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Monetary Policy in Perspective Umer Chapra

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Abstract

This research is a type of qualitative research with a study approach profound literature. The study discussed was the thought of M. Umer Chapra in the field of Islamic monetary policy. Chapra's extensive experience in teaching and research economic field as well as a good understanding of Islamic Shari'ah, bringing on the conclusion that Islam is only the most appropriate alternative system for creating the welfare of mankind. It was shown Chapra in the discussion about instruments in monetary policy, the urgency of changing the banking system and on finally realize the concept of Islamic-style welfare state.

Keywords: Monetary Policy, Reconstruction Conventional Bank, Islamic Welfare State

JEL Code: E00, E52, F42, 023, 042

A. Background

M. Umer Chapra was a Pakistani-born economist, on February 1, 1933. Chapra continued his first and master's education in Karachi, Pakistan. Then earned a Ph.D. in economics in 1961 with the predicate cum laude at the University of Minnesota, Minneapolis, United States. Then Chapra returned to her home country and joined the Central Institute of Islamic Research in the same year. During the two years in the institution Chapra actively undertook a systematic study of the ideas and principles of Islamic tradition to create a sound economic system.¹ For his work and achievements in the world of Islamic economics, Chapra received an award from the Islamic Development Bank for Islamic Economics, and an award from King Faisal for the field of Islamic studies, both achieved in 1990. In addition, Chapra also received an award awarded directly by President of Pakistan, a gold medal of IOP (Islamic Overseas of Pakistanis) for his services against Islam and Islamic Economics, at the first IOP conference in Islamabad.²

Economic Thought Chapra is a blend Between the traditional sciences, the science of religion and modern economics. His thinking was dominated by the macroeconomic sector because Chapra was much in the world economy. Among many Chapra's thoughts, the author will discuss the concept of monetary policy, sharia financial institutions that are more emphasized to the central bank and its policies, and the concept of a prosperous country according to Islam. Like other Muslim economists, Chapra put forward the moral importance of a fair and healthy economy.

¹ M. Umer Chapra, (2000) *Islam dan Tantangan Ekonomi*, Edisi terjemahan dari *Islam and The Economic Challenge*, diterjemahkan oleh, Ikhwan Abidin Basri, M.A, M.Sc (Jakarta: Gema Insani Press atas kerjasama dengan Tazkia Institute), hlm. 10

² M. Umer Chapra, Habib Ahmed, (2008) *Corporate Governance*, Edisi terjemahan : Lembaga Keuangan Syariah. Penerjemah: Ikhwan Abidin Basri, M.A, M. Sc (Jakarta Timur: PT Bumi Aksara), hlm. 221

The specialty of M. Umer Chapra's thought is his ability to blend in between Western economic concepts and Islamic values. So Chapra earned her title as a 'successful Islamic scholar'. Chapra is optimistic that the Islamic economic system can deliver to the world's socio-economic justice and be the solution to the failure of the capitalist and socialist economic system.

B. Literatur Riview

Salman Shaikh in his article *Interest Based Financial Intermediation: Analysis and Solutions*³ discuss about usury which is actually much opposed not only in Islam but also almost all monotheistic religions. Salman then departs from the fundamental definition of usury and interest in Islam. Furthermore Salman's paper analyzed the impact of interest-based financial intermediation on macroeconomic variables as well as on development objectives by highlighting some of the most striking facts and statistics and empirical evidence documented in previous studies. Salman ended his writing by borrowing some of Chapra's thoughts on usury and interest in portraying the role of capital in Islamic economics and how it can be assessed in Islamic economics without compensating it with fixed payments and also assessing how economic and financial decisions will be changed in this new interest-free framework.

The next article from Salman Shaikh with his partner Muhammad Nadim Hanif, *Central Banking and Monetary Management in Islamic Financial Environment*⁴ is a study that is still associated with the study of the author, but the difference is the author describes Chapra's thought about the Central Bank problem theoretically, while in the writings of Salman and Nadim, presents empirical evidence of statistical equality of nominal GDP growth rate and official interest rate for 'advanced', 'all' , and some Muslim countries. Salman and Nadim proposed a nominal GDP growth rate as a benchmark for the price of IFIs domestic financial transactions as well as for bilateral external / multilateral lending rates. The paper also shows nominal revenue targets as a monetary policy regime and provides a liquidity management mechanism for the banking system within the Islamic finance environment. Chapra's thought in this paper is used only briefly in the riview literature and the strengthening of the definition alone.

Another interesting article about Chapra's thinking is reviewed by Prof. John R. Presley. of Economics and Director of the Banking Center at Loughborough University. Presley began his writing by comparing the thought between Chapra and Keynes who were great Western economist thinkers. According to Presley⁵, Chapra has not been at a balanced stage in matching Keynesian thinking about its completeness in formulating modern macroeconomic theory as a general theory. Chapra used a fundamentally different approach from Keynes's approach to macroeconomics. Chapra defines what should happen, whereas Keynes thinks she is describing what happened. Persley also questioned the possibility of Islamic economics in its implementation, can idealism in Islamic economics be realized? However, from Persley's many doubts and criticisms of Chapra's thought and especially the economic existence of the Islamic

³ Shaikh, Salman (2012), *Interest Based Financial Intermediation: Analysis and Solutions*. Published in: Journal of Islamic Banking & Finance , Vol. 29, No. 4 (31 December 2012)

<https://mpra.ub.unimuenchen.de/id/eprint/42500>

⁴ Hanif, M. Nadim and Sheikh, Salman (2009), *Central banking and monetary management in islamic financial environment*. Forthcoming in: Journal of Independent Studies and Research , Vol. 8, No. 2 (July 2010)

<https://mpra.ub.uni-muenchen.de/id/eprint/23548>

⁵ John R. Presley, *Review: Toward a Just Monetary System of Umer Chapra*, JKAU: Islamic Economic, Vol. 2, hlm. 109-115 (1410 A.H./1990 A.D.) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3126116

system, Persley also confirmed that the best solution to the current crisis in the economic system can be answered in Chapra's writings, especially in *Toward Just a Monetary System*. Persley's criticism and explanation of Chapra's thinking helped the writer in getting to know Chapra's thoughts. From this Persley writing, the author got high hopes as offered Chapra as an alternative new economic system.

In addition, Chapra's thinking has also been used as a formal object in some student thesis at UIN Walisongo Semarang with the title *M. Umer Chapra View About Efforts to Suppress Inflation At Very Low Level Perspective Islamic Economy* by Onny Kusuma Mahardika Kuncoro⁶. Onny's thesis attempts to make Chapra's thinking as a solution in suppressing inflation. Chapra's strategy intended to suppress inflation was the first, moral improvement (pursued not only in material but spiritual dimensions). Second, the equitable distribution of income and wealth. Third, the elimination of usury. Another thesis by Bayu Adi Saputra⁷, student of UIN Sunan Kali Jaga Yogyakarta entitled *Thought of Islamic Economic Development by Umar Chapra*. The result of Bayu's research shows that the concept of Islamic economic development is the most comprehensive and fair development. Because, in the Islamic economy, prioritizing growth is accompanied by full labor, economic stability, distributive justice and concern for nature.

Anindya Ayu⁸ discussing Chapra's thoughts on economics in general, Ayu gives an explanation of the basic concepts of *falah* and *tayyiban* life, the economic challenges of Muslims, monetary policy, sharia financial institutions that are more emphasized to the central bank and its policies, and the concept of a prosperous country according to Islam. Writing Ayu according to the author merupakan enough sufficient writing in describing Chapra thought. But it becomes less profound in dissecting one concept to another concept, so from the writings of Ayu, the author wants to make writing about Chapra thinking that is more specific on one theme. Therefore, the authors of this paper attempt to raise a study of Chapra's economic thought on Islamic monetary policy.

C. Metodologi

The method used by the authors in this study is a qualitative method with the results of presentation is descriptive form by collecting actual data by carrying out literature study of some written literature. Primary data are a number of papers M. Umer Chapra, among others: *Towards a Just Monetary System*; *Islam and Economic Development*; *Islam and Economic Challenges*; *Islamization of Contemporary Economy*. Secondary data are reference books and journals that will complement the existing documentation. Data collection methods that the author uses is library research or library data collection. In analyzing the data, researchers used descriptive analysis.⁹

D. Result: Monetary Policy and Changing Banking System as an Effort Chapra Realizing the Concept of the Prosperous Country According to Islam

a. Monetary Policy

⁶ Onny Kusuma, (2015) *Pandangan M. Umer Chapra Tentang Upaya Menekan Inflasi Pada Tingkat Sangat Rendah Perspektif Ekonomi Islam*, (skripsi UIN Wali Songo Semarang)
<http://eprints.walisongo.ac.id/4315/1/092411139.pdf>

⁷ Bayu Adi Saputra, (2016), *Pemikiran Pembangunan Ekonomi Islam oleh Umar Chapra*, (Yogyakarta: UIN Sunan Kali Jaga), http://digilib.uin-suka.ac.id/23351/1/09240021_BAB-I_IV-atau-V_DAFTAR_PUSTAKA.pdf

⁸ Anindya Ayu Inayati, (2013), *Pemikiran Ekonomi M. Umer Chapra*, *Profetika, Jurnal Studi Islam*, Vol. 14, No. 2, Desember, hlm 164 – 176 file:///C:/Users/elraz/Downloads/2015-3835-1-SM%20(7).pdf

⁹ Mochar Daniel, (2003), *Metode Penelitian Sosial Ekonomi* (Jakarta: PT. Bumi Aksara), hlm. 17

“To ensure that monetary growth is sufficient and not excessive”, it is necessary to carefully monitor the three main sources of monetary expansion. Two of them are domestic. First, finance the government budget deficit by borrowing from the central bank. Second, the expansion of deposits through the creation of credit in commercial banks. Third, it is external, ie monetary surplus balance of payments abroad. Therefore, if monetary policies are to be less effective or too restrictive, there must be coordination between monetary and fiscal policy to realize national objectives. This underscores the need for a noninflationary and realistic fiscal policy in Muslim countries”.¹⁰

Chapra's notion of monetary policy is expressed in a comprehensive explanation. Chapra said that to create an adequate monetary growth climate in the sense of sufficient, and not "excessive", it is necessary to carefully monitor the three main sources of monetary expansion as follows:¹¹

First, the fiscal deficit. According to Chapra there is no controversy among economists about whether fiscal deficits can be an important source of monetary expansion. Efforts by the government to extract real resources at a faster pace than sustainable at a stable price level can lead to an increase in fiscal deficits and accelerate the supply of money so as to increase the rate of inflation. Economist of the Economists Advisory Group Business Research Study, states that "the greater the dependence of the government sector on the banking system, the more difficult it is for the central bank to engage in a consistent monetary policy”.

Second, the creation of Commercial Bank Loans. Commercial bank deposits are an important part of money supply. As an ease for analysis, these deposits can be divided into two parts. First, the "primary deposit" which provides the banking system on a money basis (cash in bank + deposit in the central bank). Secondly, "derivative deposits" which in a proportional reserve system represent the money created by commercial banks in the process of credit expansion and are the main source of monetary expansion in the economy with advanced banking habits.

Third, the balance of payments surplus. Only a small percentage of Muslim countries enjoy a balance of payments surplus, while most of them experience deficits. Those who experience surplus, the surplus does not occur in the private sector and does not lead to an automatic expansion in money supply. This happens only because the government is financing the surplus by spending it domestically. while the private sector's balance of payments deficit does not replace this adequately.

Chapra's deeper analysis is about the poverty and severe disparities that occur in developing countries as a result of policies adopted from the perspective of secular strategy, whether capitalism, socialism or the welfare state. So to actualize *thayyibatan* life. Chapra proposed a monetary policy mechanism consisting of six elements.¹²

1. Target growth in M and Mo

M is meant here is the circulation of money desired. While Mo is high money, or currency in circulation plus deposit at the central bank, so M and Mo growth must be arranged and adjusted to the target of the national economy, which must be oriented to social welfare.

¹⁰ Chapra, (1985), *Towards a Just Monetary System*, (London: The Islamic Foundation), hlm. 190-191

¹¹ M. Umer Chapra, (1997), *Al-Qur'an Menuju Sistem Moneter Yang Adil*, Terj. Lukman Hakim, Yogyakarta: PT. Dana Bhakti Prima Yasa, hlm. 137

¹² M. Umer Chapra, (2000) *Sistem Moneter Islam*, (Jakarta: Gema Insani Press) hlm. 141-150. Edisi terjemahan, oleh Ikhwan Abidin Basri, dari judul asli; *Towards a Just Monetary System*.

2. **Public Shares of Deposits (Deposits)**
Part of the demand deposit in commercial banks, in order to finance socially beneficial projects and not to use the principle of profit sharing. The goal is to mobilize unemployed community resources for social benefits.
3. **Official mandatory reserves**
Commercial banks are required to withhold a certain proportion of their deposits and deposits in the central bank as mandatory reserves.
4. **Credit limit**
This restriction is intended to ensure that the creation of total credit is consistent with the monetary target market. Because funding to banks is unlikely to meet accurate figures, especially in the underdeveloped money market.
5. **Value-oriented credit allocation**
This allocation should be aimed at the realization of social benefits in general. It must realize the goals of the Islamic community and maximize private profits. It must be ensured that the allocation will lead to optimal production and distribution of goods and services needed by the community. And the benefits can be felt by a large number of business people in the community.
6. **Another technique**
Chapra once again stressed the importance of morality as the key to all the techniques that have been proposed before. A good relationship between the central bank and the commercial banks will facilitate the process of achieving the desired goals.

b. Changing the Bank System

According to Chapra, Muslims must catch up in various fields, especially in the field of banking. According to Chapra for the resurgence of Muslims should be done gradually and need not be in a hurry. However, to build Islamic-patterned banking does not have to wait until the revival of Muslims. According to Chapra to change the conventional banking system to Islamic banking needs to be done carefully and gradually. These stages can be passed well if done sincerely. The stages are as follows:¹³

1. Interest must be declared illegal by allowing a tolerance period to regard interest as a crime, but once the tolerance is exhausted, interest must be eliminated from domestic transactions. Amendments (articles in law which permit the amendment) shall be made in laws concerning financial institutions and enterprises.
2. The equality / ratio of loans in Islamic societies should be increased to alter natural lending in the economy. All businesses, corporations, partnerships and sole proprietorships (monopolies) should be directed in order to establish an equality in the acquisition of financial proportions to reduce dependence on the assistance they have so far received, and all capital needs should be equally shared.
3. Changes in the tax system undoubtedly facilitate this process. The irrational tax system has led to the illegitimate gains used not for productive things through increased equality and ownership but instead have made the flight of capital and useless consumption all of which are opposed by Islam.
4. Reorganization of capital markets in line with non-speculative and Islamic lines. The organization of values corresponds to economic factors and not under the influence of unreasonable speculative forces.
5. All government sectors intended for commercial purposes, then the profit to be borne together must be changed, because the loss is borne more by the public (government).

¹³ Chapra, *Towards..* hlm. 204-205

6. Government-sponsored interest should be reduced primarily in credit institutions operating in various economic sectors. So far, the mechanisms that always take place provide opportunities and free funding facilities to those who are favored by the government so as to generate concentration of wealth.
7. All financial institutions with interest-oriented interest, whether foreign or domestic, must be replaced with profit sharing institutions. In the early stages all financial institutions are given the opportunity to use the available techniques, but there must be assurance that such methods should be gradually replaced by *mudaraba*, *shirkah* and share investments,
8. The establishment of financial aid institutions should be aimed at giving private sector opportunities to receive funds, as well as to support the establishment of commercial banks. This will include various forms of non-bank financial institutions such as cooperatives, investment companies, and investment-management institutions in Islamic norms.

c. The Concept of the Islamic State of History

According to Chapra¹⁴, that the objectives and functions of Islamic monetary policy are: (a) broad economic feasibility based on full employment and optimum growth rate, (b) socioeconomic justice with equitable distribution of welfare and income, (c) stability in the value of money to enable the medium of exchange can be used as part of a calculation unit, a fair benchmark in a deferred payment, and a stable exchange rate, (d) effective billing and all services normally expected from the banking system.

The capitalist and socialist economic system when viewed from the objectives and functions of Chapra's monetary policy has failed to create such conditions. In addition, they only focus on material welfare and negating the spiritual side. Judging from the failure of the secular and Socialist capitalist system, Chapra asserted¹⁵, the obligation of the Islamic state in creating a prosperous country is to create a decent standard of living for its people and to help those who are unable to provide for their livelihood. However, the Islamic conception in the bondage of income and the distribution of wealth does not equate ownership to everyone, but recognizes the differences that are bounded by the rights of the poor with *zakat* to bring about justice. To carry out these obligations, the state requires the existence of sources of income. These sources include: *zakat*,¹⁶ income from natural resources, tax collection and loans. The meaning of prosperity must be clarified.

According to Chapra, 'prosperous' does not mean 'the rich' but 'the ideal' is the condition in which the balance between material and spiritual conditions is obtained from existing resources. Therefore, the Islamic state can be said to be a prosperous or ideal state when the dignity and moral dignity of society increases, the obligations of the people as the caliphs on earth against natural resources have been fulfilled, and the upholding of justice and the disappearance of oppression. The Prosperous State according to Islam, is not a capitalist or socialist country, but a country with an Islamic concept and Islamic life.¹⁷

¹⁴ Muhammad, (2002), *Kebijakan Moneter dan Fiskal dalam Ekonomi Islam*, (Jakarta: PT. Salemba Empat), hlm. 16

¹⁵ M. Umer Chapra (2008), Tariqullah Khan, *Regulasi dan Pengawasan Bank Syariah*, (Jakarta: PT Bumi Aksara), hlm.102

¹⁶ *Ibid.*, Anindya Ayu, hlm. 12

¹⁷ *Ibid.*, hlm. 14

E. Conclusion

Umar Chapra is an optimistic Muslim economist in his study of Islamic economics as an alternative economy or a solution to the defect of conventional economics, both capitalist and socialist economic systems. In constructing his argument, Chapra discloses in advance where the location of the conventional economic disability originating from usury and emphasizing only material dimensions. Then Chapra asserted that the Islamic economy is the best system to eliminate the gaps caused by the previous system, so Chapra presents the theory of the monetary policy system, changing the banking system as an effort to create a prosperous country based on what is in Islamic norms.

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