A Mismatch Made in Heaven: Analysis of Islamic Social Finance Success Stories and Bank's Money Creation

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ABSTRACT

Islamic Social Finance has been identified as an important source of funding that can improve the livelihood of the underserved communities across the globe. Islamic Social Finance can also play vital role in improving the life of the disadvantaged populations. The aim of this investigation is to analyse the impact of bank's money creation on the Islamic Social Finance. Employing qualitative enquiry, the author attempts to establish the relationship between bank's money creation and Islamic Social Finance. The examination indicates the practice of money creation by banking industry may eventually derail the good intention of Islamic Social Finance.

Keywords: Islamic Social Finance, money creation, bank, Islamic bank, relationship

1.0 INTRODUCTION

Previous studies concluded that Islamic Social Finance (ISF) as an effective method in alleviating issues such as poverty reduction, inequality, economic justice (Abd. Wahab & Abdul Rahman, 2011), income enhancement, health, education improvement (Hassan, A. Rahman, A. Bakar, Mohd & Muhammad, 2013) and facilitate sustainable development as well as economic growth. United Nation's Sustainable Development Goals (SDGs) plan has also earmarked microfinance, a Social Finance instrument, that can play important role in reducing poverty and in economic and social development (BBVA Microfinance Foundation, 2021). ISF instruments include traditional Islamic social-based instruments such as zakah, sadaqah and waqaf as well as modern instrument namely Islamic microfinance (IRTI ISF Report 2020).

Money created by banks is highlighted as the source of inflation in the economy (Hulsmann, 2004; Khan & Mirakhor, 1994; Meera & Labarni, 2009; Moosa, 2018). According to De Soto (2006) and Hulsmann (2008), the practices of money creation by bank is fraudulent, immoral, unfair, destructive and result in instability. The practices also lead to inequality in the society (Murray, 2009; Paul, 2013), unemployment (Hickson & Turner, 1996), cyclical economic recessions (De Soto, 2006), market cycle (De Soto, 2006), business failures and bankruptcies (Hulsmann, 1998). McLeay, Radia & Thomas (2014a) identified the creation of money by banks as factor that result in financial crisis. The above economic malaise is as a result of high debt that is operationalise by bank's money creation (Mohd Nazari, 2018). From Islamic perspective, bank's money creation consists of riba elements hence inconsistent with

Maqasid al-Shariah (Meera et al., 2009). Meera et al. (2009) argued the prohibition of riba in Islam is partly due the resultant injustice from bank's money creation issue.

The author begins with the method of enquiry for this research after which literatures on Islamic Social Finance and bank's money creation will be reviewed. In an attempt to answer the question whether or not ISF and bank's money creation are compatible, the author will analyse the impact of bank's money creation presented by some literatures vis-à-vis the ISF. The examination indicates the practice of money creation by banking industry may eventually derail the good intention of Islamic Social Finance. This article adds up to the limited discussion on ISF considering the impact of bank's money creation.

2.0 RESEARCH METHOD

The author utilises qualitative research enquiry in an attempt to obtain the answer to whether or not ISF can fully meets its objective with the existence bank's money creation practices. Literatures discussing the impact of bank's money creation are examined and analysed with respect to ISF. Previous researches on ISF are also investigated with the aim to highlight the evaluation of ISF vis-à-vis bank's money creation.

3.0 LITERATURE REVIEWS

The term "Islamic Social Finance (ISF)" was first documented in a report by Islamic Research and Training Institute (IRTI) of the Islamic Development Bank Group titled Islamic Social Finance Report 2014 (Islamic Social Finance Report, 2020). It refers to Islamic philanthropy-based and not-for-profit sector. The report identifies ISF instruments include traditional Islamic social-based instruments such as zakah, sadaqah and waqaf as well as modern instrument namely Islamic microfinance. According to Islamic Development Bank, ISF can play vital role in improving the life of the disadvantaged populations (Islamic Social Finance Report, 2020). Jouti (2019) highlighted that ISF has a significant role to play in solving socio-economic issues as the initiatives by governments and local authorities are insufficient.

Abd. Wahab & Abdul Rahman (2011) stated that the main aim of zakat is meeting socio-economic justice of the society. They clarified that the socio-economic justice aim can be achieved via their proposed conceptual model of efficiency and governance of zakat institutions. Hassan, Abdul Rahman, Abu Bakar, Mohd & Muhammad (2013), in suggesting for a Shariah compliant microfinance product for Islamic banks in Malaysia, asserted that microfinance has been an effective tool in poverty reduction, income enhancement and health and education improvements for the last 3 decades. In congruent with Hassan et al. (2013), United Nation stated that microfinance has significance role in reducing poverty and in economic and social development (BBVA Microfinance Foundation, 2021). Microfinancing, one of the ISF instruments, has proved to be effective instrument in combatting poverty, boosting income and upgrading health and education (Hassan, A. Rahman, A. Bakar, Mohd & Muhammad, 2013).

The above literature commending the role played by ISF in achieving socio-economic justice ignore the impact of bank's money creation to the society. Hence this article fills the research gap by analysing the impact of bank's money creation including its impact to the noble objective of ISF.

The polemic surrounding bank's money creation resurfaces after the recent global 2008-2009 financial crisis prompting the eminent global finance expert and the former chairman of the UK's Financial Services Authority, member of the Bank of England's Financial Policy Committee, Sir Adair Turner to point out:

> *"The financial crisis of 2007/08 occurred because we failed to constrain the private financial system's creation of private credit and money."*

Bank's money creation refers to the practice of commercial banks creating new money to fund the amount lent out to the borrowers (Ismail, 2018). In other words, every time commercial banks disburse money to the borrowers, new money is created out of nowhere (Bank of England, 2014). The new money created by the banking sector via the lending transactions are counted as money supply in the economy (Tlemsani & Suwaidi, 2016). Tlemsani et al. (2016) elaborated that the new money created may lead to oversupply of money as they are not directly linked to additional production. As money supply exponentially increased via lending transactions outpacing the increase in goods and services, the situation results in inflation (Positive Money, 2015). Meera et al. (2009) explained the newly created money and counted as money supply in the economy resulted in the debasement of the value of real physical notes and coins circulating in the economy which is owned by the people. As a result, the value of printed money in circulation is diminishing. This practice eventually leads to the people to have their purchasing power lessened and unable to own property (Meera et al., 2009). Hence income inequality expands as wealth is transferred from the people to those who have the capability to borrow and bankable.

Researchers praising ISF (zakat, wakaf and microfinancing) for meeting socio-economic justice (Abd. Wahab et al., 2011), as an effective tool for decreasing poverty, income enhancement and health and education improvements (Hassan et al., 2013; BBVA Microfinance Foundation, 2021) have not considered the adverse effects of bank's money creation. Hence their conclusions are questionable. This is the gap this investigation attempts to bridge.

4.0 DISCUSSION AND CONCLUSION

In the context of this research, Islamic Social Finance instruments such as zakat, wakaf and microfinance have been highlighted as important and effective tools in reducing poverty, income enhancement and health and education improvements. United Nation stated that microfinance can assist in reducing poverty and in economic and social development (BBVA Microfinance Foundation, 2021). Microfinancing, one of the ISF instruments, has proved to be effective instrument in combatting poverty, boosting income and upgrading health and education (Hassan, A. Rahman, A. Bakar, Mohd & Muhammad, 2013). However, it important to highlight that the above studies have not considered the negative impact of money created by banks. Hence, the conclusion made are not conclusive. While ISF may assist the affected individuals in the short term, the practice of bank's money creation with its adverse economic impact discussed above may derail the raison d'etre of ISF in the longer term. As explained in the above, in the long-term bank's money creation results in the diminishing of the people's purchasing power. The scenario worsened the purchasing power of the poor people who are the recipients of *zakah* and the *wakaf* beneficiaries. As more and more loans are disbursed and effectively decreasing the poor's purchasing power resulting in they remain as the recipients of *zakah* and beneficiaries of *wakaf*.

A study by Hamid & Hashim (2019) concluded the increasing cost of living as one of the main reasons for the twenty-five respondents who are the *zakah* recipients continue to remain in the "*asnaf* and *fakir* miskin" category. It is vital to note that the long term impact of bank's money creation is the debasement of the value of money hence resulting in the increasing price of goods and services i.e. increasing cost of living. The scenario explains the high dependency of *zakah* recipients on the *zakah* and the statistics of *zakah* recipients show growing trend (Hamid et al., 2019) as in Table 1.

Table 1: Number of *Asnaf Fakir Miskin* in Selangor 2012-2018

Year	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
No.	26,069	30,950	43,661	44,293	46,500	45,471	50,052

Following the above, all examinations on the successful of ISF in socio-economic justice must consider the impacts of bank's money creation. This is because bank's money creation has also negatively affected the noble goal of ISF. As along as banks are allowed to create money, efforts to create a fair and equitable society difficult to reach. This is because both ISF and bank's money creation are incompatible.

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