereas the money in demand deposit is used to fund a project or to make more profit for the benefit of Bank. Otherwise, the “actual capital” is akin to 100% RBS since the demand deposit will be idle and available at any time to serve the need of the depositors. In Islam, money is basically “actual capital” a mere of supporting a transaction. If one desire to generate more wealth with his money, they have to invest in a business/project/trading so that they bare a risk and get the lawful profit (Iqbal & Mirakhor, 2013, p. 4).

5.2. *The Concept of Business Cycle*

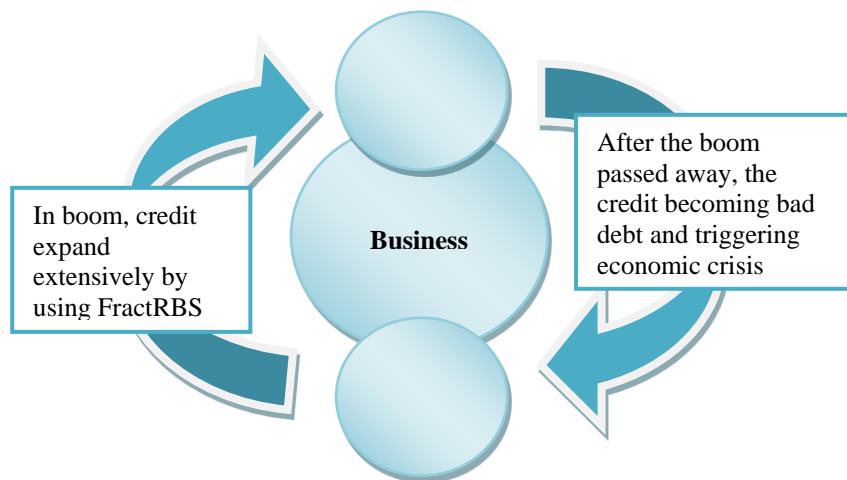


Figure 4 The Business Cycle

Source: (Bagus, 2012; Bagus & Howden, 2009; Cochran & Call, 2000; De Soto, 2006; Macovei, 2015; Rothbard, 2008, p. 98)

Basically, business cycle illustrates periodic boom and busts which are occurred in the economy. It is useful for describing and explaining observable fluctuations in macroeconomics variable (Tanjung & Siregar, 2012, p. 211). In the context of this paper, the FractRBS business cycle is based on the non-neutrality of money. For example, as per explained in the previous paragraph on the CBS, yes they absorbed the big amount of deposit from the depositors.

Afterward, instead of keeping the deposited money as safekeeping, they began to finance selected project to take some profit from it. In this case, unlike the Roman Empire Banking system in the era Justinian, the CBS channeled almost all fund to creditors. In the beginning, we said the business cycle is close to boom and bust which Keynes and other supporters of FractRBS. It means that, when CBS supplied more money into the system via credit, it drove up the borrowing for capital and at the end stimulates the economic activity. Whenever a project was started, it needs labor and will trigger the growth of income as well as consumption. The weak side of FractRBS is that the money supplied to the system gives the negative impact in terms of escalating the price level. CBS, for instance, has put their money in the investment with interest stated and agreed upfront. There no worries on what CBS did in the booming economy. Moreover, the economic has its cycle. If it is bullish there will follow by bearish. Boom economy will be followed by the bust economy. When money is supplied more and more into the system, this kind of expansion cannot last long if there is no additional capital is injected by the project owner. On the other hand, excessive money supply via FractRBS can increase the price level. The project owner itself has two major obligations; the first obligation to CBS as Creditor and the second obligation to the labor and buying the supply material that should be available at any time. The project owner will use their capital for the interest of paying the debt to CBS. It comprised some negative effect when they decided to do so. The labor not paid by the project owner so that the project itself cannot be continued because no labor can be included since they have no financial resources to finish the project. This kind of condition happens when the boom phase turns out to bust phase. The project owner could not pay its obligations to banks and resulted in some non-performing loan and drove the bank to finish the project by creating more money to be injected into the project or if banks fail to do so, the risk of bankruptcy is ahead. The Austrian Economic School defined above as the malinvestment that is resulted from the imbalance of credit and deposit and excessive credit expansion. In this case, there is no cash that is held by CBS. The 100% RBS is alive for conquering those problems. 100% RBS will deny the malinvestment since the money status is a mere of medium of exchange (Bagus, 2012; Cochran & Call, 2000; De Soto, 2006).

The nucleus of the Austrian Business Cycle is the maturity mismatching between the asset of the bank and its liabilities. The mismatch according to the Austrian school is come out from FractRBS and causing the boom and boost business cycle. So based on those core principles, the idea of 100% RBS is featured to industry practitioners as an alternative to ending the periodic economic crisis. The 100% RBS is based on the theory that money only as a medium of exchange. So that, banks who receive the money, have to be in caution in utilizing it (Bagus & Howden, 2009, 2010; Macovei, 2015).

In Islamic perspective of the business cycle, the profit and loss sharing system might give some solution to make business cycle smoother. The profit and loss, in this case, cannot totally omit the business cycle because business risk might happen and drive the *Mudharabah* – Musyarakah investment underperform. He stated that by doing the both participating contract, it might favorable to bank whenever business risk happens especially in *Mudharabah* contract. The business risk might transfer the financing risk directly to the Shahibul Maal. So, in conclusion, the profit and loss itself is not the sole solution to prevent business cycle it has a function to avoid it from being worst (Bidabad, 2013).

5.3. *Where Should Islamic Banking Stand?*

So, after discussing the epistemological of FractRBS and 100%RBS, it is time to determine which system that IB should be followed based on the extensive literature review. It is found that most Islamic Scholars are condemning the *FractRBS*. FRB is such an incompatible practice because contravening to Maqasid Sharia since the commercial bank creates money out of nothing (Kameel, Meera, & Larbani, 2006). Thus, Islamic Banking which is now operated in the dual banking system is creating purchasing power out of nothing which brings unjust transfer ownership and tantamount to theft and comprises the elements of riba. By unjust transfer of ownership means when financing is created and the money is supplied to the society, it increase the eagerness of society to buy some goods and as result of it will drive up the price level and at the same time making ownership transfer from the society to capital owners who are in this case possess companies that produce goods for society. It will also increase money supply rooting the society to pay additional tax and promoting inflation as well as causing hardship to the poor and the needy. Moreover, the effect of FractRBS can be seen by calculating the monetary aggregate of selected countries and found that money grew in some countries (Meera & Larbani, 2009). Furthermore, the practice of FractRBS is riba as the deposit can be multiplied in form of credit (Karim, 2010, p. 24). FRB system basically equipped the bank with powerful ability to create the money as well as destroy it. By that, He meant the money multiplier effect which inherent in the FractRBS resulted in an increase in the bank asset in form of credit as well as amplify the NPL (Non Performing Loans) whenever Bank distributes the money to the subprime debtor (Mirakhor, 2009). FractRBS is also said as hilah⁴ debt based which led to money supply expansion (Hatta, Dien, & Mohammad, 2014).

After a long discussion of FractRBS and its negative impact and based on the Islamic Scholars opinions, we can sum up that 100% RBS might be better for Islamic Bank. In general, this

⁴ Hillah in English can be linked to the word of knavery.

research is aimed to give some helicopter view to the Islamic Banking practitioners whenever the 100% RBS is implemented. The future 100% RBS IB might be as follows (Lainà, 2015) :

1. Pure Commodity Standard; this is the view of Austrian Economist as well as Sir David Ricardo with the basis thinking that money is not an asset, it is a mere of the medium of exchange. Due to that status, the fiat money should be printed by making some commodity back up such as gold).
2. Sovereign Money, this is initiated by the UK non-profit organization “Positive Money”. They asserted that loans still can be given to customer only by attracting saving or using own net worth.
3. Chicago Plan, associated with “Old Chicago School” in Chicago University as result of the great depression in the US when President Roosevelt was being the President on 1930. They emphasized that the Deposit Banks and Investment Banks should be separated. The Deposit Banks establish only to support the view of money as a trading media nor store of value. This Deposit Banks still have opportunities to make a profit by giving payment transactions system and charged a fee over it to the customer. Additionally, it is in line with the work of Tobin whose opined that 100% RBS applied only some certain type of deposit such as postal saving or central banks account for general public.
4. Narrow Banking, this concept has been developed to the starting point that Bank’s asset limited to “safe” by some standards. This model somehow might not be counted as 100% RBS. This is the work of Kareken, Litan, and Spong. Some western scholars advised some similarities between Narrow Banking that was formulated by Chicago School and Islam. They explore the epistemological status of money in Islam as one of six subject matter of Riba. They argued another epistemological of FractRBS; the business cycle which optimizing the deposit taken from customer to be channeled in the finest manner. They also sum up the boom-bust business cycle which is more favourable to the capital holder (in this case bank), government (whenever money supplied to the system price hiked, and the government revenue of value added tax is increase as well) as well as triggering the enactment another financial institution like deposit insurance which has main objective to secure the depositor interest away from the moral hazard of banks. Furthermore, the major idea of Chicago School is the separation between the role of the bank as a place to save money and intermediaries or on the other words disconnecting the money from credit. Again, this separation rejects the Keynes and other supporters of FractRBS who were stating the close connection of it. This division is close to the ABCT of Austrian School. In Islamic perspective, this division to some extent might drive the role of participation contract named Musharakah and Mudarabah. It leaves the option to the economic agent

either only storing the money in Deposit Banks or tries to move it to Investment Bank to take more risk and generate wealth via real sector project financing. Narrow Banking in this point covers the worries of Austrian School and might prevent the bust cycle subsequent to the boom because the project is merely dependent on the capital instead of the side money resulted from the FractRBS (García, Cibils, & Maino, 2004).

5. Limited Purpose Banking (LPB), some economist like Laurence. J. Kollikof and James Cochrane. The main feature of LPB is banks become unleveraged mutual funds. The bank born no risk. This LPB has been attracting Islamic Scholar to scrutinize it deeper (Smolo & Mirakhor, 2014). The background of that research is the 2008 financial turmoil. In general, they epistemological thinking is based on the neutrality of money which on the other hand represented in the prohibition of taking the return from lending the money. As per the name is Limited Purpose Banking, it makes some implications to funding product that is offered to the customer. Instead of offering the demand deposit based on Wadiah (and sometimes) Mudarabah as well as fixed deposit as the way for the surplus unit to invest in Islamic Bank, they suggested offering funding product that has the same feature of mutual funds. In this context, as normal mutual funds product, the net asset value might fluctuate according to the performance of the financing instrument and Investors who chip in the money to Islamic LPB are aware of the risk which is explained by Islamic LPB in the prospectus. As the LPB form akin to mutual funds, the return of investor share is solely depended on to what contract that offered to them. LPB is different if we compare to ordinary Islamic Bank. While Islamic Bank is kind “one size fit for all” or on the other word is wholesale banking with many products as well as contracts offered to the customer, LPB is such specific bank. In future, if LPB idea will be adopted, we then will see such Mudarabah Bank, Musharakah Bank, Murabaha Bank, or any bank which is established specifically and refer to kind of Islamic contract that they would operate to give satisfying return from financing activities. In term of the business cycle, it would differ according to the contract. The participations based banks who are worked under Musharakah and Mudarabah will give some fluctuation to the investor return. While in the sale based as well as rent based contract of Murabaha and Ijarah, the return will be fixed but again it is according to the performance of Murabaha asset itself.

6. Challenges to Deploy 100% RBS into Islamic Banking System

The arrangement of 100% RBS in the economic system is believed to be a revolution to the financial industry according to the Western as well as Islamic scholars. However, big challenges

are ahead in set up the concept. The barrier of the 100% RBS plan are as follow (García et al., 2004) :

1. If 100% RBS is implemented, it is opposite to the saving motives of the majority of individuals. Most of the people are *Homo Economicus* who have own self-interest to maximize their satisfaction. Epistemologically they try to take some advantage from the money that they are deposited in banks. In this case, the *Homo Economicus* treat money as a store of value as well as an asset that is should have returned at any time they put it in banks. Thus, the human behavior might affect to the scarcity of money in the banking system that might affect also to the business cycle. Or on the other words, the demand for the basic saving product will drop since the saving is just similar to put our goods in the warehouse and at the same time they won't enter to the riskier saving such as fixed deposit or *Mudharabah* deposit and at the end interrupting the business cycle.
2. The government intervention by launching deposit insurance company forces the banks both Islamic and conventional Banks to maximize their deposit taken from society for financing. In this case, deposit insurance is favorable to support boom and bust cycle by giving banks such "self-confidence" to maximize FractRBS as well as increase the chance to push the economy into severe economic condition. Deposit insurance will create such ambiguity to the Islamic Bank in particular if we compare to the application of participations contract of *Mudarabah* and *Musyarakah* that is implemented without any guarantees cause such guarantees might hike the debates to the contract and make it similar to the conventional investment which tantamount to *Riba*
3. The 100% RBS might shift the financing that normally associated with banks to the capital market. This is the challenge for Islamic Banks. To some extent, behind the goodness of 100% RBS in promoting financial stability, it resists bank to expand the credit since the credit depends on the eagerness of customer to invest their money in risky asset and at this position Islamic Bank only mere of selecting the best project before offering it to the customer. So, the project owner will approach the capital market as a source of fund. If this happens, it affects the economy and will disturb the economic cycle because the small enterprises which usually advancing their financing to Islamic Bank is not that reliable to enter the capital market (García et al., 2004). Since the potential financing customer shifted to the capital market, 100%RBS will decrease the power of Islamic Bank to make a profit. (Selgin, 2009)
4. The radical change to 100% RBS might draw attention from the opposing group of banking reforms.

7. Conclusions

In Conclusions, Based on the epistemology defined by Islamic Scholars, FractRBS has more *mafsadah* if we compare to the *maslahah*. Therefore, 100% RBS should be better for the Islamic Bank. To deploy the 100% RBS to the Islamic Banking System need a big effort and deep studies to achieve a smooth reformation process. The 100% RBS is still a theory that needs to be tested before plug it into the Islamic Banking System. The process of testing the 100%RBS theory is as follow (Furqani & Haneef, 2013) :

1. Identifying the problem; since most of the scholars prefer to employ 100%RBS, the problem will be in choosing which to be used either Pure Commodity Standard, Sovereign Money, Narrow Banking, or Limited Purpose Banking.
2. After choosing one of the possible 100%RBS forms for Islamic Bank, it needs to be formed as a good theory to ensure that 100%RBS fit in theoretical and practical side. It should be appraised so that it is epistemologically good by assessing 100%RBS with the divine revelation (Al-Qur'an and As-Sunnah), the logical side as well as the practical side to explore the factual aspect. This is mandatory to prove that the universal as well practical rules of it in line with Islam.
3. After fitting it with above criteria, a hypotical experiment should be created. The hypothesis is such way should be treated as the preliminary model.
4. The experiment should be conducted to authenticate. It is an effort to link the theory and the practical realities. If there are no obstacles that hamper the 100%RBS, it can be implemented directly. However, if there are obstacles and hinder the 100%RBS, the theory should be reassured again before launching into the financial system.
5. When above methodological processes are accomplished, we should be aware that the Islamic Banking itself is a part of the economic system. The 100%RBS basically will affect the entire financial system since it will slow the business cycle down. Nevertheless, when the time is coming to replace current FractRBS to 100% RBS it is important to prepare the banking infrastructure both for policy maker as well as the industry player. For the policy maker, since it will shift the Islamic Bank from industry driven to customer driven (or the financing solely depends on the customer's instinct to invest their money in the project), then, certain policy has to be imposed to protect the customer interest. On the other hand, for the industry player, they have to be ready because the power to make a profit will be decreased since Islamic Bank cannot use the demand deposit to finance future projects. In this case, Islamic Bank is pushed to do more participations financing via *Mudarabah* as well as *Musharakah* to provide profits. When these contracts applied to make profits and the demand deposit under *Wadiah* contract is guaranteed 100% for anytime withdrawal, the Islamic Bank may construct

another new business cycle that is better than a boom-bust cycle introduced by Keynes. The new Business Cycle is based on profit loss sharing system that is considered to be fair to the banks as well as to the business partner, and to give more stability to the economy system at large

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NOTES FOR CONTRIBUTORS

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Each article must be accompanied by abstraction, which is written in Indonesian and English. Abstract must be structured with the subtitle, starting with

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8. CHAPTER articles are written with the preparation consistently as follows:

- **Introduction**

- Introduction of research report briefly outlines the core justification why the research needs to be done.
- Introduction of research in the journal reports should be brief. Usually the required information outlined in the Introduction enough in 5 or 6 paragraphs, and overall no more than 1-2 pages.
- The first section (paragraphs 1-2) provides background research (justification of why the research needs to be done, what is known, what needs to be added and the supporting data).
- The second section (paragraph 3-4/ 4-5) of the introduction should be supported by relevant literature and strong, but need not be described in detail.
- The last section (paragraphs 5-6) contains a hypothesis or research purposes.

- **Methodology**

- In the case the research used quantitative, the methodology contains some information, including:
 1. Research design
 2. Place and time
 3. Population and sample
 4. Detailed information about how the study was conducted
 5. Definitions are important variables
 6. Means of collection and data management
 7. Computer programs used
- In case the research used qualitative approach, the methodology contains below:
 1. State the method (content analysis, descriptive analysis)
 2. State the citation (Al Qur'an, Hadits, and Book)

- **Results and Discussion**

- Result is the most important thing in research report. The result are written to a logical sequence according to research.
- For quantitative research, the result should be began with presentation of research result by chart, tables, and output from data processing. Table is made with an open table system.
- Pages, tables and figures should be numbered consecutively series.
- For qualitative research, the result could be in line with the research purposes. Supported by main literature or previous thought.
- Discussion should support the result and could be vary depends on the researcher. The discussion can be began with the major finding in the research and followed by a comprehensive finding.

- **Conclusion**

- Conclusion answer the purposes of the research, stated in introduction.
- It must be stated by paragraph and not by number.

9. Pages, tables and figures should be numbered consecutively series.

10. References prepared by following rules:

a. Publication of the book:

Author, Initials., (Year). *Title of the book*. Edition.(only include this if not the first edition). Place of publication (must be atown or city, not a country):Publisher.

Ex:

Enders, W., (2004). *Applied Econometric Time Series*. Second edition. New York : John Wiley & Son.

b. Articles in journals:

Author, Initials., (Year). Title of article. *Full title of journal*, Volume number (Issue/Part Number), Page number(s).

Ex:

Rangazas, P., (2000). Schooling and Economic Growth: A King-Rebelo Experiment with Human Capital. *Journal of Monetary Economics*, 46 (2), pp. 397-416

c. Article in a book edited others:

For books which are edited give the editor (s) surname and initials, followed by **ed.** or **eds.**

Author, Initials., ed., (Year). Title of book. Edition. Place : Publisher.

Ex:

Silverman, D.F. and Propp, K.K. eds., (1990). *The active interview*. Beverly Hills, CA : Sage.

Daryono. ed., (2005). *Concept of Fiscal Decentralization and Worldwide Overview*. Surakarta: Muhammadiyah University Press.

d. Working papers and Conference report

Author (s)., (Year). Full Title. In : Followed by editor name or organization, *Working Paper Number (or Full title of conference)* . Place of Publication: Publisher

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e. Unpublished work

You may occasionally have access to a document before it is published and may therefore not be able to provide full detail.

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Author or corporate author, (Year). Title of document.[type of medium] Place : Producer : Publisher. Available at:include web site address/URL.

Ex:

Summers, R. and Heston, A., (1997). Penn World Table, Version 5.6. [http://pwtecon.unpenn.edu /](http://pwtecon.unpenn.edu/).

g. Articles in newspapers, magazines and similar periodicals:

Authors, Initials., (Year). Title of Article. *Full titel of magazine/newspaper*, day and month before page numbers and coloumn line.

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Begley, S., (1993). Killed by Kindness. *Newsweek*, 12 April. p. 50-56.

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