Wealth, Income Distribution, and the Role of Institution: Concept and Practice of Syariah Banking in Several Countries

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シャリーア（イスラム法）では寄付行為が制度化されているが、現実のイスラム金融で富の再分配がどのように担保されているか。インドネシアやアラブ首長国連邦、英国などの例で検証した。

Abstract

The economic system is continuously developing in the era of globalization. The development is not merely related to the difference between market economies and planned economies, but also recognition of the role of institutions, environment, and social responsibility. One of the economic systems that have vast development is Islamic economics or Syariah economics. Particularly in the practice of Syariah banking, the vast emerging occurs in Middle Eastern countries, Southeast Asian countries, and Europe. This paper elaborates on a comparative study among Syariah banking practices in Indonesia, Malaysia, Bangladesh, the Uni Arab Emirate, and the United Kingdom. The reason for selecting those countries as research objects is that they become representative of their continent and consider their rapid development in Syariah banking.

A descriptive analysis then follows the historical approach analysis to depict Islamic economics's insight: property rights, equality, uncertainty, and usury, to overview the differences between conventional and Syariah. Furthermore, we analyze the institution and international organization's role in cultivating the practice of Syariah Banking. The comparison of countries also provides evidence of the Syariah finance practice, using SWOT analysis, and we describe its advantages and disadvantages. The result shows that Syariah banking is more stable than conventional banking because it encourages equality and decreases uncertainty. Moreover, Syariah economics also promotes zakat as a tool of income distribution, property ownership that encourages social responsibility and encourages the role of the institution as proposed by institutional economics theory.

Keywords Institution, Islamic finance, Syariah, income distribution, globalization, wealth

Introduction

Along with the development of the economy in globalization, the world's economic system has also developed. In several countries, Islamic economics has become an option and has received a respectable welcome in the community besides the conventional economy. It starts to be chosen by the Muslim and non- Muslim communities because the transactions are fair and mutually beneficial. One of the sectors in the Islamic Economy that is most developed and can influence other sectors' development in Islamic Finance, where this sector has six sub-sectors, namely Sukuk Arrangers, Banks, Takaful Operators Islamic Fund, Crowd Funding, and Islamic Finance Education.

The Islamic financial industry, especially banking, is experiencing rapid growth and has outstanding potential and prospects for further development. Even Islamic banking has become an essential part of the world financial industry with its presence in various countries.

One of the essential features of Islamic banking is the implementation of Islamic values in the operational. Thus, there will be no concept of interest as part of the lending procedure because it is strictly prohibited to impose usury, *maysir*, *gharar*, *dzalim*, and *haram*.

Therefore, many countries, especially countries in the Middle East, try to implement a Syariah economic system. It is flourishing in Middle Eastern countries and several Southeast Asian countries since the establishment of Islamic Development Bank (IDB) in Jeddah.

There are several international institutions as regulators and policy-making related to Islamic finance: IDB (Islamic Development Bank), AAOIFI (Accounting and Auditing Organizations for Islamic Financial Institutions), IFSB (Islamic Financial Service Board), and IILM (International Islamic Liquidity Management). However, several countries have their regulations regarding Syariah finance, some of which are Indonesia, Malaysia, Bangladesh, and the United Arab Emirates (UAE).

The role of institutions in shaping economic behavior is part of the subject in institutional economics. The early institutional economics focus on collective rather than individual action, prefer an ‘evolutionary’ rather than a mechanistic approach to the economy, and emphasize empirical observation over deductive reasoning (Ismail and Nor, 2011). The new institutional economics (NIE) was initially represented by Williamson in 1975, which interested social, economic, and political institutions.

Islamic values in economics and institution economics have similarities in social justice and the existing institution to govern economics. Therefore, this study explores the concept of Syariah economics in contrast with the Institutional Economics concepts. The objectives of this study are:

1. Compare and contrast standard features of Syariah Economics concepts and Institutional Economics.
2. Compare the role of the institution in current Syariah banking practices.

Methodology

This paper conducts qualitative descriptive analysis on both Syariah Economics and Institutional Economics from literature and documentation. Then, we gather secondary data of Syariah banking’s practice as a proxy of Syariah Economics in Indonesia, Malaysia, Bangladesh, the United Kingdom, and the Uni Arab Emirate. We exclude the Kingdom of Saudi Arabia and Egypt as they are the early adopters of Islamic banking in the world. The comparison of the practice is then analyzed to find similarities in influencing factors of Syariah banking implementation. Lastly, we analyze the practice with the Institutional Economics model.

Literature Review

The main objectives of this study are a comparison between Syariah Economics and the Institutional Economics Theory. In this section, we describe the concept of both theories.

Syariah Economics

The main principle in Syariah Economics is Islamic law which is sourced from the Al-Quran and Hadith. Any activities of Islamic banking should obey the commands and prohibitions in the holy book. Several principles should be followed:

a. The Divine Principles
   It is always assumed that the goal of every action (including economic transaction) is to obey the order of God. Since no one could escape from God’s provision, people should be responsible not only for themselves but also to other parties, society, and God.
b. The Freedom Principle (*Al-Hurriyah*)
   Any agreement between two or more parties is accepted. The form and engagement determined by the parties are binding to all parties in terms of rights and obligations. However, the freedom principle should follow the Syariah law.
c. The Principle of Equality (*Al-Musawah*)
   The purpose of an economic transaction is to fulfill human needs. Any interaction made should regard any rights and obligations based on this principle of equality.
d. The Principle of Justice (*Al-`Adalah*)
   Justice is a balance between various individuals, both moral and material, between individuals and society, or between one society and another based on Islamic Syariah. In this principle, the parties must fulfill the agreements they have made and fulfill all the obligations.

e. The Principle of Willingness (*Al-Ridha*)
   All transactions must be based on consensual or willingness between each party. It means that there should be no pressure, coercion, fraud, and misstatements. This voluntary element shows the sincerity and goodwill of the parties.
f. The Principle of Honesty and Truth (*Ash-Shidiq*)
   Failure to conduct an agreement with honesty means that the legality of the engagement is imperfect and is subject to disputes between the parties.
g. The Written Principle (*Al-Kitabah*)
   It is recommended that any agreement should be done in writing and attended by witnesses. Any agreement which is not carried out in cash should be backed by collateral.

Based on these principles, a contract in Syariah Economics is a must and should not violate the other principles. There must be no aspects of harm or fraud in the contract. Usury, maysir, and gharar are prohibited and should be avoided.

- Usury
  Excessive interest in the transaction from an economic transaction or debt agreement.
- *Maysir* or speculation
  It means that every economic transaction creates a winner and loser; thus, the winner takes all the transaction advantages.
- *Gharar* or uncertain
  It is a contract that contains an element of fraud because there is no certainty in the object of the contract, the amount, or the ability to perform the contract.

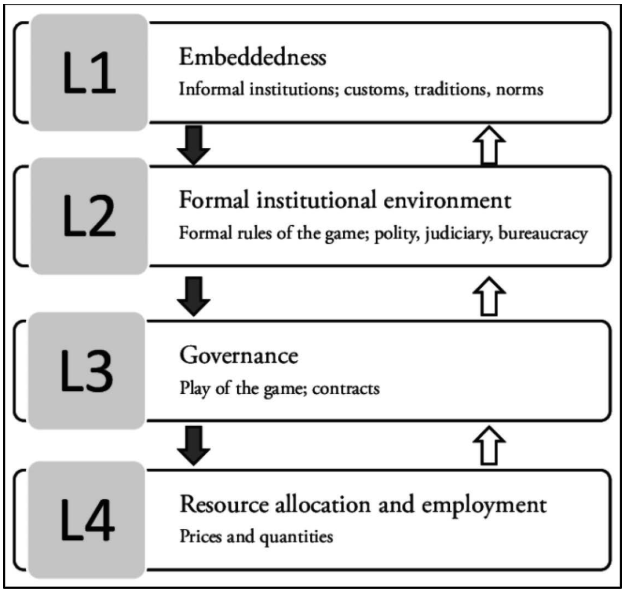
Institutional Economics

Veblen (1899) criticizes capitalism because it creates consumptive behavior and promotes personal rationality and self-interest. He believes that humans are rational and emotional, which influences how humans make economic decisions. Economics is not solely about the market but also technology application, environment, history, social, and institution. Coase (1937, 1960), North (1993), Williamson (2005), and Ostrom (2009) believes the influence of institution in economics.

The New Institutional Economics illustrates the existence of asymmetric information and transaction costs. The imperfect information creates a barrier for economic actors to enter the market. Thus, it has consequences in transaction costs. The presence of asymmetric information reflects higher the transaction costs incurred by economic actors. In the NIE's view, efforts are needed to minimize transaction costs.

Hodgson (1998) explains the relationship between information, decision making, behavior, and institution. Then, Williamson (2000) explores the role of the institution by suggesting a model of the institution in economics in four-level:

a. Level I – Social Theory
   The informal rules embedded in society include traditions, religions, norms, customs, and conventions. This level changed gradually and was influenced by economic history and social sciences.
b. Level II – Institutional Environment
   Emphasize the economics of property rights, law, politics, and governments. This level can be called the level of the rules of the game of rights and obligation.
c. Level III – Governance
   Governance that highlights the contracts and transaction cost. Although property rights remain essential, the legal system defines contract law and contract protection. This level is usually called the level at which the rules of the game of rights and obligations are played.
d. Level IV – Efficiency
   Emphasizes resource efficiency and the incentive structure, which like the neoclassical framework.



(McShane, 2017 adapted from Williamson, 2000)

Figure 1: Four levels of Social Analysis

Discussion

The Islamic Development Bank (IDB) is a Syariah-based financial institution that aims to be the institution that helps the economic development, social development, and international cooperation among Muslim countries using Syariah principles. Members of IDB must fund the economic and social development programs in Muslim countries. All the members will automatically become members of the Organization of the Islamic Conference (OIC).

The growth of Islamic banking began with establishing the Mit Ghamr Bank in Egypt in 1963 (Ghozali et al., 2019). Moreover, the first commercial bank was established in 1975 by the establishment of Dubai Islamic Bank. In Southeast Asia, the first Islamic banking is Bank Islam Malaysia Berhad, founded in Malaysia in 1983 (Ketell, 2011).

1. Indonesia

   The first Islamic bank was Bank Muamalat Indonesia (BMI) which officially began operating in 1992. After the amendment of Law Number 7 of 1992 to Law Number 10 of 1998, which provides a clear operational basis for Islamic banking, Syariah's economic development in Indonesia began to emerge, especially after the financial and monetary crises prove that Islamic more superior over conventional banks. In 1998, Bank Muamalat did not need an injection of funds when conventional banks need assistance from the Central Bank due to the negative spread.

   Until now, Indonesia's banking system is a dual system, where conventional banks and Islamic banks can operate simultaneously. Commercial banks of the conventional system can operate based on Islamic Syariah principles by establishing a Syariah Business Unit (SBU). Based on the 2019 Islamic Finance Development Indicator (IFDI), Indonesia's ranking jumped six steps to fourth from 10th place in 2018 after Malaysia, Bahrain, and the United Arab Emirates.

   Recently, Indonesia has merged three Syariah Commercial Banks into one Syariah Bank, namely the Indonesian Syariah Bank. Islamic banks are still relatively superior to conventional banks in terms of growth in assets and third-party funds that can grow despite the Covid-19 pandemic conditions.

2. Malaysia

   Malaysia officially introduced the Syariah Banking Act of 1983 (IBA 1983) and the Takaful Act of 1984. Bank Islam Berhad was the first bank to be established on March 1, 1983 (Basalamah & Rizal, 2018), which fully offers Islamic banking products and services.

   The 1983 IBA Law has given great authority to Bank Negara Malaysia (BNM) to supervise and regulate Islamic banks. The law also regulates Islamic banks' financial requirements and duties, ownership and control of Islamic banks, the limitations of Islamic banks, and the power of supervision and control of Islamic banks (IBA, 1983).

   Furthermore, Bank Negara Malaysia (BNM) introduced a form of interest-free banking scheme. The policy is often referred to as an "Islamic Window," which allows commercial banks and financial companies to offer Islamic banking products and services. The policy is remarkably successful because more Muslims and non-Muslims participate in Islamic banking (Thani et al., 2010).

3. The United Kingdom

The United Kingdom has designated its country as the center of Islamic finance. The UK has five banks which are entirely Syariah. Al Rayan Bank is the oldest and largest Islamic bank in the UK. Founded in 2004, the bank is authorized by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority and is a member of the FSCS. (Firdaus, 2019). Al Rayan Bank is an open and inclusive bank that welcomes Muslim and non- Muslim customers. The bank currently estimates that more than a quarter of its customers are not Muslim. However, in specific banking products, the composition is higher. For example, more than 80 percent of all-time deposit customers are believed to be non-Muslim.

Islamic banks can only invest in activities supported by tangible assets; in other words, speculative investments are not permitted in transactions with Islamic banks. The non- speculative process makes the public more confident in Islamic banking compared to conventional banking. Hence the fact that investment can only be made in activities under Islamic ethical values attracts people of all religions.

4. Bangladesh

Bangladesh is one of the largest Muslim countries in the world. In 1974, Bangladesh signed the Islamic Development Bank (IDB) charter and committed to developing its economy and financial system under the Syariah. Moreover, in 1983, Islamic Bank Bangladesh Limited was established, which was accompanied by IDB. Syariah banks in Bangladesh have demonstrated that these banks have met the relevant requirements and regulations that apply in that country then many conventional banks have started to open branches in the field of Syariah.

Based on data from IFSB in the Islamic Financial Services Industry Stability Report (2020), at the end of 2019, there are eight banks that fully- fledged the Syariah system and 17 conventional banks that have branches of Islamic banks. It counted as a quarter of the entire banking industry in Bangladesh.

To ensure the Islamic banking practices in Bangladesh, the Bangladesh Bank issued a “Guidelines for Implementing Islamic Banking” in 2009. Moreover, the Bangladesh bank has a dedicated department for the on-site supervision of Islamic service providers. This department is entrusted with the responsibility of supervising and monitoring the performance of Islamic banks in Bangladesh.

5. United Arab Emirates (UAE)

The UAE is a Muslim country; thus, the Islamic banking system is more needed than conventional banking, which causes numerous Islamic banks in the UAE is established (Osmanovica, 2020).

Dubai Center for Statistics believes that Islamic economic institutions contributed around 8.3% of GDP in the UAE in 2018, with growth in total financial assets of Islamic banks is 7% higher than conventional banks (4-4.5%).

The success factor of the Islamic economy’s development is the suitability of the Islamic law’s economic principle. Therefore, more than half of the UAE population (55%) has at least one Islamic financial product. Al-Malkawi and Pillai (2018) believe that UAE, Malaysia, and Bahrain have been recognized as the most developed market. Moreover, UAE is the leader in terms of total assets.

Analysis

First, we conduct a Strengths, Weaknesses, Opportunities, and Threats (SWOT) analysis to capture Syariah banking practice in researched countries.

a. Strengths
   - The amount of Muslim in certain countries
   - The establishment of Islamic financial institutions
   - Encourage justice and *takaful* between the banks and customers
   - Independent without interest

b. Weaknesses
   - Prejudice to all customers (vulnerable to those who have bad intentions)
   - A profit-sharing system requires complex calculations
   - Requires more professional staff to assess the customer’s projects

c. Opportunities
   - The Islamic window system or dual system in conventional bank
   - Non-Muslim customers increase
d. Threats
   - The conventional bank provides greater returns than Syariah bank
   - A non-halal business

In the 2020 IFD Report, the estimation of Islamic financial assets in 2024 is US$3.69 trillion with a 14% increase year-on-year. The top five countries in Islamic Finance are Malaysia, Indonesia, Bahrain, United Arab Emirates, and Saudi Arabia. Moody's vice president also believes that the Islamic banking system would lead to global growth in the financing industry. The main feature of an Islamic bank, risk-sharing, is the most attractive feature for the Muslim community and non-Muslim community. Moreover, Islamic banking provides a more secure process and procedures in investors' view (Mateev and Poutzioris, 2019).

Institutional Theory and Syariah Economics

Using the Williamson model on social analysis, we explain the features of Islamic banking, policies, and institution that exist in the model.

1. Level I
   The main principle of Islamic banking is the divine principle which is supported by the other six principles. Religion guides economic transactions. Therefore, God's rule is the main direction and is inherent or embedded in human behavior, including in economics. It is inferred that the principles of Syariah Economics form a social norm in human life.
2. Level II
   Syariah Economics supports property rights and asset ownership if the assets are utilized following Islamic principles. Therefore, any exploitation of assets should consider justice, the environment, and blessings. Thus, the need for a professional institution is a must.
3. Level III
   Syariah Economics reflects not only people's rationality but also emotional consideration. Therefore, bounded rationality and opportunistic behavior, which caused an unclear contract relationship and resulted in increased economic transaction costs, is minimized by the role of the institution as the governing party.
4. Level IV
   Managing resources' economic efficiency will be established if norms, rules, and institutions can be appropriately managed.

Income Distribution

Besides the principle of justice and equality, Syariah Economics also implements the redistribution of wealth called zakat. The mechanism is especially crucial as it is mentioned in several verses of the holy book and usually placed in the equivalent with prayer. Therefore, Muslim is bound to fulfill their religious obligations simultaneously with socio-economic purpose. Zakat also managed in Islamic institutions to distribute to entitled parties.

In general, zakat is taken from the holder of wealth (the rich) due to non-productive assets ownership. Eight types of wealth which subject to be distributed are:

- Wealth from trading activity
  Every asset possesses from trading, including merchandise, cash, and liquid receivables. The amount of zakat 2.5 percent is issued after deducting debt and losses and has reached the *nisab* (85 grams of gold) in one year of possession.
- Wealth from agricultural products and fruits
  Agricultural products are also obliged to be zoned. The nisab of zakat is 653 kg which subjects to be zoned 5 or 10 percent depends on the agricultural process.
- Wealth from livestock
  Livestock owners must also pay zakat, and the amount of zakat is depended on the number of livestock ownership.
- Wealth from *rikaz* or treasure
  Every discovery of treasure that no one acknowledges as the property owner is obliged to pay 20% of the zakat.
- Wealth form profession

Professional income also subjects to be zoned if it reaches a particular value of money equivalent to 522 kg of rice. The percentage of zakat is 2.5%.

- Wealth from investment
  Any assets obtained from investment returns subject to zakat of 5 to 10 percent depends on the income.
- Gold and Silver
  Gold or silver, which owned for more than one year and its value equivalent to 85 grams of gold, is obliged to pay zakat as much as 2.5 percent.
- Saving
  Saved money on hand or in banks as long as it is owned for more than one year and exceeds the limit, it is treated the same as gold and silver.

The institution also regulates who eligible to receive zakat. They are the poor people whose income is insufficient to fulfill daily needs or only sufficient to fulfill daily needs at a minimum level. Other people who eligible to receive zakat are (1) the institution or individual who manage zakat, (2) people who have just converted to Islam, (3) to free someone from slavery, (4) to free person in debt, (5) people who work for the sake of God, and (6) people who need supplies in their journey to the good.

If it is well regulated and professionally managed, the Syariah principle and zakat will have a significant impact on the social role to overcome poverty and develop society.

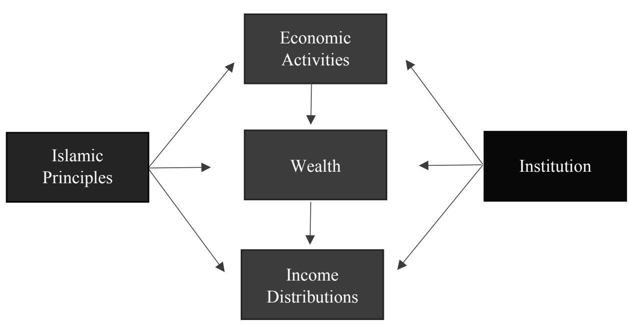


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Figure 2: The Process of Wealth Creation in Syariah Economics

Conclusion

This study suggests a resemblance of Institutional Economics Theory and Syariah Economics in terms of institution's role to promotes efficiency. Syariah Economics which is mainly dominated by Islamic banking is expected to continue to expand even in a non-dominant Muslim country because it promotes fairness and justice. Another significant feature in Syariah is the income distribution managed by a particular institution to promote wealth creation and wealth distribution.

Further Study

This study uses exploratory documents and regulations. We suggest profound research using empirical data to provide more empirical evidence on this research.

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