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ISLAMIC MONEY MARKET AND APPLICATION OF THIRD PARTY GUARANTEE FOR ECONOMIC DEVELOPMENT

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Abstract

Purpose of Study: The Islamic money market plays a significant role in the development of the economy and providing funds for short term projects. This paper discusses money market instruments such as treasury bills, certificates of deposit, short period mudharabah interbank investment and Islamic accepted bills of exchange. It examines how short term instruments can be used to import and export goods. The study analyses the mechanisms and characteristics of Islamic money market and finds that it has the same characteristics and mechanisms of the conventional money market; they differ only in the instruments that are traded in the market. In the Islamic money market any instrument which is not in accordance with the principles of Islamic law is not traded.

Methodology: A qualitative research methodology in which an Islamic jurisprudential approach is used to analyse data and the permissibility of application of third party guarantee in Islamic money market was utilised.

Results: It was discovered in this paper that application of third party guarantee in Islamic money market is permissible. However, the guarantee should be done voluntarily without charging a fee so that the Islamic money market would be differentiated from the conventional money market wherein a fee is charged. Conclusion/- and Recommendations: In the Islamic money market, the instruments used in the market must be acceptable by the principles of Islamic law. It is impermissible in Islamic law for a company that conducts the investment of Islamic money market instruments to carry out its activities in non-halal activities. Islamic money market instruments can be used to finance short period investment, to import and export assets. The researcher suggested to conduct empirical research in order to have a clear picture on Islamic money market instruments and application of third party guarantee in the market.

Keywords: *Islamic money market, Instruments of Islamic money market, Third party guarantee and Islamic law.*

JEL Classification: *https://www.aeaweb.org/econlit/jelCodes.php?view=econlit&print Unikl –Ubis.*

INTRODUCTION

The Islamic money market is a market which is free from any element of usury, gambling and uncertainty. It is a market where short period instruments are sold and purchased without contradicting the principles of Islamic law of commercial transactions. It plays a crucial role in providing funds for a short period project, or investment. In respect of this, a lot of development has taken place in Muslim and non-Muslim countries. The Islamic money market is a market where short-term debt instruments are traded, such as treasury bills, certificates of deposit and commercial paper. This market does not deal with any trading element that is in conflict with the principles of Islamic law. The Islamic money market plays a crucial role in the financial market (Ma‘sum Billah, 2018). Its instruments have been developed in many Muslim countries under agency and short-term commercial paper (Kaleem, 2007; Malarvizhi *et al.*, 2018).

The concept of third party guarantee in the Islamic money market has taken its initial form from the Islamic law perspective, as Islam has permitted the guarantee of contractual obligations on behalf of contracting parties. As a result of this concept, the application of third party guarantee in the Islamic money market appears to be like the concept of application of third party guarantee in guarantee of future liability *(Daman al-Dark)* for the contracting parties, which Muslim jurists agree is permissible in Islamic law. The concept of third party guarantee in Islamic money market is not different from the concept of market liabilities. This is to say that it is permissible in Islamic law to guarantee payment of the price for the seller and delivery of sold item for the buyer in case the contracting parties are not able to fulfil their contractual obligations.

REVIEW OF LITERATURE

Most of the accessible literature on third party guarantee concentrates on the guarantee in debt. The classical jurists unanimously agree that any guarantee is voluntary in order to facilitate dealings among Muslims. However, only a few materials are available on the topic of third party guarantee in the Islamic money market. Hence, there is a need to conduct research on this topic.

Classical scholars such as Ibn Rushd (1985); Al-Qarafi (2001); Ibn al- Sa ‘ati (2005); Ibn Qudamah (2000) highlight the rules of guarantee in financial matters by extensively discussing matters relating to guarantee in commercial transactions and its permissibility, including whether the subject matter is known or unknown, and the extent to which the guarantee contract is valid. Their discussion on guarantee focused on general matters without further elaboration on the guarantee in financial matters. However, this can help to conceptualise guarantee and its role in Islamic law.

Modern scholars such as discuss third party guarantee in banking activities and highlighted the different points of view of scholars from the Islamic law perspective. They extended their discussion to the concept of guarantee, types of guarantee, and the extent to which it is permissible in Islamic law and its conditions, as well as the form by which it is contracted.

Bek (1936) explain the concept of guarantee, its legality as well as its contract and the different points of view of scholars. They examine the banking *Fatawa* pertaining to guarantee and the guarantee in *Murabahah* sale. Their explanation concentrates on banking guarantee, the period of contract of guarantee as well as charging of a fee on guarantee. However, this could be useful for the discussion on charging of fees on guarantee.

Furthermore, Rafiq (2009); Malimi (2017) discusses guarantee of investment accounts and argues that the bank should guarantee them for investors. He extends his discussion of guarantee by permitting it with the charging of a fee, but without further elaboration on the subject.

Al-Kasani (2005) highlights guarantee, its pillars, conditions and rules, and when can a guarantor return to a guaranteed person for a refund. He defines the words *Kafalah* and *Daman* as well as their synonyms. His discussion is confined to guarantee of debt.

(Hammad, 2001); Ming and Yusoff (2018) concludes that taking a fee on guarantee may be allowed with certain conditions, among them being that it is permissible for the guarantor to charge a fee on a guarantee if he paid or deducted or settled the debt immediately on behalf of the principal debtor. For the reason that, the guarantor paid the debt on the spot without any delay which can be considered as a service which he performed on behalf of the principal debtor. Therefore, the guarantor has the right to charge a fee on that service. Furthermore, Shari'ah Advisory Council (2006) the *Shari'ah* Advisory Council of the Malaysian Securities Commission in its 36th meeting held on 6th February 2002, resolved that charging of fees on third party guarantee is permissible (Shari'ah Advisory Council, 2006). As a result of this, his work would be useful during the discussion on the charging of fees on third party guarantee.

In conclusion, it can be observed that most of the existing literature on this theme focuses on guarantee in general. Classical and contemporary jurists agree that guarantee should be done voluntarily, with the exception of Wahbah al-Zuhaili, Nazih Hammad and the *Shari'ah* Advisory Council of Malaysian Securities Commission. There is little literature in the form of articles concerning application of third party guarantee in Islamic money market. Therefore, there is a crucial need to conduct research on this subject in order to determine a clear picture on the theme. Money market instruments are means of increasing the capital for both the Islamic and the conventional money market. It mobilises the saving funds to be distributed for the purpose of investment for the development of the economy of a country, thereby creating job opportunities. Islam encourages investment of wealth and discourages the hoarding of wealth. A large number of works on third party guarantee are in the form of articles which did not cover some of the major issues to be examined in this research. Therefore, there is a need for scholarly research that will cover all the relevant issues raised in this research.

METHODOLOGY OF RESEARCH

The research adopts a qualitative approach wherein the theoretical framework of Islamic money market instruments and application of third party guarantee are approached through the collection of relevant data from literature such as textbooks, encyclopaedia, and articles in academic journals, seminars, conference papers, online databases and internet materials. This method of data collection is based on library research in order to examine the legal issues relating to Islamic money market instruments and application of third party guarantee in Islamic money market, and to refer to the opinions of scholars of Islamic law.

In order to achieve this method, the researcher resorts to initially highlighting the views of jurists on issues pertinent to third party guarantee, after which the arguments of the Muslim scholars on the issues are examined and analysed. Thereafter, the researcher extracts the legal rules that are in consonance with the principles of the Islamic law.

In addition, the researcher highlights the *fatwa* of prominent scholars and the resolutions of *Fiqh* Academies on the topic. The researcher then offers his view supported with evidence either from the *Qur'an* or *Sunnah* or the scholars' points of views. This method of analysis is adopted in order to make a comprehensive understanding of Islamic money market and third party guarantee in the Islamic money market.

MECHANISM OF ISLAMIC MONEY MARKET

The Islamic money market provides facilities for Islamic banks to manage their portfolio and funding. The financial instruments that are traded in the market are debt-trading instruments, such as Islamic debt securities and Islamic accepted bills. *Mudharabah* interbank investments and acceptance of funds on *Mudarabah* principle (Ismail, 2008) for example, *Mudharabah* interbank investment is conducted between investment banking division (IBD) of banks. A minimum capital requests for investment is RM50, 000 for a period of 12 months. The rate of return is based on the profit that can be realised from an investment of one-year deposit at the receiving bank. However, the profit shared between the two banks is negotiable. At the end of the investment period, the receiving bank will repay the principal amount used for investment and sharing profit margin with its counterpart. Another example of the practice of Islamic money market instruments is that of Islamic accepted bills (IAB), which is an agreement between a bank and its customer, wherein the customer requests the bank to pay a sum of money in the future to the holder of the bills. Once the bank endorses the bills, it is obliged to pay the holder of the accepted bills. The Islamic accepted bills can be used to import goods based on purchase agreement. For example, a customer may go to the bank and request financing for his raw materials or goods. The bank may assign the customer as its agent to buy the goods and pay the price on behalf of the bank from its own money, after that the bank will sell the goods to the customer with profit margin on deferred payment for a period of 30-90 days. IAB can also be used to export goods based on sale agreement with condition that the goods must be *halal* goods. For instance, an exporter who wants to export goods may approach the bank for financing based on the principle of *bay al-dayn*. The exporter is requested to prepare documents of export based on sale contract or letter of credit, and submit the documents to the bank to be purchased. Then, the bank will send the documents to the overseas buyer who wants to purchase the goods. After that, the bank will request the exporter to draw another bill of exchange on the bank to pay the price of the exported goods for him. Both IAB, import (purchase) and export (sale) can be traded in the secondary market (Mohammed, 2017; Ma'sum Billah, 2018).

Islamic banks focus on how to manage the funds of short period investments as the biggest source of funds is the deposit account, which constitutes a short period investment. For this reason, Islamic banks manage deposit accounts in short period investment with full cognizance that there may be an expected or unexpected withdrawal from the existing deposit accounts. Another reason is that in short period investment funds there is confidential existence of liquidity. Accordingly, some banks are obliged to invest some of their long period investment funds in investment of short period instruments. This is because they expect that there may occur unexpected withdrawal or they may fear that when they invest in long period projects, the companies may be exposed to loss or the period may continue for a long time, which will affect the liquidity of the banks. Therefore, to attract the saving account accounts owners to invest their funds in short period investment projects in order not to remain idle and to get profit as soon as possible, a bank may grant some saving and current account depositors a token of appreciation for using their saving and current account. As mentioned in the *Fatwa of Shari'ah* Advisory Council of Kuwait Finance House, it is permissible to give a prize or a gift to some specific saving and current account holders provided that this is not stipulated or observed in the contract at the time the account is opened (Ismail, 2008).

In view of the above, the Islamic money market is a milestone of investment and financing a project within a very short period. It also provides capital for a company that needs rapid funding for its projects and activities within a short investment period. For example, a company may issue Islamic accepted bills to finance its investment project. This can be done by approaching another company to request financing for its working capital requirements to purchase goods. The company will then purchase the goods and sell to the customer based on sale agreement with deferred payment with profit margin (Ma'sum Billah, 2018; Moussa, 2018). As a result of this, the Islamic money market plays a paramount role in financial markets. This is because the capital market alone is insufficient to provide capital for various projects or investments.

Money market plays an important role in development of economy of a country in planning its monetary policies because it enables the Central Bank to control and apply an effective role to change the interest rate of short period investment through controlling reserve funds of commercial banks. The Central Bank of any country can control the interest rate of money market. Furthermore, the money market provides a high liquidity for financial assets of short period investments, which amounts to a decrease in their financial costs and increase rapidity of capital market circulation to finance various economic projects (Ma'sum Billah, 2018).

It can be observed that, the difference between Islamic money market transactions and conventional money market transactions is interest charge. Islamic financier shares in profit in lieu of interest while conventional financier charges interest.

APPLICATION OF THIRD PARTY GUARANTEE IN ISLAMIC MONEY MARKET

Accordingly to classical jurists such as Ibn Rushd (1985); Al-Qarafi (2001); Ibn al- Sa 'ati (2005); Ibn Qudamah (2000) third party guarantee is permissible voluntarily without changing a fee. This is because there is no subject matter in the contract. If guarantor charges a fee on the guarantee, it is a debt in which benefit is derived from, which is *riba*. In addition, guarantee contract is *tabarru'* contract which should be done voluntarily. However, according to some contemporary jurists such as Hammad (2001); (Shari'ah Advisory Council, 2006) it is permissible to charge a fee on guarantee because of necessity in a situation wherein the person could not be able to find a voluntary guarantor.

Furthermore, in a situation wherein the Islamic money market is organised by the organisation of stock market, it is permissible for this organisation to guarantee the price of sold asset, or delivery of the sold asset for the contracting parties or any transaction that is transacted in the market. It is also permissible in Islamic law for the organisation to guarantee the rights of the contracting parties in case they are not able to fulfil their contractual rights. This guarantee by the organisation that organises the market can be considered as a third party guarantee, which is based on the principle of guarantee of market liability (*Daman al-Dark*) that is permissible in Islamic law by the consensus of Muslim jurists (Abu, 1992). In addition to this, in the *Fatawa* of Arab Institute of Islamic Banking, it was stated that it is permissible for main financial institute to guarantee transaction of investment for the benefit of the shareholders, provided that the institute does not take any fee in recourse of the guarantee and does not get involved in the investment (International Shari‘ah Research Academy for Islamic Finance (ISRA), 2017).

Based on this, it can be observed from the aforesaid that there is nothing wrong from the Islamic law point of view in the application of third party guarantee in the Islamic money market. However, this third party guarantee must be done voluntarily because it is impermissible in Islamic law to take a fee on the guarantee. Thus, Muslim commercial transactions should be differentiated from non-Muslim commercial transactions; this cannot be done by charging a fee on third party guarantee in Islamic money market as practiced by its counterparty (conventional one).

RESULT AND DISCUSSION

It was argued in this study that, Islamic money market instruments play a significant role in development of economy and financing projects. This is because, they can issue to finance a business project for a business man who is seeking financing for his project. They also can issue to import and export goods for investment purpose. The instruments which are transacted in the market should be *halal* instruments which are short period instruments of investment that banks are using to provide liquidity for their assets.

It was found in this research that, application of third party guarantee is permissible voluntarily. It is also permissible to pay the actual service fees for issuance of the guarantee contract. It is not permissible to charge a fee on mere guarantee unless the guaranteed person is in necessity. In a situation wherein the Islamic money market is organised by an organisation it is permissible for the organisation to guarantee any contractual liability on behalf of the contracting parties in case they are not be able to fulfil their contractual liabilities. This guarantee is based on *Daman al-Dark* which is permissible in Islamic law by consensus of Muslim scholars.

CONCLUSION

The mechanism of Islamic money market is that the elements used in the market should be in accordance with the principles of Islamic law. It is not allowed for a company that conducts the investment of Islamic money market elements to carry out its activities in non-*halal* activities. Islamic money market elements can be utilised to finance short period investment, to import and export assets.

In the Islamic money market, it is permissible for a third party who is not a party involved in the investment to guarantee voluntarily the principal amount or a portion of profit or the price in which the transaction will be concluded. This is because in Islamic law, it is permissible for a third party who is separate from the investors or the contracting parties to guarantee voluntarily any contractual obligation or right in case the contracting parties are not able to fulfil their contractual obligations or rights. This guarantee should be done without any chargeable fee, because if guarantee is issued with a fee, the commercial transaction would be confined only to the traders who know each other. This would affect the interest of the public and the society as a whole, and one of the tenets of Islamic law is that if there is harm within the public system, that harm must be removed in order to maintain public order and to keep afloat the public interest, which overrides that of individual interest. The researcher suggested to conduct empirical research in order to have a clear picture on Islamic money market instruments and application of third party guarantee in the market.

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